PROJECT INFORMATION DOCUMENT (PID)
CONCEPT STAGE

Report No.: PIDC26731

Project Name	SME Line of Credit (P154975)
Region	EUROPE AND CENTRAL ASIA
Country	Kazakhstan
Sector(s)	SME Finance (100%)
Theme(s)	Micro, Small and Medium Enterprise support (50%), Other Financial Sector Development (50%)
Lending Instrument	Investment Project Financing
Project ID	P154975
Borrower(s)	Ministry of National Economy
Implementing Agency	Entrepreneurship Development Fund
Environmental Category	F-Financial Intermediary Assessment
Date PID Prepared/ Updated	19-Aug-2015
Date PID Approved/ Disclosed	29-Aug-2015
Estimated Date of Appraisal Completion	18-Sep-2015
Estimated Date of Board Approval	07-Dec-2015
Concept Review Decision	Track II - The review did authorize the preparation to continue

I. Introduction and Context

Country Context

Kazakhstan has successfully harnessed its oil resources to reduce poverty and boost shared prosperity. Kazakhstan's poverty rate (defined as income under USD 5/day) has dropped from 54 percent in 2006 to 19 percent in 2013, and the size of the middle class has increased from 8 percent to 28 percent of the population. Growth in the income of the poorest 40 percent of population has been systematically higher than average GDP growth during this period, reflected in a decline in the Gini coefficient from 0.31 in 2006 to 0.28 in 2013. Economic growth has come from all sectors of the economy, and the services sector has been the driver of job creation. Labor force participation and employment rates have been traditionally high in Kazakhstan, especially for women. In 2013, among those 15 years and older, 77 percent of men and 67 percent of women were economically active. Official figures indicate that unemployment halved between 2001 and 2013, decreasing from 10.4 to 5.2 percent, with long-term unemployment declining to just 2.5 percent. Wage income has been the largest single contributor to poverty reduction over the past decade, with real wages doubling between 2003 and 2013.

While the Kazakh economy bounced back from the global financial crisis, growth slowed in 2014 due to weaker external demand and domestic imbalances. Kazakhstan's real GDP growth averaged 6.5 percent between 2010 and 2013, buoyed by higher oil prices. However, it slowed from 6 percent in 2013 to 4.3 percent in 2014 due to weaker external demand by China and Russia for Kazakhstan's crude oil, iron ore, and metal products, and the 50 percent drop in oil prices in 2H2014. In response, the National Bank of Kazakhstan (NBK) devalued the local currency by 19 percent in February 2014. However, continuing weakness in external markets caused further deterioration of the current account (from a surplus of USD6.9 billion in 1H2014 to a deficit of USD2.2 billion in 2H2014) and put further pressure on the exchange rate (which held stable in 2H2014 due to large foreign exchange interventions by NBK). Following the devaluation of the Kazakhstan tenge (KZT), consumer price inflation rose steadily from a low of 4.5 percent y/y in January 2014 to 7.4 percent in December.

The tight monetary policy and targeted policy interventions has impacted the banking system's currency composition and credit growth. Increased devaluation expectations spurred demand for foreign exchange-denominated deposits, expanding the imbalance between banks' fx deposits (rising to 46% of total liabilities) and fx lending (declining to 30% of total loans at end-2014). Rising interest rates also slowed credit growth from double digits in the first half of the year to 2.3 percent year-on-year at end-2014. Credit to the corporate sector stagnated after monetary policy tightened. Growth of consumer credit fell from nearly 50 percent y/y in the beginning of 2014 to 17 percent by end-2014 due to the NBK-imposed cap of 30 percent for each bank and due to a freeze in mortgage programs by big banks.

Amid uncertain external and domestic environments, the Government of Kazakhstan has launched its Partnership Framework Agreement with IFIs to tackle structural reforms that can boost economic growth and shared prosperity. The government of Kazakhstan is committed to accelerate progress on key structural reforms seeking to (i) restore macroeconomic stability (bolstering the monetary and fiscal policy frameworks to improve transparency and accountability) and business confidence in the post-devaluation environment; (ii) address the high level of nonperforming loans (NPLs), in line with the recent FSAP recommendations; and (iii) accelerate progress on structural reforms to promote economic diversification and private sector competitiveness. The World Bank is supporting the GoK's reform efforts through the First Fiscal Management and Resilience Development Policy Loan (DPL), currently under preparation that envisions USD2 billion in lending during 2015-2016 period. The DPL aims to address risks related to the adverse global environment by supporting the GoK's efforts to restore macro fiscal stability while accelerating reforms that would improve competitiveness of the non-oil economy.

In late 2014, the authorities launched an Economic Support Program to mitigate the impact of the downturn, including a KZT250 billion injection to the Problem Loan Fund, to clean up non-performing loans in the banking system, and KZT385 billion in subsidized lending targeting small- and medium-sized enterprises for 2014-2016 period. The year-on-year change in credit to SMEs rose from -9 percent in January 2014 to nearly 33 percent in December 2014, driven by the large subsidized credit program. The GoK also launched an Industrial Innovation Support Program providing KZT 95 billion in subsidized credit to medium-sized industries in targeted sectors, to provide KZT-denominated, investment and working capital loans up to 5 years in maturity and stipulating no higher than 11.5 percent interest rate to end-borrowers. The structure and target market of the Government SME Support Program is elaborated in Section I.C. Financial Sector.

Kazakhstan's GDP growth is expected to recover gradually over the next three years. Based on an oil price assumption of USD53 per barrel, Kazakhstan's GDP growth is expected to slow considerably from 4.3 percent in 2014 to 1.7 percent in 2015. Lower oil export revenues are expected to lead to deficits in both the current account and the overall fiscal balance in 2015. In the medium term, if oil prices start to recover, domestic demand is expected to resume and growth will contribute to higher GDP growth, projected at 2.8 percent in 2016 and 3.9 percent in 2017.

However, the external environment remains uncertain. China, Russia and the Euro area represent about two-thirds of Kazakhstan's total external demand. Oil exports account for over 80 percent of the country's total exports. Kazakhstan is vulnerable to a prolonged slowdown in China, a more severe economic contraction in Russia, possible protracted slowdown in Western Europe, and possible continuing global oil glut keeping oil prices low for several years.

The signing of the Eurasian Economic Union with Russia and Belarus, which came into effect in January 2015, envisages the free transit of goods, services, capital, and labor. However, the trade agreement is not expected to have near-term economic effects, and medium-term effects will depend on how the Union's rules and regulations will be implemented. The government is also extending collaboration with China and the OECD and completed WTO accession this year. Further government efforts are planned to promote linkages of domestic companies to global value chains and upgrading of local suppliers especially in the oil, gas and railway equipment sectors.

Improving private sector competitiveness remains core to boosting growth and shared prosperity. Kazakhstan's economy remains highly dependent on the hydrocarbons and extractive sectors, with manufacturing and agriculture accounting for only 11 and 5 percent of GDP, respectively. Boosting growth and shared prosperity requires improved private sector competitiveness through accelerated and deeper progress on pending structural reforms seeking to improve the capacity of Kazakhstani companies to increase their productivity, access to finance, ability to innovate and export, and create more and better jobs.

Sectoral and Institutional Context

Consistent with authorities' aim to develop a more diversified economic base, Kazakhstan is seeing growth in employment and productivity from the non-energy sector. Even through energy and extractive industries account for a large part of fixed investments and gross value-added (GVA), secondary industry is growing, and innovative products lead the growth. Energy and mining have traditionally been at the center of Kazakhstan's economy; the world's leading exporter of extractive industries (primarily due to oil), Kazakhstan is ahead of all CIS countries according to per capita exports. According to the Statistics Committee, the mining sector accounts for more than 30 percent of investments in fixed assets, and 18 percent of GVA, although it only represents 3 percent of employment. By comparison, secondary industry accounts for only 12 of fixed investments and 11 percent of GVA, however, its share is growing rapidly. From 2008 to 2012, GVA of the non-energy sector grew by more than 23 percent, and GVA of secondary industry grew by more than 22 percent. Labor productivity of secondary industry grew by 70 percent, and the value of innovation products grew by 240 percent. At the same time, the proportion of GDP represented by the energy sector declined by almost 14 percent over the same period.
Small and Medium-Sized Enterprise Sector

The SME sector in Kazakhstan remains nascent and highly concentrated. As of April 1, 2015, over 294,000 small and medium-sized enterprises (SMEs) and nearly 1.1 million sole entrepreneurs operated across Kazakhstan. SMEs represent over 90 percent of all enterprises in the country. SMEs include private and state-owned entities, as well as entities with foreign participation. According to the latest available information for 2013, in the small segment, private entities accounted for 83-99 percent of the total number. In the medium segment state-owned entities accounted for more than 50 percent across most regions. Entities with foreign participation accounted for between 2 and 10 percent of the registered total (10% in Almaty) number of SMEs with about 95 percent operating in the small segment. However, officially-registered entities represent only a portion of the whole SME landscape; it is estimated that a large gray economy may be equal in size to the number of registered entities.

The majority of SMEs, like the enterprise sector overall, are concentrated in the major urban centers. Enterprises of all sizes located in Almaty and Astana account for over 30 percent of GDP, and more than a third of the country's large-sized enterprises are located in these two cities, where there is a high concentration of industrial production and construction. Almost two thirds of SMEs are concentrated in the trade and services sectors, which are characterized by low risk and modest start-up capital. The remaining SMEs are active in agriculture (23 percent), transport and communications (8 percent), and manufacturing (3 percent). Such high a concentration of SMEs in few sectors is symptomatic of limited support to SMEs in the exploitation of adjacent sectors, linkages with larger companies in global value chains, and limited opportunities to improve their capacity to export and innovate.

Public Disclosure Copy

SMEs account for about 20 percent of GDP in Kazakhstan, and recent growth is mainly accounted for by increases in productivity. While employment growth over the past ten years has been subdued, gains in overall output and productivity per employee have been significant. Over the period 2009-2013, SMEs showed a CAGR of 13 percent, with lower growth rates in rural areas like Zhmbyl (CAGR 5%) and higher growth rates in South Kazakhstan region (25%). The relatively small size of the SME sector in Kazakhstan compared to regional peers is explained in part by the dominance of the extractive sector as well as by the legacy of the old Soviet system, where SMEs were effectively non-existent. The capacity of entrepreneurs to conduct business efficiently, innovate and exploit new opportunities in domestic and export markets is not likely to improve in the medium-term without public support. Kazakhstan entrepreneurs were educated in the old Soviet system and gained their business experience only after the collapse of the central planning system. In fact, until the independent state of Kazakhstan was created, there were no SMEs registered. The current economy inherited features from central planning, including inefficient business networks, clientelism, and lack of professional and managerial skills required to compete in external markets.

Deficiencies in the business environment contribute to the persistent lag in the growth of SMEs, even compared to other countries with oil-based economies. In the World Bank's Enterprise Survey most recently conducted in 2013, enterprises indicate that some of the key constraints to growth include corruption, informality, limited skilled labor, access to finance, and taxation. For small enterprises, access to finance is the top cited constraint to business after broad governance issues (corruption and informality) and electricity. An ADB survey of 1,600 SMEs in 2013 reveals similar constraints to enterprise growth: low professional skills, lac k of financial support, corruption, and excessive red tape. Factors that contributed to success of SMEs included the generation of innovative ideas, the support of family and business allies, effective business planning, and strong leadership by the business owner. The Doing Business report identifies trading across borders and dealing with construction permits as the two weakest areas in the business environment, due to a very high number of procedures, time delays and costs involved in both. Taxation is also seen to be quite cumbersome to enterprises, although in the Doing Business benchmarking, Kazakhstan shows one-third as many payments as the regional average, and half as many as OECD countries; its levels of taxation are lower than OECD countries, and take about as much time to pay. Gender imbalances in business have improved in recent years, but additional work needs to be done. While only 30 percent of businesses are owned by women, a further 19 percent are co-owned by women and men. Furthermore, managerial positions are held by women in 34 percent of firms. In general, women are more engaged in businesses in the trade, hospitality services, consumer goods production, and financial services sectors. A major obstacle faced by women in terms of the Doing Business rankings continues to be access to finance, where female top managers face increased difficulties in getting a loan than male top managers (this is elaborated in the Financial Sector section).

Financial Sector

Overview of the banking sector:

Kazakhstan's financial system is bank-centric and fairly concentrated. Its growth in recent years has been sluggish compared to GDP and lags its neighbors and other extractive industry-centered economies, suggesting that there is room for more dynamic intermediation. The five largest banks account for more than a half of banking sector assets, and lending is heavily tilted toward larger enterprises, particularly in Almaty and Astana. Lending is focused on the corporate sector, which accounted to 54 percent of total loans at 1H2014, followed by SMEs (20 percent) and consumer (17 percent). The available offer of loans is limited to certain sectors of the economy with lower level of risks and higher turnover of investments, particularly in the segments and industries supported by GoK programs. The ratio of private credit to GDP in Kazakhstan has declined from a peak at 59.9 percent in 2007 to 37.4 percent in 2011, and only slightly improved to 38 percent in 2013.

The experience from the 2008 financial crisis highlighted the importance of robust, risk-based supervision, the need for a stronger bank resolution framework, and the importance of restructuring Kazakhstan's largest problem banks effectively; and these priorities have formed the basis for World Bank's engagement in the financial sector in Kazakhstan for the past several years. Banks were saddled with a large volume of NPLs that weakened their profitability, locked up potential productive capital, and endangered the solvency of some of the largest banks. As of 4Q2014, NPLs stood at 24% of total loans, an improvement from 30% in 3Q2014. The lingering NPL problem is gradually being addressed through a systemic program of write-offs and NPL sales. The years following the 2008 financial crisis saw the departure of many foreign investors, and a steep decline in banks' funding sources. At the same time, banks have relied increasingly on deposits, which grew to represent 73 percent of banking system funding by 2H2014. Banks' uncertainty about long-term funding restrains their ability to lend on a longer-term to enterprises, and currency risk is an increasing concern as their resource base has become highly volatile and expensive.

As the 2013 World Bank Enterprise Survey in Kazakhstan has shown, most enterprises indicate decreasing use of bank financing. This is consistent with evidence from banks that as foreign funding and securities was drying up and banks were relying more on shorter-term and fx-denominated deposits, enterprises have been seeking longer-term and KZT-denominated financing. Thus, the proportion of firms with a bank loan or line of credit fell by about 40 percent since 2009, and lags most of the region. At end-2014, lending data from NBK shows that SMEs receive around one-eighth of total loans. At the same time, data from the Statistics Committee shows that SMEs have grown slower relative to large enterprises in Kazakhstan in the past five years.

Overall, the survey results suggest that the financial sector has become de-linked from enterprise growth in Kazakhstan, with a declining share of enterprise investments financed by banks over the past decade (from 19 percent in 2005 to 9 percent in 2013), and likewise fewer firms using banks for finance. Enterprises in Kazakhstan increasingly self-financed investments through earnings and savings, up from 77 percent of firms in 2005 to 83 percent in 2013. The preference for self-financing is particularly strong among small and mid-sized firms. This is consistent with empirical findings from pre-appraisal discussions with several financial institutions. While some banks have developed products specifically for SMEs, many point to lack of business management and financial planning capacity as weaknesses that limit the “bankable” clients. SMEs that lack financial capability are unlikely to develop business plans and may seek informal financing sources rather than bank financing. They are more likely to be denied credit by financial institutions or may not seek financing in the first place. At the same time, lack of business management skills and relevant market information is a key factor that limits the ability of SMEs to improve their productivity and take key transformational steps, such as participating in the supply and distribution chains of larger firms.

The problem of accessing finance seems to be more pronounced for women-owned firms, according to the 2013 Enterprise Survey; businesses with female managers face a 77 percent rejection rate, as compared to a 17 percent rejection rate for businesses with male managers, and female-managed businesses are asked for 260 percent collateral-to-loan value ratios, while male-managed businesses are asked for 170 percent collateral-to-loan value ratios on average.

Credit-Enabling Financial Infrastructure

Aspects of the financial infrastructure that enable credit, especially to SMEs, such as credit information, moveable collateral/ secured transactions, and insolvency frameworks and systems are relatively under-developed in Kazakhstan, but recent efforts by authorities supported by World Bank technical assistance have the potential to improve these systems (see Box 1). As the 2014 Doing Business study has shown, there is insufficient credit information available to Kazakhstan financial institutions to mitigate the asymmetric information problem in lending, particularly to physical persons and SMEs. A private credit bureau has been operational in Kazakhstan for some years, covering 45.6 percent of adult population in 2013(compared to 39.4 percent in 2012). Although this percentage is higher than the average for ECA (33.4 percent), it is still lower than the coverage for OECD countries. This could reflect both the limited participation of banks in the private credit bureau and the low use of formal finance. In addition, the credit bureau does not collect credit history from retailers or utility companies. A public credit register was established under the NBK auspices several years ago, but it is not yet fully operational, and the division of labor with the private bureau has not been properly defined. With regard to moveable collateral, a unified register of moveable collaterals is not yet in place, despite authorities’ efforts over past few years, making lending against moveable collateral is quite limited, and banks have limited information for credit decisions in some cases, particularly first-time borrowers and new enterprises. Creditor rights were significantly strengthened in a recent amendment to the Corporate Insolvency Law, but there is much more to be done, significant aspects of which are addressed in the World Bank DPL under development.

NBK has launched a new effort to strengthen the public credit register and improve supervision and market standards for the private credit bureaus, and there is a renewed effort to establish a moveable asset registry; authorities have invited World Bank to assess both of these efforts. The World Bank is supporting NBK in the context of the JERP technical assistance program to develop a strategy for a modern, efficient credit reporting system. During 2015-2016, World Bank is helping NBK to assess gaps and inefficiencies in the existing system, compare it with other markets, consider appropriate institutional setup and legal framework for credit information system, and improve the supervision of private credit bureaus. However, the technical assistance team notes that the possible concentration of credit reporting under a public register according to a proposed arrangement may damage the private credit information market. Assessing options and weighing risks and developmental benefits remains a work in progress.

Also, the World Bank's Secured Transactions team is providing assistance to Government of Kazakhstan to develop a moveable collateral registry and improve the legal framework for moveable asset-based financing. This latest efforts has just been initiated in Spring 2015. The technical assistance aims to complement efforts by authorities and World Bank to promote sustainable access to finance. Technical assistance in the above-related areas has been provided on a demand-basis in the context of reimbursable technical advisory.
Enactment in spring 2014 of amendments to the Corporate Insolvency Law represent a significant step forward to strengthen creditor rights, but there is still much to be done to improve legal rights to underpin enterprise finance. The recently-enacted amendments strengthen the rights of secured creditors, accelerate the insolvency process, strengthen creditor committees, and reduce the time and cost of enterprise insolvency. However, the Doing Business report highlightsseveral other gaps in the legal framework, including of specification in law of types of debts permitted in collateral agreements, absence of notice-based collateral registry, online and searchable registry, and absence of integrated framework for secured transactions extending to movable assets, for example. These explain Kazakhstan's low index ranking for strength of creditors' rights at 3 on a scale of 0 to 12 by the Doing Business report, and suggest substantial room for improvement.

Government of Kazakhstan Economic Support Program

The GoK's Economic Support Programs have played a large role in expanding credit to certain sectors and industries of the economy. Among the programs are subsidized lines of credit to support numerous policy objectives, including the promotion of small- and medium-sized enterprises. The latter is implemented by DAMU Entrepreneurship Fund, a national development institution that falls under the Ministry of National Economy. DAMU implements 18 state programs of financial support, focused on specific regions, industries and issues. DAMU promotes SMEs and entrepreneurs through: lines of credit through commercial banks, subsidizing interest rates for bank lending and leasing contracts, partial credit guarantees for entrepreneurs, and information and consulting support. Lending for SMEs offers 7 percent per annum to SME borrowers on loans 7-10 years in maturity in KZT.

Results of the DAMU-implemented programs are impressive. As of 1 January, 2015, a total of 13,704 borrowers (including 2,255 entrepreneurs) have received KZT955.8 billion in financing through these all of these lines of credit. The DAMU programs are credited with the creation of more than 38,700 jobs according to official estimates. The largest sums of funding of entrepreneurs were through the SME sector Stabilization Program, the Support Program for SMEs engaged in manufacturing, the "Damu-Ondiris" SME support program and the Support Program for manufacturing SMEs funded from the National Fund of the Republic of Kazakhstan. Geographically, the largest sums have been disbursed in the cities of Almaty and Astana and in Qaragandy Oblast. The largest number of borrowers has been financed in the East Kazakhstan and Qaragandy oblasts and in the city of Almaty.

Because the line of credit programs are structured around disbursement targets, while interest rates are determined based on generic industry projections rather than bank-specific models and credit evaluations, the program may significantly impair the development of risk-culture among commercial banks, and may contribute to further expansion of NPLs. The program’s sector- and industry-focused approach may also result in over-leveraging among certain enterprises in target segments, a problem that is highlighted in the GoK’s own implementation plans.

Relationship to CAS

The project is consistent with and supports the Country Partnership Strategy (CPS) FY12-FY17 on improving competiveness and fostering job creation. The project aims to support the Government targets of improving Kazakhstan’s ranking on the WEF’s Global Competitiveness Index from 72nd place (out of 139 economies) in 2012 to 50th place by 2020. The operation will complement the World Bank financed SME Competitiveness project, which focuses on improving business capacity and competitiveness, by supporting efficient and sustainable financial intermediation to fuel business growth. Sequencing and Complementarity with Related World Bank Projects

The extent of success in the sustainability of the outcomes of this project is dependent on progress in complementary work on competitiveness and financial infrastructure. This includes addressing: a) demand-side aspects (the pipeline of bankable and credit-worthy SMEs demanding credit) and b) strengthening banking sector soundness, prudential supervision, and credit information system development. These complementary areas of intervention are addressed in parallel by the World Bank SME Competitiveness project and technical assistance program.

The SME Competitiveness project addresses the demand side of the gap between lenders and SME borrowers by tackling the issue of poor “business readiness” and business planning, which are often cited by lenders as key reasons for SMEs’ inability to obtain financing. The component on SME capacity building addresses this directly through business training programs that will be provided to SMEs through Entrepreneurship Support Centers throughout Kazakhstan, which will include modules on business finance. These same ESCs will be leveraged as a platform for information and assistance on applying for bank lending. Furthermore, the SME Competitiveness project’s interventions on catalyzing cluster development and integrating SMEs into supply chains is expected to increase SME demand for both investment and working capital finance to fuel their business growth.

The SME Competitiveness project supports non-bank financial instruments that are just beginning to develop in Kazakhstan, and which over time could complement commercial bank credit supported by this project. One of the components of the SME Competitiveness Project supports linkages of SMEs in supply chains to promote a reverse-factoring or supply-chain financing program in Kazakhstan. The project will work with regulators, authorities, and financial institutions to define the strategic, regulatory, and operational needs to implement reverse factoring. Likewise, financial leasing is an emerging instrument with potential to improve enterprises’ access to finance, but its development has been quite limited to-date. Improving the framework for registering moveable collateral and strengthening secured transactions framework will be critical steps to enable this market. It is timely that the World Bank is providing parallel support at the authorities' request to develop a unified register of moveable assets and to improve the secured transactions legal framework. Developing these non-bank instruments alongside this line of credit project will help create a diversity of financing options for SMEs and increase competition in the financial sector.

The World Bank is taking complementary steps to strengthen the banking sector and promote more effective, risk-based supervision through measures supported by the Kazakhstan First Fiscal Management and Resilience DPL and the technical assistance to NBK in the Joint Economic Research Program (JERP). The DPL contains a component which addresses the banking sector specifically, and supports the Government to accelerate clean-up of non-performing loans by strengthening the Problem Loan Fund and amending the Corporate Insolvency Law and tax laws to enable more efficient insolvency processes and work-outs, to incentivize write-offs and sales of NPLs, and to provide the necessary capital for the Fund. The DPL also supports the NBK's efforts to improve prudential supervision of banks, including prior actions and triggers which call for stronger risk-based supervision, standardized collateral valuation and tougher provisioning standards, and required consolidated reporting by financial institutions according to IFRS. In parallel, the Bank supports the NBK in the context of the JERP Financial Stability Technical Assistance during 2014-2016 with assistance focused on improving bank inspections, strengthening prudential supervision framework, and improving the credit information system.

The project also aligns with the work of IFC in Kazakhstan focused on strengthening the financial sector, improving access to infrastructure, and promoting the development of small and medium enterprises, particularly in the agribusiness, manufacturing, and service sectors, through investments and advisory services. Since 2013, IFC provides a USD70 million loan to Sberbank Kazakhstan to expand the bank's capacity for lending to SMEs. The loan builds on the partnership with SB Sberbank JSC, which joined IFC's Global Trade Finance Program in 2012. In addition, IFC invests in microfinance to promote socially responsible and a sustainable practices . As of June 30, 2014, IFC's portfolio in Kazakhstan stood at $264 million with investments in 14 projects in financial markets, agribusiness, retail, construction materials, and the railway sectors.

In addition, the project complements related efforts by other IFIs to promote access to finance by SMEs. In 2010, ADB launched the SME Investment Program, which supports SME development and job growth through a USD500 million multi-tranche financing facility to DAMU delivering KZT-denominated credit and guarantees through participating commercial banks. ADB approved its third tranche in December 2014, and additional financing of USD98 million. At 3Q2013, the latest point for which evaluation data of ADB project is available, the SME Investment Program was disbursing quickly, and had funded more than 2000 loans. EBRD has been active through its Small Business Support Program providing advisory services to enterprises in seven regions of the country. In 2013, EBRD provided a KZT15 billion line of credit to Sberbank Kazakhstan for on-lending to small enterprises; EBRD cooperates with microcredit institutions including Arnur Credit and KazMicroFinance, to deliver services to SMEs, and operates a donor-funded Small Business Support unit that provides subsidized consultancy projects with complementary GoK grant funding to more than 1000 Kazakh firms.

II. Proposed Development Objective(s)

Proposed Development Objective(s) (From PCN)

The project development objective is to improve SME access to sustainable enterprise lending.

Key Results (From PCN)

Key PDO level results indicators include the following:
(a) Number of SMEs accessing finance as a result of the project
(b) Volume of financing disbursed to SMEs
(c) Direct project beneficiaries (of which female)

Intermediate results indicators will be as follows:
(d) Outstanding SME Loan Portfolio
(e) Percentage of Portfolio at Risk
(f) Increase in local currency long-term lending (over one year term)
(g) Percent of first time borrowers in PFI portfolio financed by the project
(h) Cost participation by PFIs in direct TA costs
(i) Number of training programs delivered to PFIs

Additional key indicators will be monitored for analytical purposes, including value of investment financed by the project, average tenure of loans financed by the project, and the impact of the project on job creation. These indicators will be analyzed as part of an impact evaluation on this line of credit, and if possible, a comparative evaluation of the impacts other DAMU managed lines of credit in the market to assess and compare different approaches, both market-based and subsidized, to improving access to finance in Kazakhstan. (To be confirmed and developed with the client in project preparation).

III. Preliminary Description

Concept Description

Public Disclosure Copy

This project has two components: 1) the Line of Credit, and 2) The Center of Excellence in Lending, part of a broader program to improve SME Competitiveness in Kazakhstan. The SME Competitiveness project, a recently approved US$ 40 million project, takes direct aim at the constraints and impediments to competitiveness at the firm-, cluster-, and supply chain-levels. The outcomes of that project will be to improve business and management practices of SMEs and their participation in supply chains, which is expected to increase both their demand for credit and their bankability and credit-worthiness. This line of credit complements the SME Competitiveness project addressing a critical supply-side constraint to SME growth, access to finance, by providing access to the type of loan products needed in any sector or region where they are needed.

Component 1 –Line of Credit ($200 million)

As a result of this component, access to both investment and working capital loans will allow borrowing enterprises to undertake new initiatives, and/or broaden the product or services range, and/or improve the existing product quality and production efficiency. Additional working capital finance will facilitate entry to markets where the payment for goods or services takes longer. More importantly, the systemic approaches to lines of credit and their management will be enhanced through introduction of best practice methods.

The aim of this component is to implement a market-based, broadly accessible line of credit as a benchmark to improve the effectiveness of future credit lines including those currently funded by the government. This will support the GOK's objective to maintain a steady flow of credit to the private sector and assist in enhancing competitiveness, including to sectors and groups of borrowers that would otherwise be excluded. It would also contribute to extending the maturity structure of enterprise lending. At the systemic level, it would also stimulate introduction of new technologies for credit risk appraisal and management and new products, and would strengthen financial intermediaries.

Table 2. Key features of the Line of Credit

Open to all sectors: The LoC would be open to all enterprises operating in any sector of the economy to allow diverse sectors of the economy to benefit from the financing

SME focused: SME focused within the maximum flexibility allowed within DAMU's governing framework, at up to a $US 5 million loan amount.

Lending in local currency: Responding to the increased demand by SMEs for KZT-denominated credit, the Project will agree with NBK providing a swap arrangement for PFIs.

Lending for longer terms: The LOC provides DAMU the option to borrow on a longer-term, a benefit which may be passed along to borrowing enterprises.

Lending to first time borrowers: A portion of the loan (to be determined) will be allocated to first-time borrowers. New firms tend to create more jobs, and are more likely to face constraints in accessing finance for the first time. Combined with technical assistance on credit risk analysis and cash flow based lending (in Component 2), this allocation will aim to broaden access to finance among the lesser served segments, including new firms, smaller firms and women-managed businesses. The project will also seek to link up PFIs with partial-credit guarantee programs already offered by DAMU to reduce collateral requirements for marginalized borrowers who may have been denied in the past due to lack of sufficient collateral.

Lending in lesser served regions: The project will seek to include PFIs with regional reach beyond Astana and Almaty and seek to leverage DAMU's engagement on both this project and the SME Competitiveness project, which will offer services to SMEs in a planned 171 Entrepreneurship Centers all over the country. The project will seek to embed lending information and assistance on loan applications to SMEs through those same centers.

Safeguard policies: DAMU has indicated already the willingness to apply Bank safeguard policies, including those triggered by Environmental Category B projects. PFIs will receive technical assistance (as needed) to improve their implementation of environmental safeguards.

Component 2 – Center of Excellence on Lending and Project Management ($2 million)

DAMU will establish a Center of Excellence on Lending (CEL) with the aim of disseminating international best practices in lending within the Kazakh banking sector. The CEL will be created within DAMU and will provide training and limited technical assistance to banks and other financial institutions on international best practices in lending. Training would be provided by experts on topics including lending technology, cost-efficient models of SME lending, credit risk assessment, cash flow based lending, implementing environmental safeguards, and other topics. The focus will be on SME lending departments of banks which tend to have lower capacity. Training may be sponsored by DAMU or provided on a cost-recovery basis, while individualized TA would only be provided on a full cost-recovery and limited scope basis. The CEL would also host a community of practice on SME lending in Kazakhstan to facilitate knowledge sharing and promote an understanding of key priorities in improving SME credit-enabling financial infrastructure.

The CEL would also collaborate with the Economic Research Institute (ERI) on developing an impact evaluation of lines of credit under its supervision, including this LoC and government sponsored LoCs, to help promote learning on the outcomes and impacts of different approaches and designs of LoCs. This impact evaluation would be proposed as one of the impact evaluation activities on the efficacy and impact SME interventions in Component 3 of the SME Competitiveness project.

Figure 10. Project Results Chain (with links to other projects and Higher-level Objectives)

The CEL would also collaborate with the Economic Research Institute (ERI) on developing an impact evaluation of lines of credit under its supervision, including this LoC and government sponsored LoCs, to help promote learning on the outcomes and impacts of different approaches and designs of LoCs. This impact evaluation would be proposed as one of the impact evaluation activities on the efficacy and impact SME interventions in Component 3 of the SME Competitiveness project.

The Project management costs, including the establishment of Project implementation unit and its expenditures, will be included in this component. The PIU will be staffed by DAMU’s staff (with consulting support) and run as part of its routine operations. It will also be linked into the implementation structure of the SME Competitiveness project through its reporting to the same Project Implementation Commission established under the SME Competitiveness project.

IV. Safeguard Policies that might apply

Safeguard Policies Triggered by the Project	**Yes**	**No**	**TBD**
Environmental Assessment OP/BP 4.01	x		
Natural Habitats OP/BP 4.04		x	
Forests OP/BP 4.36		x	
Pest Management OP 4.09		x	
Physical Cultural Resources OP/BP 4.11		x	
Indigenous Peoples OP/BP 4.10		x	
Involuntary Resettlement OP/BP 4.12		x	
Safety of Dams OP/BP 4.37		x	
Projects on International Waterways OP/BP 7.50		x	
Projects in Disputed Areas OP/BP 7.60		x	

V. Financing (in USD Million)

Total Project Cost:	200.00	Total Bank Financing:	200.00
Financing Gap:	0.00		

Financing Source	Amount
Borrower	0.00
International Bank for Reconstruction and Development	200.00
Total	200.00

VI. Contact point

World Bank

Contact: Nabila Assaf
Title: Senior Private Sector Developm
Tel: 473-0531
Email: nassaf@worldbank.org

Contact: Colleen Mascenik
Title: Financial Economist
Tel: 5248+479 / 7
Email: cmascenik@worldbank.org

Borrower/Client/Recipient

Name: Ministry of National Economy
Contact: Galiya Joldybayeva
Title: Director - Department for the Development of Entrepreneurshi
Tel: 77172743022
Email: Zholdybayeva_gt@krp.gov.kz

Implementing Agencies

Name: Entrepreneurship Development Fund
Contact: Zhanar Seitkazieva
Title: Manager, Program Loans Department
Tel: 7727244556677
Email: zhanar.sejtkazieva@fund.kz

Public Disclosure Copy

VII. For more information contact:

The InfoShop
The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 458-4500
Fax: (202) 522-1500
Web: http://www.worldbank.org/infoshop