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The World Bank

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Report No: PAD956

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVLOPMENT

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED LOAN

IN THE AMOUNT OF US$40 MILLION

TO THE

REPUBLIC OF KAZAKHSTAN

FOR A

SME COMPETITIVENESS PROJECT

February 5, 2015

Trade & Competitiveness Global Practice
Europe & Central Asia Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective November 14, 2014)

Currency Unit	=	Kazakhstan Tenge
KZT 185	=	US$1
US$ 1.47	=	SDR 1

FISCAL YEAR

January 1 – December 31

ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank
BRM	Business Roadmap 2020
CAR	Capital Adequacy Ratio
CIS	Commonwealth of Independent States
CPI	Consumer Price Index
CPS	Country Partnership Strategy
EBRD	European Bank for Reconstruction and Development
EEU	Eurasian Economic Union
EMF	Environmental Management Framework
ERI	Economic Research Institute
EU	European Union
FBS	Fixed Budget Selection
FM	Financial Management
FMM	Financial Management Manual
FPIP	Fostering Productive Innovation Project
FSAP	Financial Sector Assessment Program
FX	Foreign Exchange
GAC	Governance and Anti-Corruption
GDP	Gross Domestic Product
IC	Individual Consultants
ICB	International Competitive Bidding
IEG	Independent Evaluation Group
IFI	International Financial Institution
IFR	Interim Un-audited Financial Reports
IPF	Investment Project Financing
ISP	Implementation Support Plan
JERP	Joint Economic Research Program
KCED TA	Kazakhstan Competitiveness and Economic Diversification Technical Assistance
KIDI	Kazakhstan Industry Development Institute
LCS	Least Cost Selection
LOC	Line of Credit
M&E	Monitoring and Evaluation
MID	Ministry of Investment and Development

MNC	Multi-National Corporation
MNE	Ministry of National Economy
NBK	National Bank of the Republic of Kazakhstan
NCB	National Competitive Bidding
NCE	National Chamber of Entrepreneurs
NFRK	National Fund of the Republic of Kazakhstan
NPL	Non-Performing Loan
NPV	Net Present Value
OECD	Organization for Economic Cooperation and Development
PIC	Project Implementation Commission
PIU	Project Implementation Unit
POM	Project Operations Manual
P-RAMS	Procurement Risk Assessment and Management System
QCBS	Quality and Cost Based Selections
RBC	Republican Budget Commission
SBD	Sample Bidding Documents
SCF	Supply Chain Financing
SDO	Supplier Development Office
SDP	Supplier Development Program
SME	Small and Medium sized Enterprise
SOE	State Owned Enterprise
SORT	Systematic Operations Risk-Rating Tool
SPAIID 2	State Program for Accelerated Industrial-Innovation Development 2015-2019
TA	Technical Assistance
TMS	Third-Party Monitoring System
UNDB	United Nations Development Business
VAT	Value Added Tax
WTO	World Trade Organization

Regional Vice President:	Laura Tuck
Country Director:	Saroj Kumar Jha
Senior Global Practice Director:	Anabel Gonzalez
Practice Manager/Manager:	Paloma Anos Casero
Task Team Leader:	Qahir Dhanani

KAZAKHSTAN
SME Competitiveness Project

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Kazakhstan

SME Competitiveness Project (P147705)

PROJECT APPRAISAL DOCUMENT

EUROPE AND CENTRAL ASIA

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Report No.: PAD956

Basic Information		
Project ID P147705	EA Category C – Not Required	Team Leader Qahir Dhanani
Lending Instrument Investment Project Financing	Fragile and/or Capacity Constraints [ ]	
	Financial Intermediaries [ ]	
	Series of Projects [ ]	
Project Implementation Start Date 28-Mar-2014	Project Implementation End Date 30-Jun-2020	
Expected Effectiveness Date 01-Jul-2015	Expected Closing Date 30-Jun-2020	
Joint IFC No		

Practice Manager/Manager	Senior Global Practice Director	Country Director	Regional Vice President
Paloma Anos Casero	Anabel Gonzalez	Saroj Kumar Jha	Laura Tuck

Borrower: REPUBLIC OF KAZAKHSTAN, Ministry of National Economy			
Responsible Agency: Ministry of National Economy			
Contact:	Ms. Galiya Joldybayeva	Title:	Director
Telephone No.:	77172743022	Email:	zholdybayeva_gt@krp.gov.kz

Project Financing Data(in USD Million)					
[X]	Loan	[ ]	IDA Grant	[ ]	Guarantee
[ ]	Credit	[ ]	Grant	[ ]	Other

Total Project Cost:	46.00	Total Bank Financing:	40.00
Financing Gap:	0.00		

Financing Source	**Amount**
Borrower	6.00
International Bank for Reconstruction and Development	40.00
Total	46.00

Expected Disbursements (in USD Million)

Fiscal Year	2016	2017	2018	2019	2020	0000	0000	0000	0000	0000
Annual	4.70	9.24	8.12	9.06	8.88	0.00	0.00	0.00	0.00	0.00
Cumulative	4.70	13.94	22.06	31.12	40.00	0.00	0.00	0.00	0.00	0.00

Institutional Data

Practice Area / Cross Cutting Solution Area

Trade & Competitiveness

Cross Cutting Areas

[ ] Climate Change
[ ] Fragile, Conflict & Violence
[X] Gender
[X] Jobs
[ ] Public Private Partnership

Sectors / Climate Change

Sector (Maximum 5 and total % must equal 100)

Major Sector	Sector	%	Adaptation Co-benefits %	Mitigation Co-benefits %
Education	Vocational training	15		
Industry and trade	General industry and trade sector	85		
Total		100		

☑ I certify that there is no Adaptation and Mitigation Climate Change Co-benefits information applicable to this project.

Themes

Theme (Maximum 5 and total % must equal 100)

Major theme	Theme	%
Financial and private sector development	Micro, Small and Medium Enterprise support	60
Financial and private sector development	Other Private Sector Development	40
Total		100

Proposed Development Objective(s)
The project development objective is to enhance the competitiveness and management capacity of targeted small and medium sized enterprises in Kazakhstan.

Components	
Component Name	**Cost (USD Millions)**
1. SME Capacity Building Program	15.00
2. SME Linkages in Competitive Sectors	20.00
3. Impact Evaluations & Monitoring	8.00
4. Project Management	3.00

Systematic Operations Risk- Rating Tool (SORT)	
Risk Category	**Rating**
1. Political and Governance	Substantial
2. Macroeconomic	Substantial
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	Moderate
5. Institutional Capacity for Implementation and Sustainability	Substantial
6. Fiduciary	Substantial
7. Environment and Social	Low
8. Stakeholders	Low
9. Other	
OVERALL	Substantial

Compliance		
Policy		
Does the project depart from the CAS in content or in other significant respects?	Yes [ ]	No [X]
Does the project require any waivers of Bank policies?	Yes [ ]	No [X]
Have these been approved by Bank management?	Yes [ ]	No [X]
Is approval for any policy waiver sought from the Board?	Yes [ ]	No [X]
Does the project meet the Regional criteria for readiness for implementation?	Yes [X]	No [ ]

Safeguard Policies Triggered by the Project	Yes	No
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**

Legal Covenants

Name	**Recurrent**	**Due Date**	**Frequency**

Description of Covenant

Conditions

Source Of Fund	**Name**	**Type**
IBRD	Operational Manual	Effectiveness

Description of Condition

The Project Operational Manual (POM) has been adopted by the Ministry of National Economy satisfactory to the Bank.

Source Of Fund	**Name**	**Type**
IBRD	Establishment of PIU	Effectiveness

Description of Condition

The Ministry of National Economy has issued an order to establish the PIU, with composition, resources and terms of reference satisfactory to the Bank.

Source Of Fund	**Name**	**Type**
IBRD	Implementation Commission	Effectiveness

Description of Condition

The Project Implementation Commission has been established with Terms of Reference satisfactory to the Bank.

Source Of Fund	**Name**	**Type**
IBRD	Financial Management & Procurement Specialists	Effectiveness

Description of Condition

The MoNE has selected for immediate recruitment upon effectiveness a full-time paid financial management specialist and a full-time procurement specialist, both with terms of reference and qualifications satisfactory to the Bank.

Team Composition			
Bank Staff			
Name	**Title**	**Specialization**	**Unit**
Qahir Dhanani	Private Sector Development Specialist	Task Team Leader	GTCDR
Anna Akhalkatsi	Senior Operations Officer	Team member	CASSB
Gulmira Akshatyrova	Program Assistant	Program Assistant	ECCKZ
Paloma Anos Casero	Practice Manager	Practice Manager	GTCDR
Rakhymzhan Assangaziyev	Country Officer	Team member	ECCKZ
Rolf Behrndt	Practice Manager	Peer Reviewer	GFMDR
Yeraly Beksultan	Consultant	Team member	GTCDR
Gianfranco Bertozzi	Lead Financial Officer/Debt Capital Markets & CBP	Team member	FABBK
Steen Byskov	Sr Financial Economist	Peer Reviewer	GFMDR
Tatyana V. Chursova	Consultant	Team member	GTCDR
Xavier Cirera	Economist	Team member	GTCDR
Sascha Djumena	Country Program Coordinator	Country Program Coordinator	ECCU8
Yehia Khedr Eldozdar	Associate Operations Officer	Associate Operations Officer	GTCDR
Paula Genis	Operations Officer	Team member	GPSOS
Natasa Goronja	Operations Officer	Team member	GFMDR
Robertus Antonius Grimberg	Consultant	Team member	GTCDR
Lola Ibragimova	Senior Social Development Specialist	Social Development Specialist	GSURR
Ramiro Ignacio Jauregui-Zabalaga	Senior Counsel	Counsel	LEGLE
Thomas Kenyon	Senior Private Sector Development Specialist	Peer Reviewer	GTCDR
Svetlana Khvostova	Natural Resources Mgmt. Spec.	Member - Social Safeguards	GENDR
Aliya Kim	Financial Management Specialist	Member - Financial Management	GGODR
Christos Kostopoulos	Program Leader	Program Leader	ECCU8
Nurbek Kurmanaliev	Procurement Specialist	Member - Procurement	GGODR

Matija Laco	Country Economist	Team member	GMFDR
Esperanza Lasagabaster	Practice Manager	Peer reviewer	GTCDR
Syed A. Mahmood	Lead Investment Policy Officer	Team member	GTCDR
Jana Malinska	Economist	Team member	GTCDR
Natalia Mashaeva	E T Temporary	Team Assistant	GTCDR
Martin Melecky	Lead Economist	Team Member (Co-TTL Oct 2013-Jul 2014)	SARCE
Jasna Mestnik	Finance Officer	Finance Officer	CTRLA
Djurdjica Ognjenovic	Consultant	Team member	GFMDR
Ifeyinwa Uchenna Onugha	Private Sector Development Specialist	Team member	GTCDR
Agata E. Pawlowska	Lead Operations Officer	Lead Operations Officer	ECCU8
Lalit Raina	Adviser	Team member	GFMDR
Melissa Rekas	Private Sector Development Specialist	Team member	GTCDR
Ivan Rossignol	Chief Technical Specialist	Peer Reviewer	GTCDR
L. Keta Ruiz	Senior Operations Officer	Quality	GPSOS
Emanuel Salinas Munoz	Program Leader	Team member	SACSL
Svetlana K. Sharipova	Consultant	Consultant	GSURR
Adam Shayne	Lead Counsel	Lead Counsel	LEGLE
Kamal M. Siblini	Senior Monitoring & Evaluation Specialist	Quality	GTCDR
Hiroshi Tsubota	Lead Financial Officer/Debt Capital Markets & CBP	Team member	FABBK
Natasa Vetma	Senior Environmental Specialist	Team member	GENDR

Non Bank Staff

Name	Title	City

Locations

Country	First Administrative Division	Location	Planned	Actual	Comments

I. **STRATEGIC CONTEXT**

A. Country Context

1. **Kazakhstan enjoyed robust economic growth in the past few years, supported by high oil prices, but emerging vulnerabilities pose downside risks.** The country has enjoyed robust real GDP growth since the early 2000s, averaging 8 percent per year. However, GDP growth declined reaching 6 percent in 2013 and is estimated to decline further, to below 5 percent in 2014 (Q1 2014 growth decelerated to 3.8 percent year-on-year), because of weaker domestic consumption and external demand, and regional tensions. Fragile consumer and business confidence pose downside risks to growth projections. Inflation is expected to accelerate due to the devaluation of the tenge. The external environment remains uncertain. Kazakhstan is vulnerable to a prolonged slowdown in emerging markets (particularly in Russia with whom it maintains strong links), the slowdown in Western Europe and the declining oil prices. The signing of the Eurasian Economic Union (EEU) with Russia and Belarus in May 2014, is not expected to have near-term economic effects; medium-term effects will depend on how the Union's rules and regulations will be implemented.

2. **Amid uncertain external and domestic environments, the government of Kazakhstan has launched its Partnership Framework Arrangement with International Financial Institutions (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 Financial Sector Assessment Program (FSAP) recommendations; and (iii) accelerate progress on structural reforms to promote economic diversification and private sector competitiveness (improving the business environment, enhancing the capacity of domestic firms to export and innovate, with particular emphasis on Small and Medium sized Enterprises (SMEs), young entrepreneurs and start-ups; and strengthened linkages between SMEs and larger companies in global value chains to support improved productivity and job creation).

Table 1: Macroeconomic Indicators

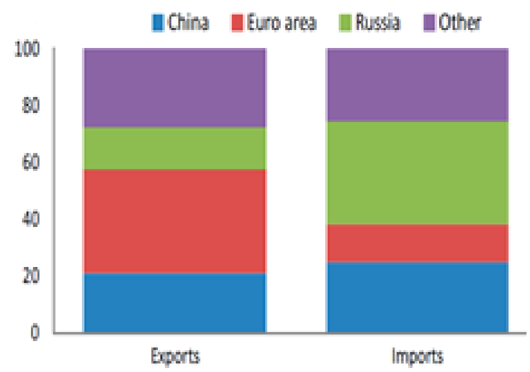
	2008	2009	2010	2011	2012	2013	2014e
GDP per capita (US$)	8,514	7,165	9,071	11,358	12,121	13,172	12,625
Real GDP growth (% change)	3.3	1.2	7.3	7.5	5.0	6.0	4.5
CPI Inflation (avg, % change)	9.5	6.2	7.8	8.3	5.1	5.8	8.9
Current Account Balance (% of GDP)	4.7	-3.6	0.9	5.4	0.5	-0.1	0.6
Fiscal Balance (% of GDP)	2.5	-0.8	2.9	6.2	4.3	4.3	3.6
Credit to private sector (% of GDP)	52.7	55.0	45.3	40.9	41.5	41.6	40.7
Non-oil fiscal balance (% of GDP)	-10.5	-9.4	-8.0	-8.2	-9.5	-7.9	-9.8
Public debt (% of GDP)	8.7	13.9	15.5	12.5	13.2	14.0	14.9
External debt (% of GDP)	80.9	97.9	79.9	66.6	67.3	66.3	72.0
Excluding inter-company lending	50.8	54.8	44.5	33.4	34.1	33.9	36.2

Source: Kazakhstani authorities, IMF, Bank staff calculations and estimates

3. In response to slower economic growth and weaker external demand, the National Bank of Kazakhstan (NBK) devalued the local currency by 18 percent in February 2014. The authorities justified the devaluation by citing the deterioration in the current account balance, concern about external competitiveness due to depreciation in the Russian ruble, and a fall in central bank international reserves. The devaluation was accompanied by the introduction of a corridor of +/- 3 tenge (roughly 1.5 percent) around the new exchange rate. The devaluation of the tenge has been fueling inflation, despite some price controls. In July 2014, headline Consumer Price Index (CPI) inflation reached 6.9 percent year-on-year (up from 4.8 percent at end-2013).

4. To restore confidence post-devaluation, the NBK stabilized the foreign exchange market and boosted tenge liquidity. After the devaluation in February 2014, the NBK injected tenge liquidity in the repo market to restore trust in the tenge. In addition, the NBK launched a $10 billion currency-swap program to mitigate the scarcity of long-term tenge funding and the high dollarization of deposits. The program includes a subsidized fixed interest rate of 3 percent for 1-3 years Foreign Exchange (FX) swaps (and 5 percent for 5-year swaps), and is open to local commercial banks.

Figure 1: Geographical structure of trade



Source: IMF, Bank staff calculation

5. The currency devaluation improved the trade balance in the short-run, but its long-run impact on competitiveness is 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. The recent devaluation of the tenge is likely to have a positive short-term impact on the trade balance but it is unlikely to have long-run effects.

6. Fiscal balances have improved, but there is a need for greater coverage and transparency of the medium term-fiscal framework. The overall fiscal surplus widened to 5.2 percent of GDP in 2013, from 4.5 percent of GDP in 2012, as a result of a decline of expenditures. The reduction of expenditures was due to lower current and capital spending relative to GDP. Non-oil tax revenues increased by 0.5 percent of GDP, reversing the declining trend of the past few years, largely on account of strong Value Added Tax (VAT) receipts. As a result, the non-oil deficit declined to 7 percent of GDP (from 8.9 percent). However, the 2014 budget was amended in February 2014 with the inclusion of additional off-budget spending to offset the negative impact of the currency devaluation and slowing growth. Public wages and social benefits were increased by 10 percent on average (effective from April 2014). On the revenue side, the oil export customs duty was increased by 30 percent.

7. The external position remains broadly adequate with large buffers. The current account was on surplus (averaging over 2 percent of GDP in the 2010-2012 period) in recent years. It turned into a slight deficit in 2013 on account of declining non-oil exports (mostly metals and grains). In early 2014 the current account balance improved, as imports declined by 14.6 percent and exports grew by 10.8 percent (because of growth in oil exports). The country's overall international investment position, including the assets in the National Oil Fund (NFRK), continues to improve. As of end-July 2014 official international reserves reached US$ 26 billion. Adding asset accumulation of the NFRK, total international reserves reached US$ 103.8 billion.

8. Kazakhstan signed the EEU and strengthened links with other trading partners but more efforts are required to deepen its global integration. The recently signed EEU came into effect in January 2015, with Belarus, Kazakhstan, and Russia as members. The EEU envisages the free transit of goods, services, capital, and labor. While the EEU suggests closer economic integration with a number of Commonwealth of Independent States (CIS) economies, the government is also extending collaboration with China and the Organisation for Economic Cooperation and Development (OECD) and aims to complete World Trade Organization (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.

9. Kazakhstan accumulated significant financial vulnerabilities that require prompt resolution. As financial conditions tightened with the onset of the 2008 global financial crisis, banks lost access to foreign financing and were forced to deleverage aggressively, triggering a decline in stock and real estate prices and a strong deceleration in non-oil economic activity. A 20 percent devaluation in 2009 further complicated matters, as widespread unhedged foreign currency borrowing led to further contractions in demand and problems with loan servicing. The crisis prompted the intervention of several banks and the restructuring of their external liabilities, but bad assets were not addressed. The currency devaluation worsened the banks' external debt servicing problems. Despite the restructuring of some these banks, the banking sector continued to face difficulties as the deceleration in growth, the collapse of real estate prices, and the currency devaluation led to a significant build-up of non-performing loans. Banks' balance sheet repair will be key to support effective financial intermediation and balanced economic growth. Sustained GDP growth amidst subdued private credit was possible because it was driven by commodity exports—an activity that funds itself abroad—and by directed lending and government subsidies to other economic sectors. However, to achieve sustainable growth over the medium term, it will be essential to restore the normal flow of credit in the economy.

10. 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.

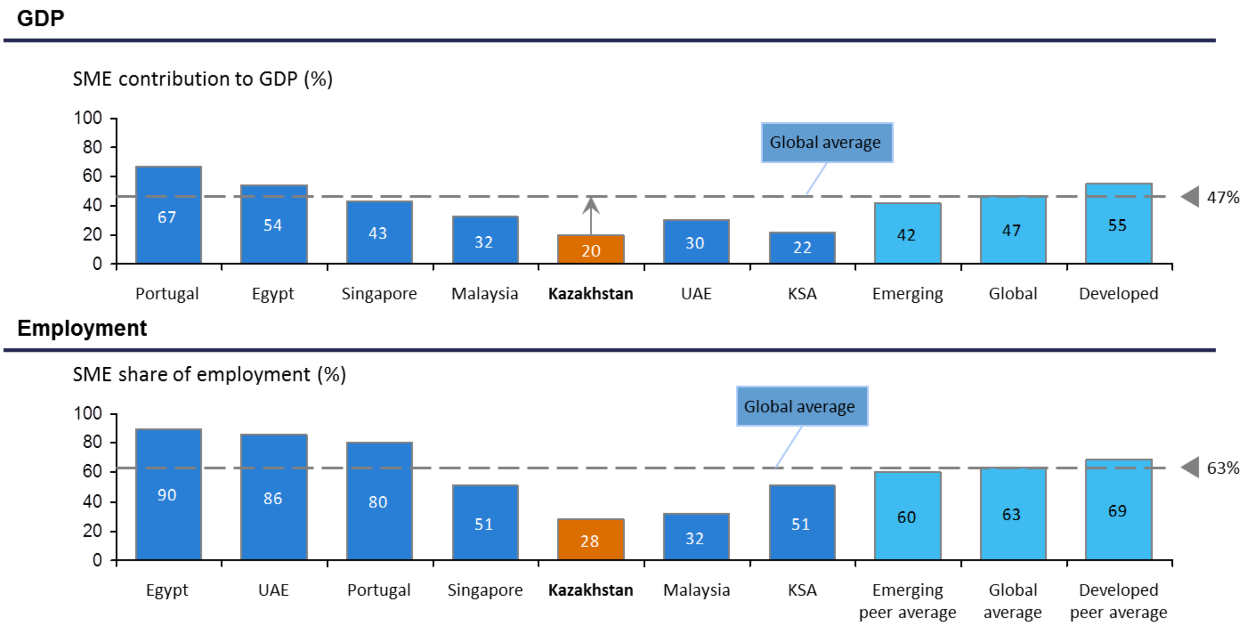
B. Sector and Institutional Context

<u>SME Sector</u>

11. The Government of Kazakhstan defines an SME as any enterprise with fewer than 250 employees. The differentiation between small and medium businesses is based on annual asset values and number of employees. Small businesses are those enterprises with annual assets lower than 1 million tenge and fewer than 50 employees. Medium-sized businesses have an asset value greater than 1 million tenge with fewer than 250 employees. The business form determines its tax load and schedule. The working definition for SMEs in this operation mirrors that of the government.

12. The SME sector in Kazakhstan remains nascent and highly concentrated. Kazakhstan has over 750,000 registered SMEs that employ over 2.5 million people and produce about 18 percent of GDP. It is estimated that up to 30 percent of registered SMEs are not active. The country lags behind global and regional benchmarks (Figure 2). SMEs represent over 90 percent of all enterprises in the country. 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. In addition, government programs supporting the SME sector have been skewed towards Astana and Almaty, where 40 percent of registered SMEs are located.

Figure 2: The SME sector is still nascent in Kazakhstan



Source: World Bank & Bank staff calculations

13. The Kazakhstani SME sector can play a key role in advancing shared prosperity, economic diversification and private sector competitiveness. SMEs are important sources of economic growth and employment generation and thereby, are critical to boost shared prosperity. In Kazakhstan, SME development could contribute to reducing the reliance of the economy on extractive industries and the country's exposure to declining commodity prices. SMEs also have the potential to be sources and conduits of innovation in production and exports, helping the introduction of higher added-value activities and the generation of more and better jobs.

14. However, Kazakhstani SMEs are faced with domestic and external uncertainty and lack the means to pursue available market opportunities. Qualitative consultations with the private sector in Kazakhstan reveal a gap in professional and managerial skills and limited access to investment financing, as two key obstacles that hold back SME development.

15. 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. Kazakhstani entrepreneurs were educated in the former 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 the central planning, including inefficient business networks, clientelism, and lack of professional and managerial skills required to compete in external markets. These deficiencies in the SME sector are compounded with uneven quality and access to public services.

16. An Asian Development Bank (ADB) survey of 1,600 SMEs in 2013 reveals the main challenges faced by SMEs in Kazakhstan. SME owners and managers raised the following factors: low professionalism of entrepreneurs, lack 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. Ninety percent of businesses are run locally and only 7 percent have national reach. The study also found gender disparities, with women representing 46 percent of entrepreneurs.

17. SMEs face disproportionate constraints in accessing finance. SMEs receive around one-eighth of total loans and grow slower relative to large enterprises in Kazakhstan and SMEs in peer comparison countries. Their share in total credit declined in the aftermath of the global financial crisis and continues to decline to date, demonstrating how SMEs are among the first and most affected casualties of a financing crunch. Lack of cash flow based financing, credit history, and high collateral requirements (on average 200 percent) acutely constrain their access to funding.

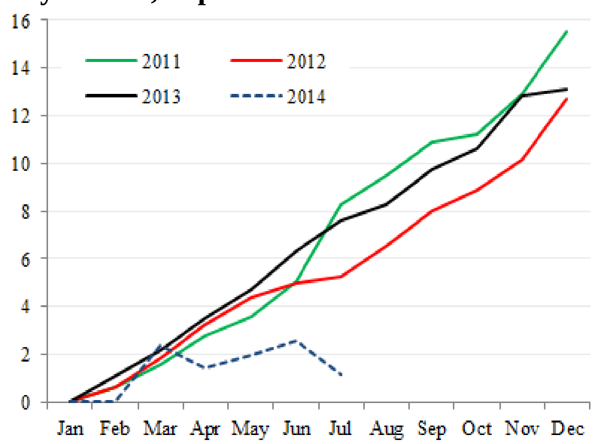
18. Financial institutions in Kazakhstan have started to develop products and services to meet SME needs. Yet, they point to lack of "business readiness" and business planning capacity, as key factors affecting SMEs' inability to obtain financing. A "bankable" business plan depends on solid financial planning, which in turn depends on an understanding of business finance (e.g., financing sources and financial statement analysis). SMEs that lack financial capability are unlikely to develop a business plan, and consequently will not seek external financing (or will use informal sources) or will be denied credit by financial institutions. They are less likely than their financially literate peers to grow to their full potential. 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.

Financial Sector

19. Tightening liquidity in international financial markets back in 2007 hit Kazakhstan's financial sector, which had relied extensively on foreign funding to finance rapid credit growth in real estate and construction, in particular. The rapid growth in the banking system in the years prior to the crisis built high exposure to international bond and syndicated loans markets, which were used to finance the expansion. Much of the credit was concentrated in real estate projects in the major cities, which created large exposure to the real estate market. Access to international wholesale markets ceased in mid-2007, triggering a liquidity crisis and speculative runs, which the NBK successfully managed, helped by large reserves. The second shock arose from the global financial crisis in 2008 and the associated sharp decline in commodity prices in 2009, which led to an economic slowdown and hence a deterioration in the quality of banks' assets. See Figure 3.

20. New bank lending has started to recover, but remains selective. Despite high demand for credit, low risk appetite of the banking sector continues to be the key factor curbing lending in the real sector of economy. The available offer of loans is limited to certain sectors of the economy with lower level of risks and higher turnover of investments. By July 2014, credit grew by 1.2 percent, excluding the exchange rate movements. Owing to the continued deposit growth of both households and corporate sector and modest overall lending growth, the loan-to-deposit ratios for both domestic and foreign currency have improved in recent years. However, the high dependence of big banks on large corporate deposits poses concentration risks.

Figure 3: Credit growth to economy, compared to year-end, in percent



Note: Exchange rate movements excluded
Source: NBK, Bank staff calculation

21. The banking sector's profitability has started to recover, but financial vulnerabilities remain due to the high level of non-performing loans. Banks' profits have continued to improve over the past year, albeit gradually, helped by rapid growth in consumer lending, with the return on assets ratio for the sector rising to 1.8 percent in 2013 (from 1.3 percent in 2012). The system's aggregate capital adequacy ratio (CAR) has stabilized at around 17 percent, with the Tier I capital ratio at around 13 percent. The financial system remains saddled with a large stock of NPLs, at 33.5 percent at end-June 2014, most of which is concentrated in three of the seven largest banks. In 2013, NBK introduced a ceiling of NPL ratio to 15 percent by end-2014 and 10 percent by end-2015.

22. Banks are restrained from extending loans to businesses, owing to increased uncertainty about long term funding availability. With limited access to foreign market and decreased liabilities to non-residents, the share of long-term funding in the structure of banks' liabilities has declined. Deposits make the basis for the funding base of the banking system (three quarters of the total liabilities of banks at the end of 2013). At the same time, the share of short-term liabilities (less than 1 year) reached two thirds of total liabilities. This makes the resource base of banks highly volatile and expensive and limits their ability to provide long-term credit to the economy. In addition, a significant portion of deposits is denominated in foreign currency, thus increasing financial risks both for banks and for borrowers which obtained foreign currency loans but do not generate sufficient foreign currency proceeds or effective hedging instruments.

C. Higher Level Objectives to which the Project Contributes

23. The project is aligned with the government's aim to improve private sector competitiveness and economic diversification. In 2013, the contribution of SMEs to GDP was 18 percent. The government aims to increase the GDP contribution of SMEs to 50 percent by 2050. The government plans to support the competitiveness of SMEs not only by strengthening the business climate, but also by launching support programs to enhance their capacity to generate business plans to export and innovate, and to improve their access to finance, thereby strengthening investment, productivity, and job creation prospects in this sector.

24. 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 becoming a top 30 economy by 2050 as measured by the World Economic Forum's Global Competitiveness Index.

D. Contribution to the World Bank's Twin Goals

25. The project is expected to contribute to boost shared prosperity by improving the competitiveness of SMEs and their ability to create more and better jobs. First, by strengthening the professional and managerial skills and easing access to finance for SMEs the project will improve the ability of the economy to create more and better jobs. Second, by building new linkages between SMEs and large buyers, the project will provide Kazakh entrepreneurs with increased access to markets. Third, by enhancing the capacity of the government to strengthen competitive sectors, the project will increase SME activity in emerging areas of the economy.

26. The project is also expected to contribute to the reduction in extreme poverty. First, by launching capacity building programs for SMEs across regions, and by increasing market linkages for firms in selected regions across the country, the project could contribute to reduce poverty in rural areas (where four out of five poor households live). Second, by creating a local market of SME suppliers of basic public goods and services and by improving SME competitiveness, the project is expected to have an indirect impact on extreme poverty reduction, as SMEs hire and train low-skilled workers which tend to be members of poor households[1].

[1] Data Survey and Case Study Analysis of Small Enterprise Assistance Fund (2007), "From Poverty to Prosperity: Understanding the Impact of Investing in Small and Medium Enterprises".

II. PROJECT DEVELOPMENT OBJECTIVES

A. Project Development Objective

27. The project development objective is to enhance the competitiveness and management capacity of targeted small and medium sized enterprises in Kazakhstan.

B. Project Beneficiaries

28. Project beneficiaries that directly derive benefits from the project include:

(a) SMEs;
(b) Providers of business advisory services to SMEs;
(c) Government entities engaged in supporting SMEs, including the Ministry of National Economy (MNE);
(d) Entities involved in promoting competitive industries and clusters;
(e) Large corporations who will benefit from efficiency of local suppliers;
(f) National Chamber of Entrepreneurs (NCE) and other private sector associations; and,
(g) Economic Research Institute (ERI).

C. Project Development Objectives Level Result Indicators

29. Key PDO level results indicators include the following:

(a) Number of SMEs who become “accredited suppliers” to large companies
(b) Percentage of participating SMEs reporting improved management & business practices
(c) Number of Cluster Competitiveness Action Plans for which implementation has begun

30. Key indicators for monitoring for analytical purposes, including the impact of the project on job creation, are explored in Annex 1.

III. PROJECT DESCRIPTION

A. Project Components

31. The project comprises four components as described below and summarized in Table 2.

Component 1 – SME Capacity Building Program (US$15 million, of which counterpart funding will be US$6 million)

32. The aim of this component is to introduce a coherent framework of SME capacity building programs to support competitiveness of all Kazakhstani firms regardless of size or sector. In particular, this component will finance training and capacity building activities to ensure that not only do entrepreneurs, SME owners and managers consistently receive high-quality services under government-funded entrepreneurship support programs, but also that policymaking processes related to the SME and entrepreneurship sectors are enhanced and local capacity is built to carry over these training programs beyond the life of this project.

33. Under this component, the quality and content of the Business Advisors network and SME support infrastructure will be enhanced. At present, government programs employ several hundred "Business Advisors" of varying levels of competency and quality, tasked with providing free-of-cost services to SMEs throughout the country. The training content and methodology implemented in this component will leverage IFC's Business Edge Program, a proven curriculum that includes content covering 60 areas of business training and methodologies designed for delivery to adult learners. Through a grant to a university or training institute that has strong credentials in continuing or adult education and a focus in regional areas, Business Edge will be adapted to the local context. In addition a strong and sustainable cadre of local master trainers, business advisors, instructional designers, and assessors will be trained. Given its targeting to working age SME owners, managers and entrepreneurs in major cities and across regions, this component will contribute to the agenda of shared prosperity in Kazakhstan. The component will include feedback loops that ensure knowledge and information is shared at three levels, including at the institutional and policy level, at the business services sector level, and at the SME level. As such, the policymaking process supporting SMEs will be influenced by information and data resulting from the activities of this component.

34. A robust communications plan will accompany implementation of this component. Success of the SME Capacity Building Program depends in a large part on the awareness SMEs have of the availability of the services being offered. A coordinated and national and regional level communications strategy and public awareness campaign will be required to ensure broad reach. This activity is will be funded by the component.

35. This component envisions close linkages with the Kazakhstan Fostering Productive Innovation Project (P150402) and the Kazakhstan Joint Economic Research Program (JERP). Although the Fostering Productive Innovation Project (FPIP) focuses on a niche market of innovation and technology commercialization, the needs for management and business capacity building among startups and new entrepreneurs cannot be understated. The two projects will work closely to ensure that the horizontal skills and capacities required by all startup entrepreneurs are met through the SME Competitiveness project, while the technical innovation needs are addressed through FPIP. Similarly, a part of the JERP technical assistance program focuses on investment climate reforms. These activities will provide a critically needed complementarity with the project and will benefit from the data produced by the project.

36. As a result of this component, (i) several hundreds of Business Advisors will receive competency-specific capacity building; (ii) a cadre of master trainers, assessors, and instructional designers[2] for SME support will be developed; (iii) several hundred SMEs

[2] "Master trainers" include a small group of individuals trained in both the content of Business Edge and in the pedagogical methodologies to deliver training to trainers. "Assessors" include individuals trained to observe, review, and assess the delivery of training and advisory services by Business Advisors to end beneficiaries with an overall objective to assess the quality of such service delivery. As such, assessors will be responsible for validating the competencies of trainers and business advisors. "Instructional Designers" include individuals who are responsible for the design of new training modules based on market demand as assessed by the project. They are trained to develop appropriate content and delivery systems for new training modules.

will benefit from improved business services; and (iv) a new market for SME business support services will be created to support longer term sustainability.[3]

Component 2 – SME Linkages in Competitive Sectors ($20 million)

37. The objective of this component is to introduce a coherent framework to promote linkages and integration of SMEs in existing and emerging competitive sectors. This component is comprised of three main subcomponents. Component 2.1 supports SME linkages in supply chains within sectors that have already become established and are growing in competitiveness (such as the extractives sector or the railway equipment sector). Component 2.2 addresses challenges in emerging competitive sectors where SMEs can play an important role, but where the government's policy and interventions towards development of these competitive sectors needs to be strengthened. Component 2.3 aims at defining the strategic, regulatory, and operational needs to implement a reverse-factoring or supply-chain financing program in Kazakhstan.

Component 2.1 – Supplier Development Program

38. The aim of this component is to improve the competitiveness of SMEs in competitive clusters in Kazakhstan through a focused and comprehensive Supplier Development Program (SDP). The project will establish a Supplier Development Office (SDO), whose role will be to increase market linkages for SMEs with large local and multinational corporations operating in Kazakhstan. Initially operating in at least two well established sectors (see below) the program will increase the ability of Kazakhstani SMEs to supply inputs into the local operations of multinational corporations (MNCs), large local firms and State-Owned Enterprises (SOEs) looking to raise their levels of local content use. On the one hand, the SDO will help to identify the needs of large buyers in Kazakhstan and improve their capacity to source inputs locally. On the other hand, the SDO will work with SMEs to enhance their capacity to meet the quality and reliability needs of the large buyers, while also facilitating their linkage with the relevant large buyers. As the SMEs engaged in the SDP attain world class standards to become viable suppliers to MNCs and SOEs, they will, in the longer term, be able to improve their competitiveness and export more widely to global markets. Further, they will create opportunities for other local suppliers thereby strengthening local clusters.

39. During its initial stages, the program will focus on the Oil & Gas, Railway Equipment Industry, and possibly the Metallurgy sectors, as each of these sectors have well established clusters.

(a) The expansion of Oil & Gas infrastructure, which is a dominant competitive sector, represents a natural opportunity for increased participation of SMEs in the economy. Over the coming decade, public and private investments required in the sector could

[3] "The Big Business of Small Enterprises: Evaluation of the World Bank Group experience with targeted support to SMEs 2006-2012," Independent Evaluation Group of the World Bank, 2013.

reach US$200 billion[4], presenting an opportunity for local SME participation, but one which local SMEs are at present unprepared to benefit from.

(b) A recent study by The World Bank Group on the Railway Equipment[5] sector noted its economic significance in developing a nascent logistics industry, and its social importance in providing passenger transportation to the population spread out over a vast geographic landmass. Over the coming decade, the government intends to spend approximately US$13 billion[6] in the modernization of railway infrastructure and fleet providing a large domestic demand for railway equipment manufacturers and an opportunity for appropriately prepared SMEs.

40. This component will address key areas of need of selected sectors and SMEs. Through the establishment of a SDO, the project will (i) build capacity within the ministry and related agencies, including the NCE to develop and implement a SDP; (ii) work with the ministry to select and establish an appropriate managing agency which will operate the program; (iii) engage with large local, multinational, and state-owned companies to enhance their capabilities to source inputs from local selected SMEs; (iv) provide direct technical assistance to SMEs within the selected sectors to upgrade their skills including helping them attain international certification, improve business and management practices, and facilitate communication and relationships between major buyers and potential suppliers; and, (v) establish a national supplier database for use by large buyers. The selection of SMEs will be undertaken through an independent process that would help protect against special interests. The approach will operate in a first stage in two sectors on a pilot basis, such that lessons are learned and integrated before scaling the program to additional sectors.

41. As a result of this component, over a hundred SMEs will benefit from hands-on capacity building to accredit them as suppliers to large firms, with over US$25 million in estimated new orders from the MNCs and SOEs.

Component 2.2 – Competitive Sectors

42. The objective of this component is to support competitiveness of SMEs in non-extractive sectors. **This component will focus on increasing market linkages for SMEs in Kazakhstani sectors that are not yet globally competitive but which have potential for growth**. The component seeks to develop a world-class cluster development team within the government that is able to implement best practices to support the competitiveness of selected sectors in at least three regions of the country. It is expected that the Government can then apply the capacity built and experience gained to other sectors and/or regions.

43. To achieve this, the component will provide hands-on implementation support to the Government of Kazakhstan to strengthen its institutional capacity to implement the cluster development program, under the State Program for Accelerated Industrial-Innovation

[4] Speech by Minister Erlan Muratov, Ministry of Industry and New Technologies, Astana, Kazakhstan, April 17, 2013.
[5] "Expanding Opportunities for Enterprise Development in Global Value Chains: The Railway Equipment Industry in Kazakhstan," The World Bank Group, June 2011.
[6] Ibid.

Development 2015-2019 (SPAIID 2)[7]. Specifically, the project will: (i) train and equip the team of specialists at the Kazakhstan Industry Development Institute (KIDI) that will implement the cluster development program, providing them with modern, market-based tools for fostering industry-specific competitiveness, and build the capacity of other government officials and private sector representatives that will participate in the program; and (ii) support the implementation of the cluster program in six sectors[8] across three regions (approximately 2 sectors per region), over a period of five years. The selection of regions and sectors/clusters will be informed by market-based analysis and consultation with the public and private sectors, and will draw on work done under the ongoing Kazakhstan Competitiveness and Economic Diversification (KCED) Technical Assistance (TA).

44. The expected results of this component include stronger market linkages for SMEs in the selected sectors and increased capacity of government to support the competitiveness of targeted clusters. For each cluster, competitiveness action plans will be developed and implemented using sound analytics and drawing on strong private sector participation. The action plans will identify constraints to growth and potential opportunities, with special attention to SMEs. The action plans will include concrete actions for increasing competitiveness at the enterprise, industry, and government levels – with this last level to include regulatory/policy aspects as well as potential public investments. Communications plans and monitoring and evaluation (M&E) mechanisms will be incorporated, to enable a continuous feedback loop on successes and challenges in action plan implementation, market conditions affecting the companies in the cluster, and implications for government policy and programs. The competitiveness action plans will be updated based on the M&E results and market trends. The action plans will increase the global competitiveness of the selected clusters, and the capacity built in the government can be deployed in support of additional clusters.

Component 2.3 – Factoring Strategic Assessment

45. The objective of this component is to conduct a strategic assessment for the development of factoring and reverse-factoring in Kazakhstan to support SMEs in local supply chains. SMEs in the various local supply chains in Kazakhstan face challenges emanating from a lack of collateral to receive loans, delays in receiving payments especially from larger companies, lack of certainty of trade, and a lack of credit from suppliers. An online platform that allows these SMEs to register (or collateralize) and verify their accounts receivables can facilitate increased access to finance for SMEs. Furthermore it would allow the buyer to register status updates on the platform including approval or dispute. Financial institutions (of Factors) can then fund the purchase of the invoices. Such a program, which can alternatively be termed Reverse-Factoring or Supply Chain Finance (SCF) involves a relationship between a finance provider and a large end-customer, under which the factor agrees to finance invoices issued by the large company's suppliers once they have been formally approved for payment.

46. The component seeks to (i) assess the reasons behind the still nascent development of factoring in Kazakhstan, with a detailed review of the relevant legal, regulatory and

[7] And any future iterations of this program, as applicable.
[8] Defined as industries at a regional or city level (e.g. fruit products in South Kazakhstan).

institutional framework, and the assessment of possible market failures, and (ii) suggest recommendations to develop the factoring and reverse-factoring (including the design of an invoice-based financing platform). The strategic assessment will, inter alia, recommend the most appropriate program design given the local context, assess the supply chain finance market in Kazakhstan, the financial institutions best positioned to be engaged in the program, the governance structure of the possible invoice-based financing platform and investment vehicle, the sectors with the highest promise, the location of the platform, and the training and capacity building requirements of related stakeholders.

47. As a result of this component, increased institutional capacity to implement and supervise a factoring development program in Kazakhstan will be developed. A detailed action plan for the development of factoring will be developed and initial steps taken to train and engage with the relevant stakeholders.

Component 3 – Impact Evaluation & Monitoring of SME Programs (US$8 million)

48. The aim of this component is to create a sustainable M&E structure that will shape SME policies and programs, helping to establish informed priorities and introduce mid-course corrections as required; as well as strengthening a sustainable Third-Party Monitoring System (TMS) that increases transparency and participation of the private sector and citizen engagement in SME policy design. The project will create the institutional capacity to carry out robust and independent impact evaluations via the ERI, with assistance from universities. A critical aspect of the component will include impact evaluations, which will aim to test the effectiveness of SME support interventions both within and outside the context of the project. These impact evaluations will provide critical inputs to policy makers as they refine approaches to enhance services to SMEs. Impact evaluations will focus on a number of topics, including but not limited to, the measurement of productivity increases experienced by participating SMEs, the impact of business advice on management practices of SMEs, and the impact of "accredited supplier" status on firms' abilities to secure new contracts, among others.

49. The project will strengthen TMS, including the NCE's call center, to allow SMEs with the opportunity to provide independent feedback to policy makers to monitor progress of related programs.

50. This component presents a test-case of good practice for World Bank Group projects that take on risks and put in place mechanisms to assess progress. The project envisages a combination of M&E efforts (mobile SMS information gathering which will allow a real-time basis assessment of progress and risks; and annual surveys and randomized trials, where feasible) that will include feedback loops to take mid-term corrective actions when needed.

Component 4 – Project management (US$3 million)

51. The management of the project over its five-year tenure will be conducted by a team of technical and fiduciary specialists in areas including project coordination, technical, procurement, financial management, and M&E specialists. It is expected that at least two of these specialists will be sourced internationally and will join the Project Implementation Unit (PIU) on a resident basis.

Deferred Activity – Line of Credit

52. **A US$ 200 million line of credit (LoC) was included in the original project design, as requested by the Government.** The objective of the LoC was to serve as a demonstration effect that international best practices for financial intermediation based on market-based principles could be applied to the Kazakhstan context. It would also provide long-term financing to SMEs. The LoC would have been implemented by the Entrepreneurship Development Fund (DAMU). The preparatory work related to the LoC, including the LoC design and implementation arrangements, the appraisal of DAMU (LoC borrower and financial intermediary), eligibility assessments of six participating financial institutions, the draft operations manual, and the Environmental Management Framework (EMF), were completed at the time of project appraisal. However, increased short-term risks[9] at the time of project appraisal; the announcement of a government-financed subsidized line of credit[10]; and increased pressure on the local currency, with the market for tenge becoming very tight, volatile, and expensive, thereby rendering the cost of funds to banks and end-borrowers unpredictable in the near term, precipitated the need to defer delivery of the LoC. It was therefore agreed with the Government that this component be deferred until the minimally sufficient conditions for a LoC to be effective are in place. Possible additional financing to support the LoC program may be considered.

[9] These additional short-term risks go over and beyond the medium-term risks assessed at the time of the project Decision Meeting, namely the high level of NPLs and the weak financial infrastructure. It should be noted that the government announced on November 11, 2014 the allocation of over US$1.4 billion (250 billion tenge) to a Bad Loans Fund to help the recovery of the banking sector and clean-up of NPLs.

[10] On November 11, 2014, President Nazarbayev announced a new economic stimulus package, including the provision of highly subsidized credit lines to SMEs. In particular, he announced the launch of a line of credit of over US$ 275 million (50 billion tenge) intermediated by DAMU and offered to SMEs through local commercial banks. This line of credit is offered at subsidized interest rates of 6 percent to end-borrowers with loan maturities of up to 10 years. Virtually all productive sectors are eligible for funding. This subsidized government program may render the LoC offered at IBRD terms uncompetitive in the near-term.

Table 2: Summary of Project Components

The Project Development Objective is to enhance the competitiveness and management capacity of targeted SMEs in Kazakhstan. **PDO Result 1:** Number of SMEs who become "accredited suppliers" to large companies **PDO Result 2:** Number of Cluster Competitiveness Action Plans for which implementation has begun **PDO Result 3:** Percentage of participating SMEs reporting improved management & business practices						
Component	**Sub-Component**	**Description**	**Expected Results**	**Lead Agency**	**IBRD funding ('000s)**	**Gov funding ('000s)**
1. SME Capacity Building		Strengthen government SME support programs by enhancing quality and introducing international standards to increase SME competitiveness and enable them greater access to other programs.	• SME Capacity Development Infrastructure with cadre of 40 SME Dev. Professionals (master trainers, assessors, instructional designers) • 750+ qualified advisors • Two thirds of participants find the training offered as effective and useful • Hundreds of SMEs benefiting with improved risk profile, financial management, business plans, quality	MNE	$11,454	$3,546 (40%)
2. SME Linkages in Competitive Sectors	**2.1 Supplier Development Program**	Program to increase supply-chain linkages between SMEs and Large firms in Kazakhstan through facilitation of linkages; focused technical assistance to SMEs; establishment of Supplier Development Office	• Institutional capacity strengthened by establishing and training a new "Supplier Development Office" • 100 SMEs with "accredited supplier" status and an additional 100 SMEs in the process of becoming accredited suppliers • Two thirds of participants find the training offered as effective and useful	NCE	$10,870	$1,130
	2.2 Competitive Sectors	Support the development of non-extractive sectors in and around priority geographic areas through institutional capacity strengthening.	• Enhanced institutional structure, governance, and technical approach for promoting cluster competitiveness • Six Cluster Competitiveness Action Plans developed	KIDI	$5,534	$466
	2.3 Factoring Strategic Assessment	Strategic assessment for supply chain financing (SCF) program to improve access to and terms of credit for SMEs	• Recommendations on the design, partners, structure, location, and regulation of a SCF program developed	MNE	$1,786	$214
3. Impact Evaluations & Monitoring		Deploy rigorous impact evaluations and M&E tools to gain evidence for policy, program design and transparency; citizen engagement through PPDs and a strengthened SME Call Center	• A fully functioning and credible third-party monitoring system for SME policies and programs • Critical insight into what works and what does not work in improving SME capacity through at least 6 impact evaluations • "Realtime" feedback from SMEs and entrepreneurs	MNE, ERI	$7,356	$644
4. Project Management		Operation of the project by a team of resident local and international technical and fiduciary specialists	• Smooth implementation of all components with appropriate oversight • 125 government and associated professionals/staff trained across the various project areas • Increased public awareness of programs offered by the government	MNE	$3,000	N/A
					$40M (87%)	**$6M (13%)**
					Total: US$ 46M	

Gender

53. The project is gender informed. Gender equality in Kazakhstan is somewhat balanced compared to the regional comparators. Kazakhstan inherited from the Soviet times a legislative framework that includes many provisions enabling women's participation in the social and economic life of the country. However women working in the private sector are facing more challenges than their peers in the public sphere. According to the recent ADB survey[11], the share of women among entrepreneurs is less than the share of men, indicating more challenges and fewer opportunities for female entrepreneurship. Some of those hurdles, besides the typical for entrepreneurship such as access to funding and information, include more specific problems such as balancing work with the family and child care; resistance of immediate environment and absence of family support; and social stereotypes and traditions requiring a woman to keep a more passive position. At the same time the share of female managers is not much lower than that of males (34 percent and 36 percent respectively), which suggests that while women have fewer opportunities to start their own business, they can be equally successful than a man in carrying out management functions.

54. The project team will seek to emphasize during project implementation that all the components are targeted to both genders and maintain equality. The project will also ensure that the entities working directly with the project target audiences are informed and provide the services accordingly. In particular, the Component 1 on SME Capacity Building, which aims at preparing qualified cadre of SME development professionals, will aim to adjust the training program so that it reaches out both to male and female entrepreneurs. Likewise, Component 2.1 on Supplier Development, aimed to increase supply chain linkages, will aim to ensure both gender entrepreneurs' participation.

55. The project includes rigorous impact evaluations and M&E tools to gain evidence for policy and program design. The project will also aim to monitor gender equality maintenance in the project, by ensuring close collaboration with counterparts. This critical insight from both the target groups and the counterpart feedback will allow close monitoring and the opportunity to respond and course-correct accordingly.

Citizen Engagement

56. Citizen engagement approaches were utilized to design the project and have been incorporated in the ongoing implementation plans for relevant components. Design of the project included consultation with various civil society organizations including a number of business and professional associations. A survey was also deployed to ensure inputs were sought and incorporated into the design of Component 2 on linkages. Implementation, particularly in relation to Component 2.2, will include structured public-private-dialogue sessions to ensure cluster competitiveness plans appropriately reflect and include citizen feedback. Component 3 will include explicit efforts to ensure citizen engagement through surveys and real time monitoring of progress.

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[11] Jappar, Akbota, and Janar Jandosova. "Kazakhstan: Improving Capacity to Support SME Development." Sange Research Center. Astana 2013, financed by the ADB.

57. A TMS, which aims to capture and redress grievances is included in the design of the project. Component 3 includes funding for a TMS, whose sole purpose will be to ensure a mechanism for the registration of grievances with delivery of services to end beneficiaries. The TMS will develop reports and escalate issues to the appropriate policymaking levels to ensure that any grievances are appropriately managed. The TMS will be designed for sustainability beyond the end of the project.

B. Project Financing

58. The project financing includes (i) the proposed Investment Project Financing (IPF) of US$40 million and (ii) Government counterpart funding of US$6 million. The IPF will entail a variable spread over reference rate for IBRD loan in USD (Libor) with the repayment schedule linked to commitment. The front-end fee will be paid by the Borrower upfront from own resources. With regards to the status of including the project into the annual state budget, the MNE has finalized the Program Document and has received approval from the Republican Budget Commission (RBC) review on December 8, 2014.

C. Project Cost and Financing

59. The breakdown of costs by component is presented below.

Project Components	Total Cost	IBRD	% Financing (Exclusive of taxes)
1. SME Capacity Building Program	US$15,000,000	US$11,454,000	85%
2. SME Linkages in Competitive sectors	US$20,000,000	US$18,190,000	100%
3. Impact Evaluation & Monitoring of SME Programs	US$8,000,000	US$7,356,000	100%
4. Project management	US$3,000,000	US$3,000,000	100%
Total Costs	**US$46,000,000**	**US$40,000,000**	87%

D. Lessons Learned and Reflected in the Project Design

60. The design of SME Competitiveness Project is significantly informed by lessons learned from the experience of the government in implementation of programs for SMEs to date. Additionally, the experience of similar projects in other countries has been factored into the design. The relevant lessons are summarized below.

(a) Independent Evaluation Group (IEG) Evaluation of Support to Small Businesses (2013);
(b) Experience of IFC's Business Edge capacity development program methodology and substance;
(c) Learnings from the Entrepreneurship Education and Training study conducted by the World Bank's Human Development Network in 2013;
(d) Experiences from SDPs in the UK, Czech Republic, Ireland and other countries;
(e) Experience in facilitating increased industry-specific competitiveness in Singapore, Malaysia, the EU, Chile, Brazil, Spain, Colombia and elsewhere;
(f) Experience in developing supply chain financing schemes in Peru, Mexico and other relevant countries.
(g) Impact evaluation and trials from various experiences in Bank projects.

61. The project design draws substantially from the IEG evaluation of World Bank Group programs to support SMEs. The learnings from the evaluation include the need for development of a sustainable supply of services by establishing well-functioning markets and institutions. Further, targeted interventions need to be strategic and leverage resources to produce broader benefits for the institutions involved and the markets. Clear definitions of SMEs are a critical requirement. The project includes responses to these questions embedded through its design.

IV. IMPLEMENTATION

A. Institutional and Implementation Arrangements

62. The proposed Project includes 4 components, overseen and implemented by the MNE. The Department of Entrepreneurship Policy and Development of the MNE will oversee implementation of the project and will be responsible for strategic oversight and technical aspects of project implementation.

63. A dedicated PIU will be established within the MNE. The PIU will manage overall project implementation and will be responsible for such functions as fiduciary, safeguards, monitoring and evaluation, and reporting.

64. A Project Implementation Commission (PIC) to be chaired by the Minister of MNE will be established for strategic project management and coordination across ministries and agencies, as well as escalation of any issues. Given the wide-range of areas covered under this project, the PIC will include high-level representation from the Ministry of Investment and Development (MID), KIDI, DAMU, and the NCE. The Steering Committee will meet at least twice a year.

65. The KIDI, under the MID will be the direct beneficiary of component 2.1. The PIU at MNE will work with KIDI and MID management to implement this component. KIDI and MID will have primary responsibility for developing terms of reference for activities under the component. Procurement and financial management will be handled by the PIU as Implementing Agency. KIDI will sit on the selection committee for all procurement packages under this component. KIDI will report to the PIU on progress against results framework indicators (see section IV.B below). At the strategic level, MID will be represented on the project's Steering Committee. Lessons learned and policy recommendations from the implementation of this component will be transmitted to MID, MNE, and other ministries as applicable.

B. Results Monitoring and Evaluation

66. The Project Results Framework is included in Annex 1. The World Bank will evaluate progress on the proposed indicators through regular reporting and through implementation support missions. Activities associated with Component 3 on Impact Evaluations & Monitoring of the Project will operate in tandem with the Project Results Framework and will provide all necessary data inputs for project reporting. The PIU will produce regular progress reports (including project progress and financial monitoring reports) bi-annually, a mid-term report for the World Bank and key stakeholders, and inputs into the results and a completion report at the end of the project. Project management interim Un-audited Financial Reports (IFRs) will be prepared under the project.

67. **The PIC will regularly review project M&E data to ensure satisfactory achievement of the project outcomes.** The PIU will organize semiannual events linked to PIC meetings to disseminate project results.

68. **In addition to the PIU's monitoring of the project results, the NCE and ERI will engage in detailed impact evaluations and monitoring of development progress of the SME sector (Component 3).** These activities will inform future policy making as well as provide clear line-of-sight into the success of the interventions undertaken by the project.

C. Sustainability

69. **The likelihood of sustaining the project objectives beyond the closing date of the project is high.** The Government is committed to an ambitious objective of supporting SME growth in its Strategy 2050 program. Indeed, it is the government's aim to increase SME contribution to GDP to 50 percent by the year 2050. To date 11 of initiatives have been undertaken to gear up for this goal, including establishment of the NCE, the development of an Integrated Plan for SME support, and promotion of financial products and services.

70. **In addition to the Government's ownership of the project objectives, sustainability is increased through the project design in multiple ways.** These are elaborated upon in the detailed project description, Annex 2. The focus of the technical assistance across all components is primarily on capacity building, which will develop (i) a large cadre of professional support providers to SMEs in a variety of topic areas; (ii) institutional capacity to implement supplier development and cluster development programs; and (iii) increased capacity of SMEs to meet demand in domestic and international markets. Inclusion of a dedicated evidence-based policy making component focused not only on the project's deliverables but on the government's entire approach to SME development within relevant stakeholder institutions will ensure that these processes are integrated into the day to day operation of SME programs and policies.

V. KEY RISKS AND MITIGATION MEASURES

A. Overall Risk Rating and Explanation of Key Risks

71. **The overall risk rating of this project is substantial.** The major risks of this operation are related to implementation capacity, fiduciary, and macroeconomic risks. Given the ambitious nature of project design that aims to touch on multiple aspects of the SME development ecosystem, a sophisticated level of coordination, governance and implementation capacity is required. At present, engagement with counterpart agencies has demonstrated a strong willingness to develop these, but significant strides are required. To minimize these risks, the key mitigating measures include: (i) ongoing consultation with stakeholders to ensure the project responds to their objectives; (ii) a strong focus on capacity building and institutional strengthening; and, (iii) leveraging of the PIC in the early stages of project implementation to ensure a positive momentum is built. The World Bank team will continue to coordinate with

other government authorities, private sector associations, donors, and other stakeholders as necessary to support successful project implementation.

72. Institutional capacity for implementation and sustainability risk is substantial. This is the first IBRD project to be implemented by the newly established MNE. A steep learning curve in terms of project implementation and governance is anticipated. Close supervision and capacity building from the Bank and trainings in specific functions to ensure availability of competent staff with adequate skills will be critical. Additionally, project management (Component 4) will include expatriate resident technical & fiduciary advisors who will work closely with local staff to ensure effective implementation of the project. Moreover, the procurement plan has been developed with sufficiently larger contracts to allow for more coordinated and structured implementation.

73. Fiduciary risk is substantial. Implementing entities will require capacity building to effectively implement and manage project according to the Financial Management (FM) requirements and requirements to respond to all the issues in a timely fashion. The Financial and Operational Manuals will reflect specific activities of the project, the internal control procedures as well as accounting policies and procedures. The FM Operations Manual will clearly define and outline measures to prevent conflicts of interest and related party transactions, promote transparency, ensure adherence to the Bank's procurement practices. Regular supervision and site visits, audits of contracts and payments, and timeliness and quality of the financial audit will address these issues. Assessment and description of practices (including the commercial practices) used in Kazakhstan will be captured in the Projects' Operations Manual (POM). Regular monitoring by the World Bank will check for consistency and quality of the practice.

74. Macroeconomic risk is substantial. Foreign currency risk and volatility in the banking sector continues to be high. Lower oil prices and a declining ruble are adding pressure on the local currency. While lower dependence on foreign currency denominated wholesale funding has led to lower FX-related liquidity risk, dollarization keeps the economy vulnerable to exchange rate volatility and exchange rate-induced credit risk. To restore trust in the local currency and stimulate lending activity for growth, the Government together with the Central Bank are working on stabilizing the exchange rate and supply of tenge liquidity. In addition, high NPLs in the system, reaching 60 percent in some banks, have restrained many banks from lending to SMEs. Through complementary TA, the Bank will support the Government and Central Bank to enhance the government's efforts in addressing high NPLs, promoting market-based activities, and addressing inefficiencies. In addition, the risk that the overall business and investment climate does not improve during the project lifetime could impact the full extent to which the project achieves its development objectives. Complementary TA and JERP activities are aimed at addressing investment climate issues.

VI. APPRAISAL SUMMARY

A. Economic and Financial Analysis

75. Results of the economic analysis and sensitivity to key variables: The principal benefit of the project comes from sustainable development of private sector in general and SMEs in particular through following vehicles:

- Increased capacity of government agencies, several hundred local business advisors and SMEs;
- Benefit to local SMEs from additional business with national and foreign large companies and enhanced ability to increase exports;
- Greater outreach of an underserved economic sector, i.e., SMEs;
- Financial inclusion of new SMEs by banks, and MFIs through increased investibility;
- Better monitoring and design of SME support policies;
- Better transparency and accountability of SME policies.

76. Assessment of costs of the Project is straightforward and, in broad terms, is based on two types of costs: (i) direct financial outflows under the project components and (ii) indirect cost of public funds needed to finance the project. The cost-benefit analysis based on a series of assumptions, available statistical data, and relevant literature indicates the project's net present value (NPV) of US$ 22.13 million. To test sensitivity of the result to changes in key variables, NPV was recalculated using 7.5 percent discount rate (vs. 5.5 percent in baseline case) and lowering projected multiplier effect to 5 (vs. 7 in the baseline case). Application of a higher discount rate had a net negative effect, while lowering the Project's expected impact on economy reduced benefit streams and did not impact its costs. See Table 3.

Table 3: Comparison of Net Benefits in Base Case and Alternative Scenarios

Scenario	**NPV**	**BCR**
Baseline	$22.1 million	1.50
Pessimistic	$15.1 million.	1.34
Worst-case	$11 million.	1.27

77. Consideration of economic analysis in the Project design. The cost-benefit analysis presented in this analysis supports implementation of the Project in light of positive net benefits. As an alternative to the project, continuation of the Damu Fund's existing SME support programs could be considered. Although in this case there would be lower administrative costs and time savings, this avoided cost is much smaller compared to foregone benefits. These foregone benefits include, among other, economies of scope and strong linkages achieved by Component 2.1, enhanced institutional capacity aimed by Components 1, 2.3 and 3.

78. Use of economic analysis during project implementation. The PIU will collect information on disbursements by component/subcomponent, cost structure of SME support programs, result indicators (Annex 1), and results of impact assessment carried out under component 3 of the project. This information will be used to determine at mid-term of project implementation whether the economic analysis needs an update. A full economic analysis will be carried out in the Implementation Results and Completion Summary at the end of the project life to compare with the economic analysis at appraisal.

79. Project impact on the Borrower's fiscal situation. The Project poses no risk to the monetary or fiscal stability of Kazakhstan. A total of US$ 46 million to be spent within 5 years of the project's lifetime comprises about 0.02 percent of the annual GDP of Kazakhstan and 0.1

percent of the total budget spending in 2013 and should not result in inflationary processes or cause a budget deficit.

B. Technical

80. The technical design of the project is closely linked to various Government strategic directions including the various "2020" strategy documents, particularly Business Road Map 2020. In addition, the project leverages directions and learnings from SPAIID 2. Moreover, World Bank technical expertise and international good practices for SME development have been incorporated. The project design is based on extensive consultations with numerous stakeholders, including government agencies, private sector, civil society organizations and donors.

C. Financial Management

81. The FM assessment of financial management arrangements in MNE, including budgeting and planning, accounting and reporting, internal controls, flow of funds and external audit are found to be overall adequate. MNE does not have experience with World Bank financed projects and will be supported by the PIU, including an experienced FM consultant to be hired prior to implementation as part of the PIU. Also in order to bring the FM arrangements for the Project into full compliance with the Bank requirements MNE will complete the following actions: (i) document the financial management procedures including internal controls for the project in the Financial Management Manual (FMM) that is a part of the POM, and (ii) develop a module to the existing accounting software to generate IFRs and capture this new project's accounts within 60 days after the effectiveness.

82. Audit report on the Project Financial Statements will be submitted annually. An audit will be conducted in line with the terms of reference acceptable to the Bank and the report will be provided within six months after the year-ends, the last one within six months after the closing of the Project. The reports will be made publicly available as per the World Bank Policy on Access to Information.

D. Procurement

83. Procurement of Goods and Non-Consulting services for the proposed Project will be carried out in accordance with the World Bank's "Guidelines: Procurement of Goods, Works and Non-Consulting Services under IBRD Loans and IDA Credits & Grants" dated January 2011 and revised July 2014 (Procurement Guidelines); and procurement of consultant services will be carried out in accordance with the World Bank's "Guidelines: Selection and Employment of Consultants under IBRD Loans and IDA Credits & Grants by World Bank Borrowers" dated January 2011 and revised July 2014 (Consultant Guidelines) and the provisions stipulated in the Loan Agreement. World Bank's "Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants", dated October 15, 2006 and revised in January 2011 (Anti-Corruption Guidelines) will apply to this Project.

E. Social (including Safeguards)

84. The overall social and gender impacts of the project are expected to be positive, especially in terms of increased employment opportunities. The project will ensure that men and women benefit equally from its interventions. The results of these interventions will be monitored, using gender-disaggregated data based on capacity and participation intermediary indicators included in the Results Framework. The project will also cover underdeveloped regions and can therefore potentially have a large impact on shared prosperity.

85. OP 4.12 is not triggered.

86. The project will promote transparency, consultations and feedback mechanisms. To do so, specific activities will include: (i) the introduction of systems which will allow SMEs and other stakeholders to provide independent feedback to policy makers; (ii) the creation of a sustainable TPM mechanism that increases transparency and participation of the private sector in SME policy design; and, (iii) the strengthening of an SME Call Center. The Call Center will collect feedback from beneficiaries and guarantee the transparency and accountability by establishing a credible channel for complains and grievances. The project anticipates on-going consultations with stakeholders to ensure that project responds to its objectives and will retain a strong focus on capacity building and institutional strengthening of agencies involved, as well as a strong focus on good governance.

F. Environment (including Safeguards)

87. The project does not trigger the Environmental Assessment policy (OP/BP 4.01) and according to the policy is categorized as Environmental Category C.

88. The Integrated Safeguards Data Sheet (ISDS) was publicly disclosed on November 24, 2014.

Annex 1: Results Framework and Monitoring

KAZAKHSTAN: SME Competitiveness Project (P147705)

Results Framework

Project Development Objectives

PDO Statement

The project development objective is to enhance the competitiveness and management capacity of targeted small and medium sized enterprises in Kazakhstan.

These results are at	Project Level

Project Development Objective Indicators

Indicator Name	Baseline	Cumulative Target Values					
		YR1	YR2	YR3	YR4	YR5	End Target
Number of SMEs who become "accredited suppliers" to large companies (Number)	0.00	0	5	25	60	100	100.00
Percentage of participating SMEs reporting improved management & business practices (Percentage)	0.00	5.00	10.00	30.00	50.00	75.00	75.00
Number of Cluster Competitiveness Action Plans for which implementation has begun (Number)	0.00	0	0	2	3	4	4.00

Intermediate Results Indicators

Indicator Name	Baseline	Cumulative Target Values					
		YR1	YR2	YR3	YR4	YR5	End Target
Direct project beneficiaries (Number) - (Core)	0.00	500.00	1500.00	3000.00	4000.00	5000.00	5000.00

Female beneficiaries (Percentage - Sub-Type: Supplemental) - (Core)	0.00	50.00	50.00	50.00	50.00	50.00	50.00
Number of local SME Advisors trained to undertake SME capacity building based on an established competency framework (Number)	0.00	0	150	350	550	750	750.00
Percent of Women Advisors trained (Percentage - Sub-Type: Supplemental)	0.00	0	50.00	50.00	50.00	50.00	50.00
Percent of training participants who found the training offered as effective and useful to them (Percentage)	0.00	25.00	35.00	45.00	55.00	66.00	66.00
Number of master trainers, assessors, instructional designers developed and trained in global best practice (Number)	0.00	15.00	40.00	0.00	0.00	0.00	40.00
Number of SMEs who are in the process of becoming "accredited suppliers" to large companies (Number)	0.00	0	30	60	125	200	200
Value of increased sales of SMEs facilitated through participation in the Project (Amount(US$))	0.00	0.00	1,000,000	5,000,000	12,000,000	25,000,000	25,000,000

Enhanced institutional structure and technical approach for cluster competitiveness (Text)	Current approach focuses on providing financial resources and is measured primarily by output	Institutional structure for enhanced approach is established	Initial training on relevant best practices has been provided	On-the-job capacity building continues and techniques imparted are applied	On-the-job capacity building continues and techniques imparted are applied	On-the-job capacity building continues and techniques imparted are applied	Government's approach to cluster competitiveness includes an enhanced institutional structure and incorporates relevant best practices.
Number of Cluster Competitiveness Action Plans that have been developed (Number)	0.00	0.00	2.00	3.00	4.00	6.00	6.00
Strategic assessment for supply chain financing program has been completed, including recommendations on design, partners, structure, location, and regulatory requirements. (Text)	Activity is new and no prior experience available in the country	Selection of consulting firm or individual consultants to conduct the assessment completed and assessment has been initiated	Interim findings of assessment completed workshop / training held with relevant stakeholders to gather inputs and define remaining areas of inquiry	Assessment with recommendations on all aspects of the terms of reference completed.	-	-	Strategic assessment completed with clear and actionable recommendations on the next steps for development of supply chain financing in the country by project mid-term.

A fully functioning and credible third-party monitoring system (Text)	Existence of a Call Center at NCE that is largely unknown and not fully independent	Review of Call Center progress and development of action plan for enhancement including training on best practice methods for appropriate civic engagement and feedback loops	Enhancement of the Call Center and introduction of new technologies such as SMS based feedback tools, as well as launching of public awareness campaigns about the call center	Fielding of calls and feedback from SMEs and others on their experiences with government services and developing appropriate escalation plans for feedback received	Actively operating feedback loop in which calls are received, triaged, and escalated to the appropriate level with continuous engagement to the original source	TMS operational and actively managing a flow of calls, escalating issues to the appropriate policy levels to ensure resolution and policy change based on systemic and specific feedback received. SMEs also view the TMS as credible and responsive.	TMS operational and actively managing a flow of calls, escalating issues to the appropriate policy levels to ensure resolution and policy change based on systemic and specific feedback received. SMEs also view the TMS as credible and responsive.
Number of impact evaluations on SME interventions conducted or underway (Number)	0.00	0.00	0.00	2.00	2.00	6.00	6.00
Number of government and associated professionals/staff receiving capacity building through trainings, workshops, study visits, etc. (Number)	0.00	50.00	80.00	110.00	125.00	125.00	125.00

Indicator Description

Project Development Objective Indicators

Indicator Name	Description (indicator definition etc.)	Frequency	Data Source / Methodology	Responsibility for Data Collection
Number of SMEs who become "accredited suppliers" to large companies	The Supplier Development Program will work with SMEs to create linkages between them and large buyers. This will be done through various methods from training to SME-specific technical assistance. This indicator will count the number of SMEs who participate in the program AND as a result of this participation become "accredited suppliers" to large companies.	Semi-annually	NCE & SDO	SDO
Percentage of participating SMEs reporting improved management & business practices	This indicator will count the number of SMEs who report improved business performance and management practices through annual surveys and business reviews carried out through the project.	Semi-annually	NCE & ERI	ERI
Number of Cluster Competitiveness Action Plans for which implementation has begun	This indicator will measure the outcome of the efforts to enhance capacity of relevant government agencies (notably KIDI and MID) in the implementation of advanced methods for cluster competitiveness, including strong public-private dialogue, inter-institutional coordination, understanding of value chains and end markets, and evidence-based policy making.	Semi-annually	KIDI, MID	KIDI

Intermediate Results Indicators

Indicator Name	Description (indicator definition etc.)	Frequency	Data Source / Methodology	Responsibility for Data Collection
Direct project beneficiaries	Direct beneficiaries are people or groups who directly derive benefits from an intervention (i.e., children who benefit from an immunization program; families that have a new piped water connection). Please note that this indicator requires supplemental information. Supplemental Value: Female beneficiaries (percentage). Based on the assessment and definition of direct project beneficiaries, specify what proportion of the direct project beneficiaries are female. This indicator is calculated as a percentage.	Semi-annually	Methodology for measurement of direct beneficiaries will be developed. It is anticipated that such measurement will involve a direct scaling/multiplication of SMEs benefiting, the number of average employees per SME and the average family size. Specific notation will be made for the bottom 40% beneficiaries.	MNE
Female beneficiaries	Based on the assessment and definition of direct project beneficiaries, specify what percentage of the beneficiaries are female.	Semi-annually	MNE	MNE
Number of local SME Advisors trained to undertake SME capacity building based on an established competency framework	This indicator tracks the number of SME Advisors trained by the Project. These Advisors are placed within the Entrepreneurship Service Centers operated by the government throughout the country. Their responsibility is to provide advice to local SMEs and entrepreneurs in good practices related as well as to conduct trainings locally. There are 161 centers throughout the country, each with a varying number of advisors ranging from 2 to 10.	Quarterly	MNE, NCE	NCE
Percent of Women Advisors trained	This indicator tracks the number of female SME Advisors trained by the Project.	Quarterly	MNE, NCE	NCE

Percent of training participants who found the training offered as effective and useful to them	Each training offered will include an evaluation survey for participants administered either on paper, electronically, or via SMS. This measure will count the percentage or participants who indicated that they were satisfied or very satisfied with both the quality and relevance of the trainings offered, thereby indicating the level of usefulness of the trainings.	Quarterly	MNE, ERI	ERI
Number of master trainers, assessors, instructional designers developed and trained in global best practice	This indicator tracks the number of professional SME service providers/trainers certified by the Project to offer training of trainers, to develop new training programs, and to assess quality of trainings offered by the trainees. It is anticipated that there willbe at minimum 12 Master Trainers, 20 Assessors, and 8 instructional designers.	Semi-annually	MNE, NCE	NCE
Number of SMEs who are in the process of becoming "accredited suppliers" to large companies	The Supplier Development Program will work with SMEs to create linkages between them and large buyers. This will be done through various methods from training to SME-specific technical assistance. This component will count the number of SMEs who participate in the program AND become "accredited suppliers" to large companies.	Semi-annually	NCE & SDO	SDO
Value of increased sales of SMEs facilitated through participation in the project	This indicator will track increased competitiveness through the dollar value of new sales between participating SMEs and other large firms operating in Kazakhstan	Semi-annually	NCE & SDO	SDO
Enhanced institutional	This indicator will evaluate the enhanced	Semi-	MID, KIDI	KIDI

structure and technical approach for cluster competitiveness	capacity of relevant government agencies (notably KIDI and MID) in the implementation of advanced methods for cluster competitiveness	annually		
Number of Cluster Competitiveness Action Plans that have been developed	The indicator measures the number of clusters to for which cluster competitiveness action plans have been developed, demonstrating that the government’s approach is being enhanced and incorporating relevant best practices	Annually	MID, KIDI	KIDI
Strategic assessment for supply chain financing program has been completed, including recommendations on design, partners, structure, location, and regulatory requirements.	This indicator will track progress made towards the completion of the strategic assessment of reverse-factoring (supply chain financing) for development in Kazakhstan	Annually	MNE	MNE
A fully functioning and credible third-party monitoring system	A functioning and transparent institutional framework that facilitates a dialogue between the private sector, the government and civil society that ensures transparency and accountability of SME policies, and that allows better monitoring and design of SME support policies. The development of this system will follow an evolution to "fully functioning" and "credible" as outlined in the milestones	Semi-annually	MNE, NCE	NCE
Number of impact evaluations conducted or underway	Sustained improvement in impact evaluation of government programs following international good practice (At least two impact evaluations a year and implementation of a transparent system that determines what programs are	Every two years	MNE, ERI	ERI

	evaluated)			
Number of government and associated professionals/staff receiving capacity building through trainings, workshops, study visits, etc.	This indicator includes staff of the Ministry of National Economy (10), PIU(5) National Chamber of Entrepreneurs (30), Ministry of Investment and Development (5), Supplier Development Office (10), ERI (20), KIDI (20), DAMU (15), other relevant public entities (30) in charge of formulation and implementation of programs to SMEs trained by the Project	Semi-Annually	MNE	MNE

Annex 2: Detailed Project Description

KAZAKHSTAN: SME Competitiveness Project

1. The project development objective is to enhance the competitiveness and capacity of targeted small and medium sized enterprises in Kazakhstan.

2. To achieve this objective, the project envisions activities in four components, as described in detail below.

A. Sector and Institutional Context for the Project

3. The SME sector can play a key role in addressing Kazakhstan's development challenges, and in advancing shared prosperity and economic diversification. SMEs are widely identified as important sources of economic growth and employment and thereby an important foundation for shared prosperity. In Kazakhstan, SMEs have the potential to contribute to reducing the reliance of the economy on extractive industries, thus decreasing the exposure of the country to negative external shocks, such as commodity prices. SMEs also have the potential to be sources and conduits of innovation, helping the introduction of higher added-value activities and thus creating opportunities for generation of more and better jobs.

4. However, SMEs are faced with sizable uncertainty and cannot pursue available opportunities with needed flexibility. Discussions with the private sector in Kazakhstan reveal a lack of professional skills to manage SMEs and difficult access to investment financing, as two key obstacles that hold back SME development.

5. Banks in Kazakhstan are beginning to view SMEs as viable clients and are developing products and services to meet their needs. Yet financial institutions and business service organizations point to a lack of "business readiness" and business planning as key reasons for SMEs' inability to obtain financing. A "bankable" business plan depends on solid financial planning, which in turn depends on an understanding of business finance (e.g., financing sources and financial statement analysis). SMEs that lack financial capability are unlikely to develop a business plan, and consequently will not seek external financing (or will use informal sources) or will be denied credit by financial institutions. They are less likely than their financially literate peers to grow to their full potential. 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.

6. 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. The current generation of entrepreneurs was 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. However, even the new market economy inherited many features and networks from the central planning, including inefficient business networks, clientelism, and a lack of professional skills to complete in external markets. The low quality of public services and infrastructure is not likely to change dramatically in the short- to medium-term.

7. Entrepreneurship and business ownership remains an aspiration for many Kazakhstani nationals. Based on a survey conducted by the Prime Minister's website, nearly 9 out of 10 Kazakhstani respondents would like to start their own business.[12] This largely latent opportunity is not exploited for a number of reasons including high administrative and tax burdens as well as lack of government help and startup capital.

8. Support to SMEs is not evenly available across the country's vast geographic area. The SME sector has been disproportionately skewed towards Astana and Almaty, where 40 percent of registered SMEs are located.[13] The Ministry of National Economy has been tasked with addressing these imbalances and ensuring that all Kazakhstani nationals have access to the same resources in starting their own businesses.

9. In January 2014, the President of Kazakhstan has set out additional strategic directions to move the economic growth and diversification agenda forward. Among the priority areas that the President highlighted in his January 17, 2014 Address to the Nation include innovative industrialization, an efficient agro-industrial sector, regional development, and small and medium enterprise development. The President set out a vision that contemplates increasing the share of non-oil products in Kazakhstan's export basket to 70%, and increasing SMEs contribution to GDP from the current 20% to 50%.

10. To implement the strategic directions outlined in the President's speech, the Government announced an action plan with some new initiatives and updates to existing initiatives, including those that support SME development through a combination of financing and non-financial support to SMEs.

11. In 2014, the Government will develop a strategy for the formulation of agglomerations in Astana and Almaty through 2030. It will also finalize the draft of the National Program for Accelerated Industrial-Innovation Development for 2015-2019 (NPAIID) and unify or better-coordinate this with Business Roadmap 2020. The updated BRM 2020, which focuses on SMEs and is implemented by the Ministry of National Economy, aims to "assure sustained and balanced growth of regional entrepreneurship in non-primary sectors of the economy, as well as preservation of existing and creation of new permanent jobs". The program includes (i) support of new business initiatives, (ii) strengthening and recovery of entrepreneurial capacity, and (iii) support for export-oriented industries.

12. The Government of Kazakhstan has dedicated significant efforts and resources to support the development of SMEs, but with mixed results so far. The SPAIID and other programs implemented by various agencies and ministries, together with financing from International Financial Institutions (IFIs), have made available concessional financing and grants to support SMEs. However, the contribution of SMEs to the economy and employment are still limited as compared to Kazakhstan's aspirations. The specific impact of the various programs and financing provided so far also appears limited and difficult to assess, limiting the possibility to learn from what has worked and what has not. From their side, in spite of the support provided

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[12] Kapital.kz, January 12, 2012, as reported by the Eurasia Daily Monitor.
[13] Eurasia Daily Monitor, April 29, 2013.

over the last years, SMEs in Kazakhstan continue identifying a number of factors limiting their potential, including lack of professional skills to enhance competitiveness and limitations in access to finance.

B. Component 1 – SME Capacity Building Program (US$15 million)

Objective

13. The objective of this component is to strengthen and expand existing SME advisory programs offered by the government to entrepreneurs, SMEs owners and managers by enhancing their quality in substance and methodology, by introducing international best practice, and by increasing awareness of these programs widely in the country.

Context & Rationale

14. Eleven government funded programs, including BRM 2020 aim at "Strengthening Entrepreneurial Capacity" through provision of Non-Financial Services (NFS). Within this area, the focus is on expanding the coverage of potential and existing entrepreneurs with management training and consultancy services.

15. While existing programs support entrepreneurs and SME owners, substantial constraints remain in terms of both the national reach of these programs and their effectiveness to deliver the highest quality technical knowledge to the target group. For example, the above-listed NFS to entrepreneurs under the BRM 2020 are provided through a network of Entrepreneurship Support Centers (ESCs). Until recently, the network of such centers consisted of 17 regional ESCs (one-stop-shops), 27 mono-industry town centers, and 14 mobile ESCs. In the second half of 2014, this network has expanded to cover all districts in the country and now includes additional 161 centers, employing almost 500 consultant advisors/mentors.

16. The current model for operating these centers involves contracting between 5 and 10 local consultants to serve as Business Advisors to local SMEs. These Advisors offer free consultant support to SMEs through one-on-one sessions. However the effectiveness of these efforts may be hampered by uneven qualifications of SME Advisors and lack of a consistent approach to consultancy, which translate into great variability in the quality of services provided at the ESCs from center to center and from advisor to advisor. At the same time, as a result of limited awareness on the side of entrepreneurs (reaching less than 40% in some areas), many potential beneficiaries are inadvertently excluded, reducing the overall reach and impact of these public programs.

17. In addition, there is a need to support institutional capacity building within different government bodies in charge of the formulation and implementation of SME development strategies, including establishment of a feedback and monitoring mechanism to assess and adjust effectiveness of policy instruments to maximize impact and reach.

18. The World Bank Group has a comparative advantage in supporting the Government of Kazakhstan's SME agenda given its 'honest broker' role, access to international best practice and expertise, and extensive track record in SME development through its lending and technical assistance projects. This Project builds on the WBG strengths and puts forward an intervention that combines SME lending and advisory elements, thus providing a holistic approach to addressing SME needs.

19. The World Bank's SMEs Solutions combine adult learning approaches with targeted business training tools to help SMEs increase productivity, efficiency and capacity, and improve their access to finance and new markets. The IFC's Business Edge program (www.BusinessEdgeWorld.com), which will be deployed in this project, is a world-class proprietary training program designed to improve management capacity and business performance of small businesses. This program has been used to train more than 190,000 individuals globally, 30% of which were women, reaching 19,000 MSMEs. Business Edge courses are readily available in over 30 countries and delivered through a network of 500 trainers and 65 certified training providers.

20. Business Edge is a comprehensive solution that includes over 59 world-class courses, delivered in 20 languages, and a targeted capacity building program to improve the adult training competencies of local training providers and their trainers. The curriculum is delivered through a select group of certified Business Edge local training providers and their trainers. Training providers can be private sector training companies, universities, chambers and associations, governmental and non-governmental organizations, or corporate training academies.

21. World Bank works closely with its clients to build the capacity of Business Edge training providers and their trainers, by (i) Identifying and selecting training providers and trainers on the basis of both content expertise and practical, local experience; (ii) Improving the adult training competencies of the selected training providers and trainers through Business Edge workshops and certifications in the areas listed below; and (iii) Ensuring the continuous in-depth assessments of selected training providers and trainers to guarantee consistency and quality.

a. Conducting training needs assessment

b. Customizing and designing curriculum

c. Training delivery and facilitation skills

d. Measuring training impact

e. Assessing trainer delivery skills

Design and Key Activities

22. This Component will ensure that entrepreneurs, SME owners and managers consistently receive high-quality services under government funded entrepreneurship support programs. The content and methodology will leverage IFC's Business Edge program. Project activities will be targeted at three levels:

a. At the institutional/policy level: The Project will support development of institutional capacity, planning and management systems for provision of NFS under the government-funded programs.
b. At the Non-Financial Services sector level: The Project will
   i. Develop a Kazakhstani cadre of master trainers, assessors and instructional designers to ensure long-term sustainability of the program, and
   ii. Use the train-of-trainers approach to build capacity of business advisors and consultants through completion of internationally proven curriculum for adult education and training.

c. At the SME level: The Project will develop demand-based training content and tools, and will increase awareness about the NFS available to citizens of Kazakhstan.

23. Project activities will be structured around four tasks.

Task 1: Strategy and Planning Advice

24. The Project will work with the MNE and NCE, who are in charge of formulation and implementation of SME development programs, including provision of NFS to SMEs. The Project will (i) support development of SME strategies, (ii) help coordinate implementation of these strategies and respective programs, (iii) create reporting, monitoring and evaluation mechanism to assess effectiveness of various programs and relevance of policy instruments, (iv) build staff capacity, and (v) equip staff with relevant tools and resources to facilitate effective management of the NFS programs.

Task 2: Master Trainers Network

25. Quality of SME advisors will define the success of the government-funded NFS programs. The option of using foreign experts to build capacity of these advisors in line with a pre-defined competency framework is an expensive one and requires advance planning. In order to ensure long-term sustainability of the NFS programs, this Task will build local capacity of master trainers that will be deployed to train business advisors as and when needed. In addition, the Project will build capacity of instructional designers who will be used to develop sector and SME segment specific training content. And finally, the Project will train quality assessors to provide continuous monitoring of Business Advisor performance.

Task 3: SME Advisors Capacity Building

26. This Task will facilitate skills transfer to more than 500 SME Advisors and Consultants using the train-of-trainers approach. Master trainers will offer SME Advisors capacity building through implementation of the IFC's Business Edge program, a proven curriculum for adult education and training. Additionally, the Project will develop and make available to SME advisors tools and other resources that are needed to provide quality consultancy to SMEs. To the extent needed, the Project will adapt the Business Edge materials to the local Kazakhstan context.

Task 4: SME Outreach and Demand-based training

27. While the Project does not intend to deliver NFS to SMEs directly, there is a need to develop and pilot demand based training content and tools targeted at SMEs. This Task will therefore focus on SME level, and in addition to the training above, will support a comprehensive and first-rate awareness campaign about NFS programs.

<u>Expected Results</u>

28. Through project activities, the quality and efficiency of services provided to SMEs will be objectively increased in both substance and methodology. Several hundred business consultants will be trained, who in turn will deliver advice to several thousand entrepreneurs and SMEs. Through enhanced advice, the capacity of these entrepreneurs, owners and managers to access finance and markets will increase, resulting in increased firm productivity and revenues, and augmenting the overall contribution of SMEs to the economy. Additionally, Government ability to plan, coordinate and implement entrepreneurship support programs will improve. A cadre of locally based master trainers, training assessors and instructional designers will be established to ensure long-term sustainability of the training program. Finally, awareness levels of the NFS among all citizens will increase.

C. Component 2 – SME Linkages in Competitive sectors (US$ 20 million)

D. Component 2.1 – Supplier Development Program

Objective

29. The objective of this component is to improve the overall competitiveness of individual SMEs in competitive sectors in Kazakhstan through a focused and comprehensive Supplier Development Program (SDP). The project will establish a Supplier Development Office (SDO), whose role will be to increase market linkages for SMEs with large local and multinational corporations operating in Kazakhstan. Initially operating in at least two sectors, the program will increase the ability of Kazakhstani SMEs to supply inputs into the local operations of multinational corporations (MNCs), large local firms and State-Owned Enterprises (SOEs) looking to raise their levels of local content use.

30. The SDO will be an important facilitator in ensuring small and large firms work together. On the one hand, the SDO will play a critically important role in understanding the needs of large buyers in Kazakhstan and improving their capacity to source inputs locally. On the other hand, the SDO will work with individual SMEs to enhance their capacity to meet the quality and reliability needs of the large buyers, while also facilitating their linkage with the relevant large buyers.

31. As the SMEs engaged in the SDP attain world class standards to become viable suppliers to MNCs and SOEs, they will, in the longer term, be able to export more widely to global markets. Further, they will create opportunities for other local suppliers hence strengthening local clusters. The SDP will directly address key areas of need of selected MNCs and SMEs. The program will identify potential demand and upgrade skills of suppliers including attaining international certification, improving business and management practices, and facilitating communication and relationships between major buyers and potential suppliers.

32. This component is complementary to the ongoing Competitive Industries and Innovation Program Technical Assistance grant, which aims to build capacity of the Kazakhstan Industrial Development Institute (KIDI) and other stakeholders in the approach, methodology, and analytics of cluster development. As progress is made in the Technical Assistance, key analytical outputs, including sector action plans will be incorporated into the SDP expansion roadmap, so as to ensure that the two projects leverage and benefit from each other.

Sector & Institutional Context / Rationale

33. SDPs are proven powerful tools to promote competitiveness of local companies and widen the benefits of foreign investments for the recipient country. Based on a partnership approach and drawing on mutual self-interest, they create a win-win situation for all parties: MNCs and SOEs (by providing the total cost advantages of a competitive local supply base), local SMEs (through opportunities for increased business and the ability to move up the value added chain) and the Government (by providing a particularly effective basis for the use of business support, and the wider benefits it brings to the economy).

34. Kazakhstan has several well-established major international companies and large local companies operating in the oil, gas, steel and other industries, such as railway equipment. However, it's economy does not derive the maximum benefit from the value-added generated in these sectors or the potential access to global value chains, new technology and modern working practices provided by such investment because these large enterprises are supplied primarily by foreign suppliers and imported inputs. Thus, there is a need to develop linkages between large companies and potential local suppliers both through identifying business opportunities and improving the capability amongst local firms to exploit them.

35. Thus in contrast to local content policies, SDPs achieve this objective by enabling rather than requiring firms to source locally, and act as a positive spur to SMEs to improve their competitiveness and productivity. They assist firms to meet the Quality, Cost and Delivery requirements of MNCs, as well as developing their wider strategic management and business capabilities.

36. The largest revenue potential for SMEs is in the Kazakh upstream oil and gas industrial sector. According to a recent Shell Kazakhstan study and based on an assessment of investment trends in capital and operations projects which are likely to proceed in Kazakhstan within the next 10 years, the revenue potential for local SME companies could reach levels in excess of US$ 4 billion per year by 2018. The interest in the industry in such a program was confirmed in 2008 in a World Bank Assessment for a Supplier Development Program.

37. A World Bank report on the railways equipment industry in Kazakhstan in 2011 found that there was particular potential for a supplier development program in this sector with the setting up over recent years of new JV manufacturing agreements with MNCs such as Alstom, GE, Talgo and Siemens to produce diesel and electric locomotives and rolling stock and the existence of a base of manufacturing enterprises which could potentially substitute for present large import volumes of railway equipment and components. A cluster of MNC companies has thus developed in Astana, which present a major opportunity for local manufacturers to upgrade their production.

38. While MNCs in these and other sectors will already have their own supplier development programs to varying extents, these will not be as comprehensive or as strategic as the proposed national SDP. In many cases they tend to be reactive addressing immediate problems/firefighting rather than proactively focusing on longer term change and competitiveness. They tend also not to take on unknown companies. The SDP however will look to build on and extend existing activities as appropriate. For example, Shell have been facilitating partnerships between KZ and UK companies by working with UKTI. Looking for the opportunities to develop such partnerships would also be a component of the proposed national program.

39. EBRD has also been carrying out supplier development as part of their business support activity in response to a direct approach for assistance from Mittal Steel at Temirtau at the beginning of 2013. They have also been approached by 3 or 4 other MNCs with requests for similar support. It would seem appropriate to build on these existing contacts and activities as part of any initial national program.

40. There is clearly significant potential for a comprehensive SDP to add major value in improving the competitiveness of Kazakhstani SMEs, and indeed larger domestic companies. There appears to be sufficient interest in MNCs in supporting and participating in such a program, and evidence that a significant group of Kazakhstani companies have the potential and commitment necessary to improve their performance to the levels necessary to be able to operate competitively in the supply chains of MNCs (or SOEs setting the same international standards as their targets.). WB and other reports highlight major areas of need which would be addressed in an SDP: (i) international certification, (ii) business and management practices, and (iii) information gaps - both for MNCs in terms of information about local suppliers and their competencies, and for local companies in terms of knowing how and where they can fit into the supply chain.

41. The SDP would draw on and complement ongoing SME support programs, and the other components of the project, in providing a focused emphasis on building linkages between SMEs and large buyers. While some of the instruments are similar (technical assistance, consultancy and mentoring, financing), the program is focused on those SMEs that have the potential to become suppliers of larger firms through enhancement in their capacity, efficiency and competitiveness, and bringing together the necessary support to achieve this in a streamlined coordinated and customized way.

Design and Key Activities

Task 1: Institutional Capacity Building

42. The project will build institutional capacity to develop and implement a Supplier Development Program and to conduct analyses on competitive industries. It will work with the designated entities (e.g. NCE) and other relevant stakeholders. This entity would have a dedicated team with the mandate and time to operate the SDP. The team would have technical expertise, experience bringing stakeholders together, and would be empowered to convene varied stakeholders and make decisions. The entity would coordinate closely with and involve representatives from MNE, line ministries, local governments, and coordinate strongly with the private sector and other institutions (e.g. universities and research institutions).

43. The project will provide training, capacity-building, tools and methodologies for all of the aspects required to implement the SDP. Training and capacity-building will be provided to all relevant public and private, stakeholders.

Task 2: Establish Supplier Development Office as the managing agency for the program

44. This office will have a key role in ensuring that all the relevant corporations, departments and agencies work closely together to achieve a seamless delivery of the necessary services and support to the participating companies. The Office will oversee the deployment of international and local assessors and consultants and the relationships and contracts with participating MNCs/SOEs and supplier companies. The training of staff in the SDO in the skills necessary to implement such a program, and set up an administrative system to support its management and monitoring will be an initial priority.

Task 3: Select Sectors and Establish Framework for Pilot SDP

45. Rather than seeking to launch a full-scale national program from the outset, project activities in this component will start with two pilot programs operating in parallel. It is proposed that the first pilot will focus on oil and gas and the second on railway equipment. A third pilot could build on the current activity of EBRD with the steel sector, including engagement with ArcelorMittal and other MNCs.

46. Selection of these sectors is directly linked to their role in the economy. The oil & gas sector is clearly among the drivers of the economy, but participation of SMEs as supplier to large O&G companies such as Tengizchevroil or KazMunayGaz continues to be limited. Given the large expanse of Kazakhstan, and substantial investment being made into expansion of the railways networks, this sector is also prime for inclusion in the SDP. A recent report by the World Bank on the Railways sector noted its potential for promoting increase competitiveness in the country. Finally, ArcelorMittal engaged with various suppliers through a corporate social responsibility initiative, demonstrating the potential for a robust SDP. The company is ready to reinitiate such activities with support of international experts and a more nationally oriented platform.

47. International consultants will be appointed through competitive tender to undertake the program's diagnostic business reviews, and local consultants identified to work alongside them both to ensure transference of skills and to facilitate communication and local understanding.

48. A parallel priority will be to confirm the MNCs which are prepared to actively participate in and support the program, and engage with those MNCs in identifying opportunities, taking their views on the assessment procedure and recommendations on current and potential suppliers which could be invited to participate in the program. The list of companies to be invited to participate in the program will be finalized by drawing on these views and other sources of information, including intelligence held by Government agencies, trade associations, and universities.

49. A high level strategy group for the program chaired by the relevant Minister or Vice-Minister and involving senior representatives from the MNCs, SOEs, SMEs, relevant supporting agencies and universities would be established to strengthen ownership and commitment.

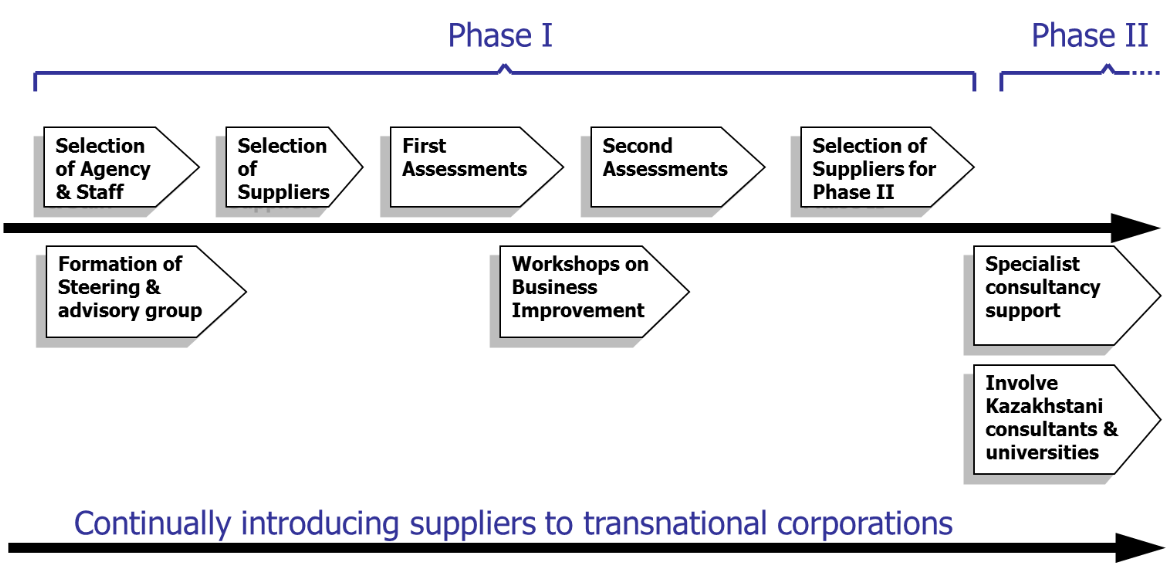
Task 4: Implement Pilot Programs

50. The detailed approach proposed for the Kazakhstan pilots is one which has been successfully used for initial Supplier Development Programs in other developing countries, and which includes two phases and a competitive element.

51. In the first phase suppliers selected for the program are evaluated against an assessment methodology in in-depth (2 day) business reviews, which looks at the totality of their business, such as provided by the EFQM (European Quality Model), and which also ensures that the areas of performance of most importance to MNCs are addressed. On the basis of these reviews short-term (6 month) essentially self-improvement plans are agreed with the companies. These firms are then provided with general technical assistance and training through workshops, master classes and other mechanisms to improve their business processes and products, while they are implementing these plans.

52. At the end of the plan period, companies are re-assessed in a second business review on the progress made, the commitment and capacity for improvement shown and the level of performance attained. On this basis companies are selected for the second crucially important intensive support phase. In this phase the firms are provided with more intensive and in-depth mentoring, consultancy support and training, on a 1:1 basis tailored to their specific needs. This would involve joint mentoring teams of international and local consultants, whose role would be to agree and monitor a business development plan with the company, act as coaches and draw in other business support as necessary, and facilitate communication with the MNCs participating in the program. The remaining firms continue to receive more general support.

Figure 4



Task 5: Scale Up SDP Program Based on Learning from Pilots

53. The timescale for an effective pilot program to make a measurable impact on participating companies and for reviewing the experience and specific lessons learned from running such a program in a Kazakhstan context would be 18 months to 2 years. The program could then be extended by doing more in the same sectors, and /or addressing new sector or regions of the country in the final 3 years of the project. However the intention is to create a sustainable capability to run such programs beyond the end of the project, particularly by developing the capacity of the managing agency to run such programs, and by developing local consultants to carry out the diagnostic reviews, consultancy and mentoring to international standards.

54. An additional element of the program would be the establishment of a supplier database, which would only be open to companies meeting the world class standards required by MNCs. Not only would this help listed companies to obtain further businesses, but it would become a useful tool in helping Kazakhstan attract new inward investors and retain and encourage the expansion of existing investors. A Supplier of the Year competition for those participating in the program has also be found to be effective in raising the profile of the program, with awards for the highest ranking suppliers and the most improved suppliers.

Expected Results

55. A SDP will bring a number of contributions to Kazakhstan:

a. It will enhance the general competitiveness of local SMEs by looking at the whole of their business to identify priority needs and providing intense technical assistance to meet quality standards certification and other MNC requirements. These will result in significant firm-level productivity enhancement, which will be measurable against international benchmarks through the assessment system used in the business review process.

b. It will work to secure "approved supplier status" for Kazakhstani firms, thereby opening them up to substantial new business with both multinational corporations and SOEs. The enhanced revenue impacts will translate into greater wealth generation in the country and increased investment in production of firms.

c. Through approved supplier status, firms will increase their ability to supply MNCs operating outside the country, thereby increasing exports.

d. By improving the supplier base, it will create a more attractive operating environment for MNCs, which will help to retain and expand existing activities, as well as in drawing new inward investment.

e. It will build Kazakhstan's institutional capacity to the develop and run such a program. It will also contribute to generating demand for local consulting skills and assist in building a market for Kazakhstani consultants.

56. This component is expected to drive substantial improvements in the performance of non-extractive industries, economic growth, and job creation. It will achieve these impacts by enhancing the competitiveness of local SMEs, preparing them to benefit from additional business with large national and international companies, and enhancing their ability to increase sales and exports. By considering the whole value chain and the industry-specific business environment, the component will also increase the competitiveness of larger players in the value chain. In addition to increased revenue and job creation at the enterprise level, the component will have the added benefit of increased tax revenue based on improvements in enterprise performance.

E. Component 2.2 – Competitive Sectors (US$6 million)

Objective

57. The objective of this component is to support the development of higher value-added production and increased competitiveness of SMEs in non-extractive sectors. This component will focus on increasing market linkages for SMEs in Kazakhstani sectors that are not yet globally competitive but which have potential for market-based growth. The project will develop a world-class cluster development team that is able to implement best practices, and will result in increased global competitiveness of selected clusters in three regions. The Government can then apply the capacity built and experience gained to other clusters.

58. To achieve this, the project will increase the Government of Kazakhstan's institutional capacity to implement its cluster development program under State Program for Accelerated Industrial-Innovation Development 2015-2019 (SPAIID 2)[14]. The project will: (i) train and equip the team of specialists at the Kazakhstan Industry Development Institute (KIDI) that will implement the cluster development program, providing them with modern, market-based tools for fostering industry-specific competitiveness, and build the capacity of other government officials and private sector representatives that will participate in the program; and (ii) support the implementation of the cluster program in six clusters[15] across three regions (approximately 2 clusters per region), over a period of five years. The selection of regions and clusters will be informed by market-based analysis and consultation with the public and private sectors, and will draw on work done under the ongoing Kazakhstan Competitiveness and Economic Diversification (KCED) TA.

<u>Sector & Institutional Context / Rationale</u>

59. The Government is taking a regional approach to industry competitiveness and cluster development, given that the competitive advantages of its industries are driven by region-specific endowments and characteristics, including oil and mineral deposits (value-added industries based on extractives), climate (agri-business), and geographic features (tourism). SPAIID 2 includes a strong focus on developing clusters around extractive industries, manufacturing industries, and innovative, "new economy" industries.

60. In addition to SPAIID 2, this component will be coordinated with cluster development initiatives in NCE and regional/local authorities; the supplier development program (component 2.1), where applicable to the clusters of focus; SME management training (component 1) for SMEs in cluster value chains that require enhanced capacity; Business Roadmap actions for SME support; the upcoming joint GoK-WB jobs and skills project; the OECD's work on attract foreign direct investment into agribusiness value chains in Atyrau, Kyzylorda, and East Kazakhstan (where relevant); and the EU's Regional Development Project (in relevant regions). This component will also draw on previous analytical work at the sector level, including OECD's reports on competitiveness in the agribusiness, information technology, chemicals, and logistics sectors.

61. This project component differs from previous projects because it focuses on building implementation capacity and will take a deep, analytical look at the level of individual value chains and clusters. In addition, implementation of this component will be informed by previous work that the World Bank has done with KIDI under the Joint Economic Research Program (JERP), particularly with regards to tools for sectoral analysis (product space analysis) and impact assessment.

62. This project component will enrich the Government's initiatives to facilitate industry-specific competitiveness, by building capacity to take a comprehensive approach that applies

[14] And any future iterations of this program, as applicable.
[15] Defined as industries at a regional or city level (e.g. fruit products in South Kazakhstan).

international good practices, tailored to the Kazakhstan context. The approach draws on the rich knowledge and experience of the World Bank Group's Competitive Industries practice. In addition, while the overall focus of this project is on SME growth, the approach this component will take will consider the whole value chain, including larger enterprises.

Design and Key Activities

63. The competitive industry and cluster development approach to be applied through this component will first looking into the value chain of each industry at the local and regional level, then build an understanding of the entire value chain, opportunities in end markets, the role of SMEs and large enterprises, and opportunities and binding constraints for enhanced competitiveness. The component will help the Government (central, regional, and local levels), private sector, and other relevant institutions (universities, research centers, etc.) work together to design and implement action plans that will increase cluster competitiveness, with actions identified at the enterprise, industry, and government levels – with this last level to include regulatory/policy aspects as well as potential public investments. Public-private dialogue and intra-government coordination will not simply serve as a means by which to disseminate analytical findings, but rather to ensure genuine engagement of all parties throughout the process.

64. The design of the cluster competitiveness action plans will be informed by a number of technical and analytical tools that will expose constraints to growth and highlight potential opportunities. Solutions will be market-based and leverage Kazakhstan's comparative advantages (or potential to develop comparative and competitive advantages). Mechanisms to introduce evidence-based industrial policy will be implemented – this will enable to the Government to use the activities and reforms identified through industry action plans and monitoring and evaluation results to inform the design of Government programs.

65. The cluster development program will be housed in the Kazakhstan Industry Development Institute (KIDI), which has been mandated to develop and oversee the implementation of GoK's cluster program under the State Program for Accelerated Industrial-Innovation Development 2015-2019 (SPAIID 2). KIDI will appoint a team of professionals with technical expertise in competitive industries and cluster development and experience bringing stakeholders together. This team will be empowered to convene varied stakeholders and make decisions during the implementation of the cluster program.

Task 1: Establish Approach and Prioritize Regions and Clusters

66. The project will first establish a comprehensive cluster development approach, focused on facilitating the development of competitive industries and SME growth within them. This approach will incorporate international best practices that are tailored to Kazakhstan. Establishment of the approach will be supported first through the KCED TA (ongoing through September 2015), and will be further elaborated upon through the project.

67. During the first six months of project implementation, there will be an intensive period of work to help KIDI finalize the plans for implementing its cluster development program, based on international good practices and lessons learned from pilot projects carried out under the KCED TA. This will include: (i) identifying the appropriate institutional structure and linkages with other government and non-government institutions (including but not limited to MID, MNE, National Chamber of Entrepreneurs, regional and local governments, research institutes, and other private sector associations); and (ii) refining the technical approach to cluster development, based on work done to date by KIDI and the World Bank team (under the KCED TA). In addition to KIDI as the main implementing entity, the institutional structure will include a high-level authority that can make policy decisions and convene stakeholders to resolve any issues that arise in the implementation of the cluster development program (This may be the Commission on Industry Development).

68. The technical approach will apply international good practices tailored to the Kazakhstan context. It will incorporate the following principles, which have been found to be keys to success of competitive industries initiatives around the world, including Malaysia, Singapore, Chile, Brazil, the European Union, and Spain (not an exhaustive list). Successful competitive industries and cluster initiatives:

a. Are based on sound understanding of the value chain and comparative advantage
b. Are based on sound understanding of competitive forces in end markets
c. Include deep engagement with the private sector, multiple levels of government, and other relevant institutions
d. Allow private sector “champions” to emerge naturally
e. Have strong monitoring and evaluation with private sector input
f. Include flexibility to change the approach as market conditions evolve
g. Are housed in government entities that have a clear mandate to implement these programs, and have a direct link to policy-making decisions.

69. Through this task, the regions and clusters of focus will be identified, using market-based analysis and consultation with the public and private sectors, and drawing on work done under the ongoing Kazakhstan Competitiveness and Economic Diversification (KCED) TA.

Task 2: Institutional Strengthening to Apply the Approach

70. The project will build institutional capacity to apply the approach developed in Task 1, through the following:

a. A thorough, five-year, on-the-job capacity-building and institutional strengthening program for KIDI. This will include training, tools, methodologies, and documentation for all of the aspects required to implement the approach, including: (i) industry prioritization and analysis (including, but not limited to value chain analysis, market segmentation and trend analysis, and business enabling environment analysis); (ii) public-private dialogue; (iii) monitoring and evaluation tools for evidence-based industrial policy; (iv) enhanced institutional design; and (v) management information systems and other IT tools to support implementation.
b. Institutional structures for coordination and policy-making, and associated communications strategies.
c. Training and seminars capacity-building for other relevant, public and private, practitioners and stakeholders.

71. This component will be led by a Senior Technical Lead – an international consultant, global expert in cluster development, based at KIDI, who will coordinate all capacity-building and deliver hands-on implementation assistance throughout the project.

Task 3: Support to Implementation of the Cluster Development Approach

72. The cluster development approach will be applied to six clusters across three regions (approximately two clusters per region). The project will provide ongoing support to KIDI and other institutions involved in implementing the approach in these clusters. It is envisioned that the approach will be implemented through a multi-step process such as the one illustrated in Figure 5 below.

73. The support to be provided during implementation includes: (i) full-time, on-the-job mentoring from the Senior Technical Lead; (ii) access to specific international expertise, including experts in the analytical methodologies listed in Task 2 above and experts in the industries of focus who understand market trends and the competitive landscape for Kazakhstani products; (iii) funding for the cost of travel and workshops to develop the cluster competitiveness action plans and oversee and monitor their implementation; and (iv) provide manuals, guidelines, and IT tools that will support the implementation of the approach in the six clusters of focus as well as additional clusters.

Figure 5: Illustration of Proposed Approach

	Step	Timing
1	Prioritize industries for phase 1	• 2 months
2	Value chain analysis of "phase 1" industries	• 4 months
3	Develop "phase 1" industry action plans and their implementation mechanisms	• 2 months
4	Develop timelines and monitoring and evaluation indicators	• 1 month
Ongoing	Action plan implementation and monitoring	• Several years
5	Identify lessons learned and adjust approach	• 1 month
6	Prioritize industries for phase 2	• 1 month
7	Implement approach in phase 2 sub-sectors	• As in phase 1
Ongoing	Monitoring and reporting; Training	• Ongoing

<u>Expected Results</u>

74. This component is expected to drive substantial improvements in the performance of non-extractive industries, economic growth, and job creation. Enterprises in the clusters of focus will benefit from an identification of opportunities and obstacles to growth, and tangible actions to remove those obstacles and increase their capacity to pursue the opportunities identified. The will enhance the competitiveness of local SMEs and improve their ability to increase sales and exports. By considering the whole value chain and the industry-specific business environment, the project will also increase the competitiveness of larger players in the value chain. In addition to increased revenue and job creation at the enterprise and local levels, the component will have the added benefit of increased tax revenue from improvements in enterprise performance.

75. The project will also increase the Government's institutional capacity to facilitate such results in an ongoing manner. The component will result in increased understanding in Government of the role of clusters, other approaches to enhancing industry competitiveness, and how to apply these approaches; and understanding of the role of varied stakeholders in implementing these approaches. The Government of Kazakhstan may extend the cluster development program to other regions and sectors, using the capacity built through this project.

76. Through this component, it is expected that private sector actors, academic institutions, and other industry stakeholders will take a more active role in driving each industry forward and forging an increased role for Kazakhstani industry in global value chains. The Government's role will continue to be nurturing industries using good governance techniques, and through the proposed program, the private sector will be encouraged to be flexible in responding to market trends.

F. Component 2.3 – Factoring Program (US$2 million)

Objective

77. The objective of this component is to conduct a detailed assessment for development of factoring and reverse-factoring in Kazakhstan. SMEs in the various local supply chains in Kazakhstan face challenges emanating from a lack of collateral to receive loans, delays in receiving payments especially from larger companies, lack of certainty of trade, and a lack of credit from suppliers.

78. An online platform that allows these SMEs to register (or collateralize) and verify their accounts receivables can facilitate increased access to finance for SMEs. Furthermore it would allow the buyer to register status updates on the platform including approval or dispute. Financial institutions (of Factors) can then fund the purchase of the invoices. Such a program, which can alternatively be termed Reverse-Factoring or Supply Chain Finance (SCF) involves a relationship between a finance provider and a large end-customer, under which the factor agrees to finance invoices issued by the large company's suppliers once they have been formally approved for payment. Successful examples of such systems from Peru and Mexico are detailed in Boxes 1 and 2 below.

79. Given the nascent nature of factoring in Kazakhstan, the project will include a detailed strategic assessment in which the design of an invoice-based financing platform, as well as a review of the relevant regulations in Kazakhstan will be conducted. The assessment will assess, inter alia, the most appropriate program design given the local context, the overall supply chain finance market in Kazakhstan, the financial institutions best positioned to be engaged in the program, the governance structure of the platform and investment vehicle, the sectors with highest promise, the location of the platform, and the training and capacity building requirements of related stakeholders.

Sector & Institutional Context / Rationale

80. At present there is very limited receivable-based finance in Kazakhstan. A few traditional factoring companies are operational in the country, but the industry is very small with less than US$25 million in receivables finance outstanding at present. The industry growth is limited by funding and capitalization issues. As of yet, the government has not performed effective actions to support receivable finance products. Further, supply chain financing has not been introduced in the country. One of the purposes of the current program will be to help the factoring market take off.

81. SMEs in the various local supply chains in Kazakhstan face the following challenges: (i) a lack of collateral to receive loans, (ii) difficulties in receiving payments (especially from larger companies) combined with lack of certainty of trade; (iii) a lack of credit from suppliers; and (iv) a lack of ease or benefits to formalize the business. The current SME finance programs in Kazakhstan to provide loans to SMEs do not focus on solving these specific working capital problems. The proposed supply-chain financing component aims to resolve these issues, in particular in sectors with limited support to date including agriculture, trading and services. The program will enhance the value of invoices as collateral, will assist SMEs in securing trade, getting paid and receiving finance on invoices, will stimulate the flow of supplier credit to SMEs and provide a direct incentive to formalize each invoice presented and is therefore complementary to other programs.

82. Currently in Kazakhstan the majority of SMEs are in the trade and service sectors. These companies have little assets other than receivables for collateral. In Kazakhstan it is difficult to ascertain that an invoice is not fake, fraudulent or who is the owner of the receivable of the invoice. As a consequence receivables are not valued at present in Kazakhstan and trading and service companies are unable to obtain loans. With the current platform the trading and service companies will be able to release capital now locked in their receivables. Such capital can be used to make long term investments.

83. In Kazakhstan, factoring companies have very limited capital. As a consequence factoring companies cannot raise funding, neither are banks able to allocate capital to new unproven products. Equally for the government it is risky to provide capital or funding to unproven institutions. Furthermore it is risky for SME and large companies to direct payment of all its invoices through an institution of low credit quality. The proposed platform resolves these problems by segregating the cash flow from the Participating Financial Institution through an SPE and as such allows scale-up of the factoring market at acceptable risk for SME, the Participating Financial Institutions and the government.

Design and Key Activities

84. The design will draw on best practices in supply-chain financing (SCF) or reverse-factoring, including the experience of schemes to help solve similar challenges in Peru, Mexico, and Kosovo. The fundamental underpinning of SCF is to finance approved receivables that SMEs have from high-quality buyers. For example, in Mexico, over 150,000 SMEs can sell their receivables, but only from a selection of about 80 pre-approved buyers. This arrangement provides advantages to suppliers, customers and the financier. The supplier is able to raise finance against “approved receivables,” which in turn are backed by the credit rating of the buyer; the buyer is able to optimize its own working capital position by extending its payment terms to 90 days and beyond without adding pressure to the SME suppliers it works with (but at the cost to the SME); and, the finance provider is able to manage its credit risk effectively as credit information on large corporate buyers is readily available, but does not assist in the assessment or absorption of risk of SME.

Box 1: The NAFIN program in Mexico

Probably the best example of what can be achieved by providing greater access to working capital for SMEs in emerging markets via SCF or Reverse Factoring in the Nafin programme in Mexico. This project, backed by the state-run development bank Nacional Financiera (Nafin), created an online marketplace in which SMEs that are accredited suppliers to large, creditworthy companies can offer their invoices for sale to a range of financial buyers in return for immediate access to working capital. All factoring is done without recourse and is offered without additional collateral or service fees at a maximum interest rate of seven percentage points over the bank rate. SMEs must be approved by the "Big Buyer" and have a successful trading history with them before they can join the scheme.

Between its establishment in September 2001 and the end of 2004, Nafin's Factoring programme grew to account for more than 60% of all factoring turnover in Mexico. The development bank's aim in launching its online Reverse Factoring platform was to greatly enhance access to finance for the country's SMEs, 80% of which received no bank credit according to a 2004 study by Banco de Mexico.

By mid-2004 Nafin's service had recruited 190 "Big Buyers" and had brokered more than 1.2m transactions, together worth more than US$9 billion, and more than 70,000 of their SME suppliers (from a total of about 600,000 SMEs in Mexico at that time, according to the World Bank). The use of electronic platform and digital documents proved crucial in reducing the cost and effort of using the platform for all concerned and greatly speeded it uptake.

It is clear, therefore, that providing a digital marketplace in which suppliers to large, established companies can offer their receivables for sale to raise working capital can have a rapid and significant impact on economic and social development. The Mexican experience shows that the opportunity to invest in receivables in this way is likely to be attractive to a range of financial buyers – by 2004 about 20 domestic bank and non-bank lenders were buying receivables on the Nafin platform – and that therefore significant additional sources of finance can be made available by this method.

(Source: "Receivables Finance in Emerging Markets," Andy Davis & Peter Chen, 2014.)

85. Another best practice the design builds on is the TREFI program in Peru. This program uses the relationship between companies to understand better the risk of SMEs. In order to get information on the relationships, it provides tools for companies to manage invoicing, collections and risk management of receivables in order to capture that knowledge. A World Bank study concluded that such knowledge can results in more than 60% reduction in loss ratio on financing MSMEs. The TREFI program has two modules relevant for the design. The first component (see Box 2 below) provides tools to manage credit to MSME clients and uses a Special Purpose Entity to refinance the SME credits. This program won the G20 SME finance challenge in 2010.

The second module assists financiers to provide working capital straight to SMEs by buying all receivables from SMEs, by leveraging a collateral registry and a mobile and internet invoicing and confirmation platform. This program was a finalist in the G20 financial inclusion challenge in 2012 and is now being rolled out. The key benefits are that the program provides enhanced risk indicators for SMEs based on analyzing trade flows and payments and increases the value of receivables.

Box 2: Benefits of the TREFI Model in Peru

For SMEs: (i) Increased amount and maturity to obtain credit with purchases, as it no longer has a bad impact on the working capital liquidity for corporations, but a positive impact on sales; (ii) No additional administration for the SME.

For Corporations, in addition to advantages offered by capital markets factoring: (i) Ability to increase amount of finance to SME customers, without compromising their working capital. This allows them to increase sales to SME customers with adequate credit; (ii) Increased certainty to obtain finance of SME receivables, if compliant with structure requirements as compared to issuing corporate bonds, CP or loans. This results from the fact that TREFI finance is not correlated with the rating of the corporation. If the corporation manages its credit well, adequate credit quality portfolios can be sourced from the corporation; (iii) Low barriers to entry when compared to issuing bonds, as no public ratings are required for the corporation and lower legal expense; and, (iv) Lower set-up and operational expenses. Minimal administrative impact.

For private sector investors: (i) Increase of the amount of high quality investment product supplied. Non-rated and smaller corporations by themselves have highly diversified portfolios of SME receivables, out of which large amounts of high quality rated investment product can be obtained; and, (ii) Due to low correlation with corporate debt, ability to diversify portfolio.

For government compared to alternative SME finance stimulation: (i) As the model generates true economic value by improving SME risk assessment, improving risk management and reducing transaction costs, SME finance can be stimulated in a budget neutral way; (ii) Price and selection mechanism can be used to direct any government support to specific groups of SME (e.g. regional, industry type, SME size); (iii) The method is easy to administer for government as compared to SME guarantee programs; and, (iv) As the credit capabilities of suppliers are used in the process, a vast new resource is applied to stimulate SME finance.

(Source: "World Bank Report No. 47348-LAC Developing New Structured Financial Products to Channel Savings Towards Small and Medium Enterprises (SMEs).

Task 1: Conduct Strategic Assessment for the Reverse-Factoring Program

86. The project will conduct a detailed strategic assessment and design of a supply-chain financing program and platform based on international best practice, as well as a review of the relevant legislation in Kazakhstan. The assessment will include, inter alia, the size of the market in Kazakhstan, which financial institutions are interested in participating, the governance structure of the platform and investment vehicle, the sectors with highest probability of success, the location of the platform, the tax, regulatory and legal feasibility, the capacity of institutions involved in overseeing or managing the platform, the training and capacity building requirements for both operation and use of the system, and the timelines for deployment of the program, based on a detailed project plan to establish the platform.

87. In addition to refining the design of the model and platform, an implementation team will need to be established and dialogue with an initial set of participating institutions will need to be conducted. The initial team and relevant policy makers from the MNE and NCE may also engage in a learning visit to Peru, Mexico and Kosovo to learn from the positive experiences there.

G. Component 3 – Impact Evaluation & Monitoring of SME Programs (US$8 million)

88. The main objective of this component is to support the improvement of design, prioritization, sequencing and effectiveness of SME development policies and programs. This will be supported by strengthening existing monitoring and evaluation (M&E) frameworks, public private dialogue and transparency around SME policy and implementing rigorous impact evaluations. As a result, this will improve evidence based SME policy making in order to increase the effectiveness and impact of SME policies.

89. More generally, the objectives are to:

(a) Contribute to understand and analyze the impact of SME support policies on competitiveness of the sector.
(b) Contribute to better design SME policies and priorities
(c) Contribute to a culture of dialogue and transparency between the government, private sector and civil society around private sector development policies.
(d) Ensure direct real-time feedback and inputs from SMEs to enhance the quality and impact of policies and inform effective functioning and adjustment of programs.

<u>Objective</u>

90. The objective of this component is to create a sustainable M&E structure that shapes new SME policies, establishes better priorities and achieves more transparency; as well as creating a sustainable third-party monitoring mechanism that increases transparency and participation of the private sector in SME policy design. A critical aspect of the component will include a number of impact evaluations, which will aim to test the effectiveness of SME support interventions both within and outside the context of the project. The project will create the capacity to carry out robust and independent impact evaluations via the Economic Research Institute (ERI), with assistance from universities. These impact evaluations will provide critical inputs to policy makers as they refine approaches to enhance services to SMEs. Additionally, the project will introduce systems whereby SMEs may provide independent feedback to policy makers to monitor progress of related programs. The project will strengthen the NCE with a sustainable third-party monitoring mechanism that increases transparency and participation of the private sector in SME policy design. It will strengthen existing systems such as the Call Center and introduce new mechanisms such as SMS-based real-time feedback.

<u>Sector & Institutional Context / Rationale</u>

91. In Kazakhstan, policies related to SME development, program design, prioritization, and sequencing are evaluated using mainly output-based indicators and insubstantial information on impact. M&E systems are fragmented across implementing agencies. Rigorous impact evaluations that measure the true effect of programs have not yet been conducted, though they provide critical insight into the prioritization, design, re-design and implementation of government programs. In addition existing departments doing M&E are uncoordinated and do not use robust frameworks. A robust M&E framework ensuring evidence informed policies needs to be in place, resulting in more effective program implementation. This is particularly important in SME support programs which deal with complex market systems.

92. There is already a think-tank depending on the Ministry of National Economy, the Economic and Research Institute (ERI), with a mandate and structure to evaluate PSD policies in general. ERI carries out already an extensive firm survey and is implementing investment climate assessments across different regions of the country. This institution is, therefore, already mandated with the role of evaluation of these policies, and support will be provided for increased methodological capacity to implement surveys, impact evaluation methods, as well as better institutional design to guarantee independence and cooperation with government agencies and the national statistical agency.

93. At present, credible third-party monitoring mechanisms are not available to SMEs. This limits private sector-government dialogue around competitiveness and reduces policy transparency since no mechanism for feedback and inputs coming directly from SMEs about the services and policies that impact them are established. Similarly, real-time feedback loops are not in place and available to high level policy makers, hindering effective adjustments and functioning of programs under implementation.

94. At the same time the National Chamber of Entrepreneurs has been created to represent government and private sector. Therefore, the creation of such mechanism for the dialogue between the private sector, government and civil society in the chamber is critical to address competitiveness issues in the country, and more importantly support productivity and employment growth.

95. Given the increasing ownership by the Ministry of National Economy on the SME policy space, the role of coordinating M&E systems is likely to stay in their evaluation department. However, it is important to stress that various implementing agencies have analysis departments that collect information about existing programs and policies. Therefore, it is important to ensure the empowerment of a single unit to coordinate M&E across these institutions; collect data and results, ensure the quality of the M&E frameworks and provide feedback the lessons learned to policy design.

Design and Key Activities

Task 1: Support to the institutional integration of the evaluation of public policies in government

96. The objective of the activities in this component is twofold; first, the objective is to raise awareness among the different ministries and statistical agency in order to adopt an M&E framework that is capable to provide better evidence based policy for SMEs. The second objective is to assist these institutions with the design of an institutional framework to evaluate public policies.

97. Several activities are envisaged to support the institutional integration of the evaluation of public policies:

a. *Institutionalizing evidence-based policy formulation at multiple policy levels, including the Ministry and the Cabinet, and the National Statistics Agency.* These are related to workshops highlighting the importance of M&E frameworks, as well as exposing the different agencies to international best practice experiences. These workshops will include other ministries and government agencies, as well as sub-national authorities.

b. *Assisting with the design of a framework and a government institution for the M&E of policies supporting SMEs*. The activity will elaborate a proposal documenting the different alternative institutional designs for the M&E of public policies. More importantly, it will propose a framework that designs an appropriate system and coordinates existing M&E departments in implementing government ministries and agencies.

c. *Improving monitoring through streamlining of M&E frameworks and adding indicators to nudge more effective implementation.* This activity will provide technical assistance to MNE to develop a standardized M&E framework to be implemented across all SME support institutions based on international best practices. This will include the development of a logical theory of change for each SME program, the selection of realistic indicators for inputs/outputs and outcomes of the programs, capturing changes in these indicators as well as changes in SME's systems, tracking program costs and interpreting and reporting results.

d. *Developing an outputs and outcomes "Dashboard" that integrates results from all related activities to regularly inform policy makers and policy formulation, as well as learning to reshape the design of existing instruments of support to SMEs.* The activity will provide technical assistance for reporting results and learning, so lessons can be incorporated into redesigning and adapting existing programs in order to make them more effective. We will work with SMEs policy institutions to develop an outputs and outcomes "Dashboard" that helps policy makers to understand areas of success and areas where there is lack of effectiveness.

Task 2: Support to impact evaluation

98. The design and implementation of impact evaluations of SME support programs is an essential element of any public policy. Given the existence of the Economic Research institute (ERI) as a government think-tank that has the mandate to evaluate policies, this institution will be the anchor of this activity.

99. Several activities are envisaged to support the impact evaluations:

a. *Supporting the implementation of rigorous impact evaluation methodologies to assess the impact of existing programs, as well as designing pilot evaluations for the new SME programs that are being created.* This activity will provide capacity building and technical assistance mainly to the Economic Research institute (ERI) and existing universities in the evaluation of public policies through a set of short courses and workshops. The objective is to start with the evaluation of two programs, one ongoing and one new.

b. *Technical assistance on institutional design to existing departments in ERI evaluation public policies in order to strengthen their role implementing impact evaluations.* This activity aims to propose a framework that designs an appropriate system and guarantees the independence of the evaluators from political pressure for results.

c. *Working with ERI and the Statistical agency to establish a relevant national baseline survey of SMEs to allow mapping the SME space in the country, as well as assisting on the selection of firms for programs and evaluations.* The first step of the M&E framework is the development of a rich SME baseline survey that will allow mapping the SME sector in Kazakhstan, as well as facilitating the diagnose of SMEs needs and the design of SME programs. To this end, this activity will work with the national statistical office and the relevant ministries to complement existing data and carry out a national census/survey of SMEs if needed. Some of the tasks shall include assistance on survey design, data collection and data processing.

Task 3: Support the creation of a third-party monitoring mechanism for SME policy in NCE

100. The intervention will design a third-party monitoring institution possibly in the National Chamber of Entrepreneurs that will facilitate the public-private dialogue, and monitoring and transparency of SME policies. This will require the creation of a governing body and governance structures for the institution, which must include representatives from the government, SME sector, other private sector, academia, and civil society.

101. One of the main instruments to ensure credibility of the monitoring mechanism will be the creation of an ombudsmen office for SMEs within the institution. The ombudsman office will operate as an independent office with the mandate of representing SMEs and channeling their feedback on SME policy and government support programs, both to the third-party monitoring institution and the government.

Task 4: Support to the activities of the third-party monitoring mechanism for SME policy

102. The activities of the third-party monitoring mechanism for SME policy can be grouped in the following elements that determine its mandate:

a. Support the creation of thematic working groups in the NCE that will lead the discussion about key components of policies and issues of competitiveness for SMEs composing the mechanism and design of dialogue structures.

b. The independent office of SME ombudsman will collect key feedback from SMEs and, more importantly, guarantee the transparency and accountability of SMEs policies by establishing a credible channel for complaints and grievances from SMEs about government policy and support programs.

c. The secretariat for the third-party monitoring mechanism will lead and organize the discussions of the different working groups, produce analysis about the situation in SME sector, disseminate results from evaluations of programs and establish a communication channel with the government to pass on the recommendations from discussions to high-level policy makers and thus shape existing and future SME policies and support programs.

Expected Results

103. The expected result is the implementation of an institutional framework that will allow better monitoring and design of SME support policies. More specifically, the goal is to deliver:

a. More transparent monitoring frameworks that promote accountability (adoption of M&E best practice across all SME implementing agencies)
b. A functioning institutional framework that facilitates a dialogue between the private sector, the government and civil society that ensures transparency and accountability of SME policies, and that allows better monitoring and design of SME support policies (fully functioning third-party monitoring system)
c. Sustained improvement in impact evaluation of government programs following international good practice (a number of impact evaluations over the course of the project and implementation of a transparent system that determines what programs are evaluated)
d. Robust baseline and tools for use by the project and government in making policy decisions (SME baseline and surveys follow up)
e. Policy decisions related to SMEs will be based on robust real-time information
f. Implemented evidence based approach to programs for SMEs that promote increased competitiveness and participation in the sector

H. Component 4 – Project Management (US$3 million)

104. This component will finance the day-to-day PIU functions (project administration, procurement, financial management, disbursement, M&E, safeguards, program management, public awareness) and assessments of the legal and regulatory framework. It will finance PIU staff, consultant services as well as operational costs.

105. At least two international resident technical and/or fiduciary advisors will be recruited to the PIU for support in implementation. The role of these consultants will be to ensure smooth implementation, capacity building of MNE and PIU staff, and knowledge transfer.

Annex 3: Implementation Arrangements

KAZAKHSTAN: SME Competitiveness Project

A. Project Institutional and Implementation Arrangements

1. The proposed Project includes four components, overseen and implemented by the Ministry of National Economy. The Department of Entrepreneurship Policy and Development of the MNE will oversee implementation of the project and will be responsible for strategic oversight and technical aspects of project implementation.

2. A dedicated Project Implementation Unit (PIU) will be established within the MNE. The PIU will manage overall project implementation and will be responsible for such functions as fiduciary, safeguards, monitoring and evaluation, and reporting.

3. The following main principles will be applied for clarifying management and coordination of project implementation, as well as segregating duties and responsibilities of parties:

4. **The MNE** will provide policy guidance and advice to the PIU.

5. **The Project Implementation Commission (PIC)** will be established to ensure smooth implementation of the project. The PIU will work under the overall guidance of a PIC composed of members of the main entities facilitating implementation of the project (e.g., the MNE, MID, NCE, KIDI, DAMU, ERI, among others). The PIC will be chaired by the Vice-Minister of the MNE. The scope of work of the PIC will include: (i) strategic guidance for overall project implementation; (ii) development and approval of annual plans for project activities, project budget, and procurement plan, as well as regular review of project M&E data to determine progress and make adjustments, if need be, to ensure satisfactory achievement of the end of the project outcomes; (iii) coordination and consensus building on key policy issues related to implementation; and (iv) monitoring of broad issues related to implementation of reforms.

6. **The National Chamber of Entrepreneurs (NCE) will be responsible for the technical aspects of the respective sub-components and activities,** i.e. preparing and monitoring implementation plans (work programs and budgets), drafting TORs, preparing technical specifications, participating in selection processes, signing contracts and monitoring the performance of consultants/suppliers, collecting project monitoring indicators and handling any other project implementation matters, as they relate to Components 1 and 2.1.

7. **The Project Implementation Unit (PIU) will be established within the MNE**. It will manage the project according to the detailed rules and procedures agreed with the World Bank and outlined in the Project Operations Manual (POM). The PIU will assist all parties in the implementation of the project.

8. **The PIU will be responsible for day-to-day project administration.** This includes such issues as (i) procuring the specialists who will administer the implementation of programs to be supported by the project; (ii) overseeing procurement of all goods and services required by the Groups, and other entities to be established under the project to ensure that the procurement

procedures comply with all applicable World Bank rules and regulations; (iii) liaising with the Steering Committee, NCE, KIDI, ERI, bringing matters to their attention where appropriate, and implementing their decisions; (v) carrying out project M&E activities; (vi) ensuring that individual project activities comply with all applicable World Bank fiduciary and environmental requirements; and (vii) liaising with the World Bank for routine, day-to-day implementation of legal, procurement and financial management matters.

B. Financial Management, Disbursements and Procurement

Financial Management

9. The MNE with the support of the PIU will be responsible for the implementation of the financial management (FM) function of the project including, the flow of funds, planning and budgeting, accounting, financial reporting, internal controls, and auditing.

10. While the FM arrangements existing in MNE were assessed to be overall adequate, the following actions will need to be implemented to bring them into full compliance with the Bank's requirements: (i) documenting financial management arrangements in the financial management section of the Project Operational manual (POM) and within the timeline of the POM preparation; (ii) contract an experienced FM consultant as part of the PIU within 15 days of the project effectiveness; and (iii) develop and launch a module automated accounting software to capture the proposed project's accounts and generate Interim unaudited financial reports (IFRs) within 60 days after effectivenss.

11. **Staffing**: The Project will be implemented by MNE with support of the PIU, including experienced Financial Management Consultant. There should be a clear segregation of duties between the staff with respect to review of documents and approvals, accounting and reporting. Work flows specific to the project will be documented in the Project Operations Manual (.

12. **Information systems**: MNE is using automated accounting software called 1C for budget organizations that meets the World Bank accounting and reporting requirements. For the purposes of the proposed projects a separate module will need to be developed to incorporate the accounts and reports under this Project.

13. **Accounting Policies and Procedures**: Project Operational Manual(POM) will be developed for the Project by MNE. The POM will include the Financial management Manual (FMM) documenting accounting policies, internal control procedures, detailed work flow charts, as well as the templates for the IFRs.The POM, including FMM should be agreed with the Bank and approved by the MNE.

14. **Internal Control and Internal Auditing:** MONE have adequate internal control procedures documented in the government resolutions, rules and orders.. The internal controls to be used in the Project will be documented in the POM. In addition to that the MNE is subject to regular checks by the Accounts Committee and the Internal Control Department of the MOF. The results of those are shared with the Bank.

Table 4. Audit reports and due dates

Audit Report	Due Date
Entity financial statements	Not Applicable
Consolidated Project Financial Statements (PFS) including SOEs and designated account. PFS include sources and uses of funds and designated account statements.	Within six months after the end of each calendar year and also at the closing of the project

15. The audit of the Project Financial Statements (PFS) will be financed by the Ministry of Finance from the Republican Budget funds that are not a part of the Project costs.

16. Funds Flow. MNE will open designated account (DA) for the project in the Financial Institution acceptable to the Bank.

Disbursement arrangements

17. The disbursement procedures will be communicated in the Disbursement Letter that is an integral part of the legal package of the Project. General arrangements are described below:

18. Disbursements from the IBRD Loan Account will follow the transaction-based method, i.e., traditional World Bank procedures: Advances, Direct Payments, Special Commitments and Reimbursement (with full documentation and against Statements of Expenditures (SOEs)). Full documentation in support of SOEs would be retained by the implementing agency for at least two years after the World Bank has received the audit report for the fiscal year in which the last withdrawal from the Loan Account was made. This information will be made available for review during supervision by World Bank staff and for annual audits which will be required to specifically comment on the propriety of SOE disbursements and the quality of the associated record-keeping.

19. **The MNE will open and manage one Designated Account (DA) specifically for this project, in a commercial bank agreed with the World Bank[16].** The project account (PA) will be opened in the Treasury for transfer of Government Counterpart Funding. Project funds will flow from:

(a) the Bank, either via DAs, which will be replenished on the basis of documentation specified in the Disbursement Letter. Further details on this are provided in the Disbursement Letter; and

(b) counterpart funds will flow via the Treasury.

20. **Both World Bank and Government funds will be managed by the MNE with support from the PIU.**

[16] It is a possibility that all designated accounts will be moved to the Treasury at some stage during the project implementation, in which case it will be applicable to this Project as well.

Procurement

21. Procurement of Goods and Non-Consulting services for the proposed Project will be carried out in accordance with the World Bank's "Guidelines: Procurement of Goods, Works and Non-Consulting Services under IBRD Loans and IDA Credits & Grants" dated January 2011 and revised July 2014 (Procurement Guidelines); and procurement of consultant services will be carried out in accordance with the World Bank's "Guidelines: Selection and Employment of Consultants under IBRD Loans and IDA Credits & Grants by World Bank Borrowers" dated January 2011 and revised July 2014 (Consultant Guidelines) and the provisions stipulated in the Loan Agreement. World Bank's "Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants", dated October 15, 2006 and revised in January 2011 (Anti-Corruption Guidelines) will apply to this Project. A General Procurement Notice shall be published for the procurements under the Project by MNE.

22. Procurement activities will be carried out by the MNE through its PIU. In addition to the procurement process management, the PIU will provide (i) logistical and administrative support for training, conferences, seminars, workshops and study tours; (ii) other project communications and outreach support (e.g. project webpage, project newsletter, stakeholders, communications, advertisements, travel, basic office equipment, bank charges, etc.). The risk assessment rating for the entire project was done through Procurement Risk Assessment and Management System (P-RAMS). Identified risks and proposed mitigation measures are described in Table 1 at the end of this section. The procurement risk is rated as high. The procurement risk is rated as high before mitigation measure and after mitigation measures are implemented, the residual risk would be substantial.

23. The procurement plan covering the first 18 months of project period was prepared by the MNE. It includes eight large-value consultancy packages, mainly for (i) strengthening government SME support programs by enhancing quality and introducing international standards to increase SME competitiveness and enable them greater access to other programs; (ii) program to increase supply-chain linkages between SMEs and Large firms in Kazakhstan through facilitation of linkages; focused technical assistance to SMEs; establishment of Supplier Development Office; and, (iii) supporting the development of non-extractive sectors in and around priority geographic areas through institutional capacity strengthening. The procurement plan will be updated at least once per calendar year and each update will be subject to the Bank's prior review. The initial procurement plan together with the subsequent updates will be published on the Bank's external web site in line with the requirements of the Bank's Guidelines. A General Procurement Notice covering the project procurement activities has been prepared and published. Specific Procurement Notices will be published for all International Competitive Bidding (ICB) and National Competitive Bidding (NCB) procurement, as well as for all consulting services contracts as required under the respective Guidelines.

24. *Procurement of Goods.* Goods contracts above US$500,000 million equivalent will be procured under ICB procedures using the Bank's Standard Bidding Document (SBD) for procurement of goods. The NCB method will be applicable for procurement of goods contract with the estimated budget of less than US$2.0 million. The ECA Sample NCB bidding documents shall be used taking into account the NCB conditions set forth in the Loan Agreement. Goods contracts with an estimated budget less than US$100,000 equivalent may be

procured using Shopping procedures on the basis of at least three comparable written price quotations obtained from qualified suppliers. The list of suppliers to be invited to submit quotations should be defined by an evaluation committee.

25. *Selection of Consultants*. The methods for selection of consultants will include Quality and Cost Based Selections (QCBS), Fixed Budget Selection (FBS), Least Cost Selection (LCS), Selection based on Consultants Qualifications (up to US$300,000), Single Source Selection in compliance with Paragraph 3.8 of the Bank's Consultant Guidelines, and Individual Consultants (IC). Contracts estimated to cost above US$300,000 equivalent will be advertised through United Nations Development Business (UNDB), the Bank's website and local media (one newspaper of national circulation or the official gazette, and MNE's website). Shortlists of consultants for services estimated to cost less than US$300,000 equivalent per contract may be composed entirely of national consultants under the provisions of paragraph 2.7 of the Bank's Consultant Guidelines.

26. *Operating Costs*. The expenses of the MNE PIU would include communications, translation/interpretation, bank charges, office supplies, cost of advertisements, mail and business trip expenses of government officials and other experts. Such costs will be financed by the project based on the annual budget prior reviewed and agreed by the Bank. Purchases will be carried out in accordance with the implementing agency's internal administrative procedures. Operating costs will not include salaries or allowances of civil servants.

27. *Training and Study Tours*. Training and study tours will be carried out based on the annual training/study tours program and budget to be prepared by the PIU and reviewed and agreed by the Bank. The institutions for training/study tours would be selected considering the availability of such services, duration of training/study tour and reasonableness of cost.

28. *Governance and Anti-Corruption Action Plan (GAC)*. The project will follow the Bank Group's Anti-Corruption policies as set forth in the Guidelines: On Preventing and Combating Fraud and Corruption in Projects financed by IBRD Loans and IDA Credits and Grants (current edition). The Bank team intends to maintain close oversight and will carry out prior review of all major contracts according to the thresholds that will be regularly reviewed and adjusted as needed in the procurement plan. The following measures will be carried out to mitigate corruption risk:

(a) *Training of fiduciary staff* starting from project launch and periodically thereafter; training will be customized to the procedures and methods that would be required for the next 12 month periods. The relevant project staff shall attend the Central Asia Regional Procurement Workshops organized by the Bank on a regular basis.

(b) *Prior review:* There will be close supervision by the Bank's procurement accredited staff. In addition, all contract amendments will be subject to prior approval by the Bank.

(c) *Publication of Advertisements and Contracts:* All publications for advertisements and contract awards, including the results of the awards, will be done in accordance with the Procurement Guidelines and published in the Bank client connection system and on external websites, i.e., UNDB and Bank websites.

(d) *Debarred Firms*: Appropriate attention will be given to ensuring that debarred firms or individuals (to be verified from the Bank's external website) are not given opportunities to compete for Bank-financed contracts.

(e) Temporarily *suspended firms*: Appropriate attention will be given to ensuring that temporary suspended firms or individuals (to be verified through client connection) are not given opportunities to compete for Bank-financed contracts.

(f) *Complaints:* All complaints by bidders will be diligently addressed and monitored in consultation with the Bank.

(g) *Tender Committee:* If required, the Bank will review qualifications and experience of proposed members of the evaluation committee(s) with a view to avoiding nomination of unqualified or biased candidates. All members will be required to sign a confidentiality/impartiality form.

(h) *Monitoring of contract awards:* All contracts are required to be signed within the validity of the bids/proposals and, in case of prior review contracts, promptly after the Bank's "no objection" is issued. Procurement plan format shall include information on actual dates (of "no objections" and award) and will be monitored for cases of delay which will be looked at on a case-by-case basis to identify the reasons. The PIU will maintain up-to-date procurement records available to the Bank staff and auditors.

(i) *Monitoring of payment vs. physical progress:* Monitoring reports prepared for the Bank will be customized to include a form to monitor physical progress compared to payment installments to avoid upfront-loaded payments.

(j) *Timeliness of payments:* The PIU will maintain a system/database to ensure payments to the suppliers and contractors are paid without delay according to the conditions of the contract.

Table 5: Summary of Procurement Risk Assessment

Risk	Rating Before	Mitigation	Rating After
MNE staff lack capacity to undertake the proposed procurement work under the project, particularly regarding Bank procurement guidelines.	High	Qualified procurement consultant will provide on-the-job training to MNE staff and to bid evaluation committee members. Consultant will provide assistance in the preparation of bidding documents, bid evaluation reports and contract agreements. Training in procurement under Bank guidelines will also be provided by Bank staff during the project launch workshop.	Substantial
Bid evaluation committee members are not familiar with international	High	Consultant will provide assistance in the preparation of bidding documents, bid evaluation reports and contract agreements. The	Substantial

procurement procedures, and may obstruct or delay the procurement process, especially the evaluation of bids and proposals.		risk may continue to be high as some of the evaluation committee members may not agree with the consultant assessment.	
Lack of awareness of procurement opportunities available in the project for goods and services.	Medium	Carry out public awareness programs using various media, such as newspapers, brochures, radio, TV, project website, etc.	Low
Average Risk	High		Substantial

29. *Frequency of Procurement Supervision*: Initially, procurement supervision will include prior review of contracts and procurement implementation support missions (part of project supervision missions) once every six months. Once the capacity of the implementing agency is strengthened, frequency of procurement supervision missions and prior review thresholds may be revised.

30. *Post Review*: 20% out of all contracts not subject to prior review will be post reviewed. There will be a number shopping contracts.

31. Prior review thresholds will be set up in the project procurement plan and will be generally based on the following requirements

(a) All goods contract awarded through ICB and NCB (>US$500,000).

(b) All consulting contracts for firms >US$100,000 and contracts with individual consultants estimated to cost US$50,000 equivalent or more.

(c) All direct contracts, single-source contract and amendments are subject to the Bank's prior review.

32. The prior review thresholds will be periodically reviewed and revised as needed during project implementation based on risk assessment, procurement post-review reports and improved capacity of the implementing agency.

33. *Disclosure:* The following documents shall be disclosed in the MNE website: (i) procurement plan and updates, (ii) invitation for bids for goods and works for all ICB and NCB contracts, (iii) request for expression of interest for selection/hiring of consulting services, (iv) contract awards of goods and works procured following ICB/NCB procedures, (v) list of contracts/purchase orders placed following shopping procedure on quarterly basis, (vi) short list of consultants, (vii) contract award of all consultancy services, (viii) list of contracts following DC or CQS or SSS on a quarterly basis, (ix) monthly physical and financial progress of all contracts and (x) action taken report on the complaints received on a quarterly basis.

34. The following details shall be sent to the Bank for publishing in the Bank's external website and UNDB: (i) invitation for bids for procurement of goods and works using ICB procedures, (ii) request for expression of interest for consulting services with estimated cost more than

US$300,000, (iii) contract award details of all procurement of goods and works using ICB procedure, (iv) contract award details of all consultancy services with estimated cost more than US$300,000, and (v) list of contracts/purchase orders placed following SSS or CQS or DC procedures on a quarterly basis.

C. Implementation of the Environmental and Social Management Policy

35. For all TA components financed under this project, the Safeguard policies will be applied as usual for TA operations, i.e. through incorporating safeguards-related considerations as appropriate in TORs for studies and capacity building activities. The relevant ToRs will be revived by WB environmental specialist.

D. Monitoring & Evaluation

36. Leveraging the expertise and infrastructure built through Component 5, the MNE will monitor and evaluate progress against the proposed indicators through regular reports. The MNE will report on the PDO and intermediate indicators as set out in Annex 1 on a semi-annual basis. The data will come from the institutions working on Component 5 and from information provided by DAMU and PFIs. The specific reporting templates will be defined in the Project Operations Manual. MNE and DAMU's financial performance will be audited by the appropriate auditing authority in Kazakhstan.

Annex 4: Implementation Support Plan

KAZAKHSTAN: SME Competitiveness Project

Strategy and Approach for Implementation Support

1. **This implementation support plan (ISP) describes how the World Bank will help the client achieve the expected results.** It has been developed based on the risks and risk mitigation measures identified in the Systematic Operations Risk-rating Tool (SORT). The ISP puts particular emphasis on (i) monitoring and evaluating results on the ground; (ii) facilitating the timely implementation of the risk management measures identified in the SORT, and (iii) providing the necessary technical advice to the client to build capacity, bringing international experience and good practices when appropriate.

2. The implementation support strategy for the proposed project would include regular dialogue with the Government, joint review of the project implementation and regular exercise of fiduciary oversight throughout implementation.

a. ***Regular dialogue with the Government and MNE*** would facilitate early identification of problems, obstacles and risks that could delay implementation. Dialogue would focus on monitoring inputs, outputs, results and risks based on the procurement plan, result framework (Annex 1) and SORT and enable the timely provision of technical advice and support to remove obstacles. This would help to identify issues as they emerge and address them through advice and support in an expeditious manner, without waiting for joint reviews. Dialogue would be carried out through regular implementation support missions, video and audio conferences.

b. ***Joint reviews*** would take place three times a year, aimed at examining the progress in achieving agreed targets and results. The Bank Task Team would participate in the reviews with representatives of the Government. During each review, the type of implementation support that is needed would be identified, followed by joint decisions on necessary assistance.

c. To ensure appropriate implementation support **for financial management**, the World Bank will conduct risk-based financial management implementation support and supervision within six months from the project effectiveness date, and then at appropriate intervals, as part of its project implementation support and supervision missions. During JSISP implementation, the World Bank will supervise the project's financial management arrangements by: (a) reviewing the project's quarterly IFRs, annual audited financial statements, the auditor's management letters and remedial actions recommended therein and (b) during the World Bank's on-site implementation support missions, reviewing (i) project accounting and internal control systems, (ii) budgeting and financial planning arrangements, (iii) disbursement arrangements and financial flows (including counterpart funds, as applicable) and (iv) any incidence of corrupt practices involving project resources. As required, a World Bank-accredited financial management specialist will participate in the implementation support and supervision process.

d. In the initial stages of project implementation, intensive support will be provided to the MNE for **procurement** of various packages. In addition to prior review of documents, support will be iterative and allow for capacity building on the part of the PIU. Technical Specialists from the Bank will closely review Terms of Reference and other procurement and strategy documents to ensure the technical needs of the project are fully met and addressed.

e. **Resident international technical & fiduciary consultants** will be recruited by the PIU. These individuals will have specific responsibility to ensure effective implementation of the project from both an implementation and a technical perspective.

Implementation Support Plan

3. The project has designed the following implementation support at different stages:

Table 6. Main Focus in Terms of Support to Implementation

Time	Focus	Skills Needed	Resource Estimate	Partner Role
First year (January 2015- December 2015)	Loan signing, meeting of effectiveness conditions, project launch, establishment of PIU, facilitation of internal processing within Government agencies	TTL Technical leads/ operational staff	10SW 6SW	MOF, MNE process Government's internal approvals
	Help with institutional set up for the new PIU arrangement, organize trainings, develop action plans for each component, trainings on best practices from around the world related to project specific activities.	TTL Technical leads/ operational staff	4SW 4SW	MNE establishes PIU and processes recruitments
	Setup of fiduciary systems. Risk-based FM IS mission within the first year	Procurement Financial Management specialists	1SW 2SW	PIU implements necessary components
	Support preparation of TORs to engage consultants, review of technical specifications for procurement of software and hardware, clear relevant procurement documents for the first year (additional PIU staff)	TTL Technical leads Procurement specialist	4SW 3SW 1SW	PIU works closely with technical staff to complete relevant documents for procurement
	PIU staff training on fiduciary issues	Procurement and Financial Management specialists	0.5SW	PIU attend trainings

Each subsequent year	Four Implementation Support Missions per year to review progress on each area of project	TTL & Technical Leads	20SW 12SW	Ongoing implementation of project
	Risk-based FM IS missions at appropriate intervals of the project effectiveness. Support IS missions with regards to FM issues and review the regular IFRs and annual project audit reports	Financial Management specialist	16SW	Transparency and clear record keeping
	For all components, provide ongoing remote implementation support ranging from design of a particular financing window/instrument, review/assess the implementation of selected programs/activities.	TTL & Technical leads	12SW 2SW	Regular engagement with TT through audio and video conferencing
	Review procurement documents	TTL Procurement Specialist	8SW 8SW	Regular interaction with procurement specialis

Table 7. Skills Mix Required Annually

Skills Needed	***Number of Staff Weeks***	***Number of Trips***	***Comments***
Task Team Leader	32SW	4	
Co-Task Team Leader	32SW	-	
Program Leader	1SW	1	
Technical leads / operational staff	16SW	2	
Project Implementation Consultant	32SW	-	Based in Almaty
Financial Management Specialist	4 SW	2	Based in Almaty
Procurement Specialist	4 SW	2	Based in Almaty

Table 8. Partners

Name	***Institution/Country***	***Role***
Timur Zhakysylykov	MNE VM	Vice Minister
Galiya Joldybayeva	Entrepreneurship Development Department	Head
Chingis Akhmetov	PIU	PIU Director
Aydyn Kulseitov	KIDI	Chairman
Ablay Myrzakhmetov	NCE	Chairman

Annex 5: Gender

KAZAKHSTAN: SME Competitiveness Project

Although official data and reports indicate increasing role of female population in economy of the country[17] when compared over time and other countries, data on gender issues in private sector of the economy implies possible existence of gender imbalances. Figures 1 and 2 below indicate that female owners and top managers are underrepresented in all Kazakh firms regardless of size.

Figure 1. Percent of firms with female participation in ownership (sorted by size of firm)

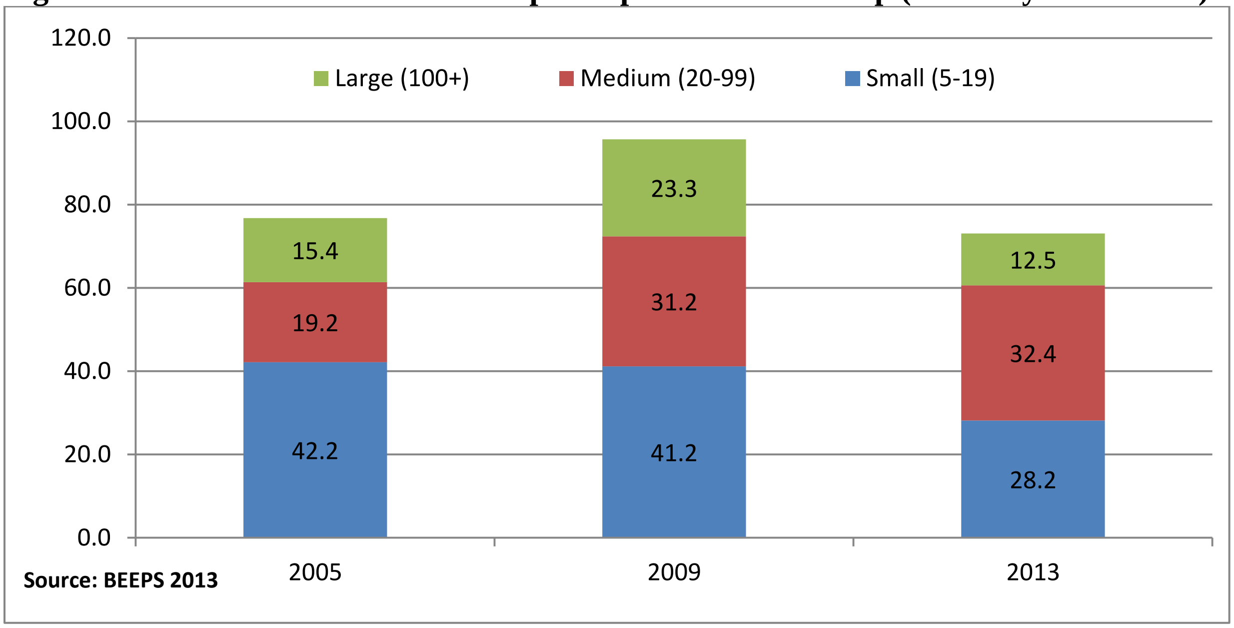
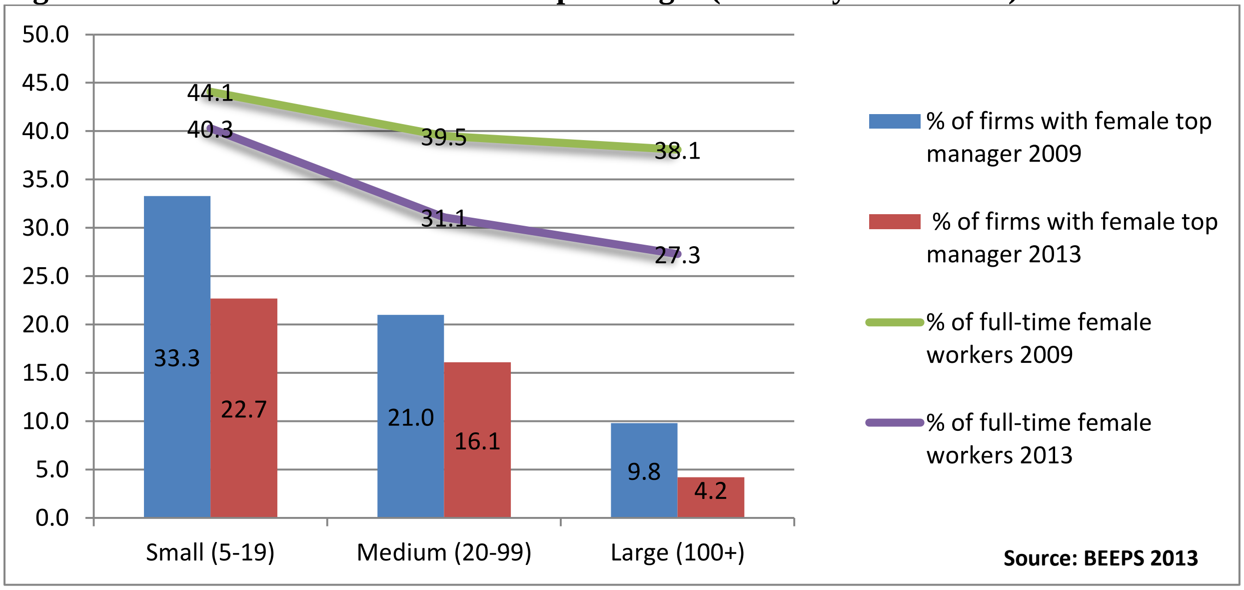


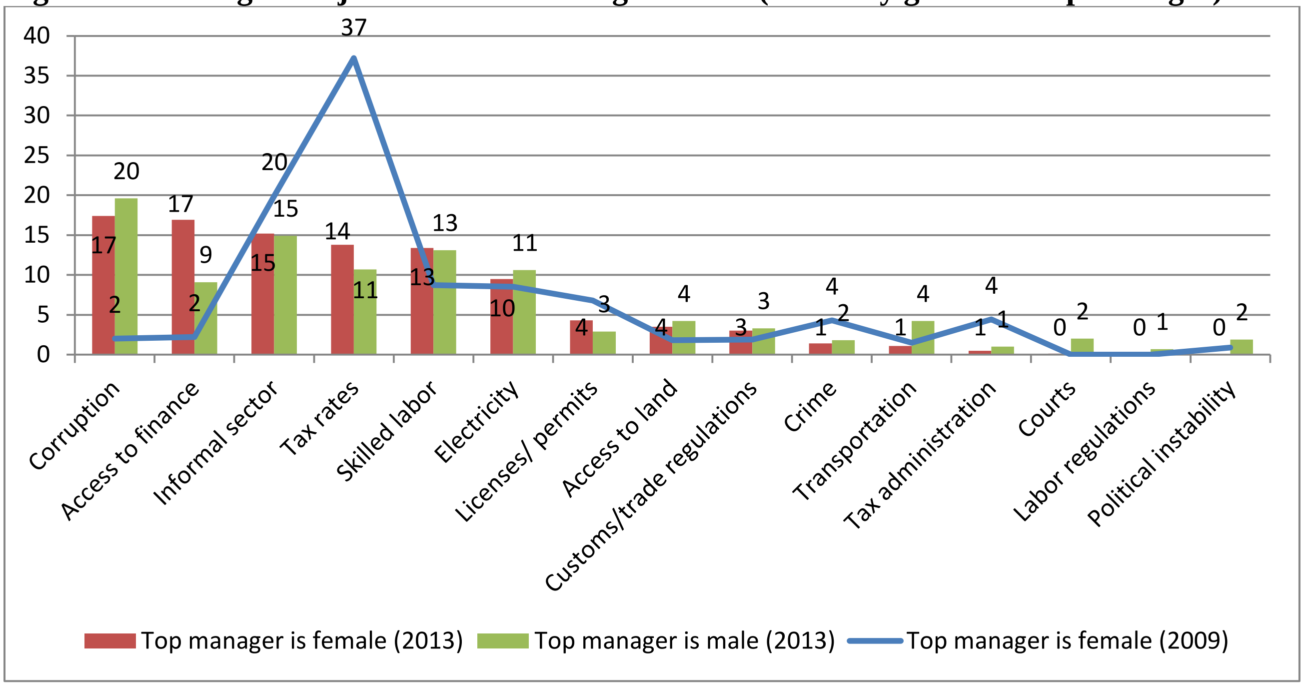
Figure 2. Percent of firms with female top manager (sorted by size of firm)



[17] E.g. see statistical compilation of Statistical Agency of Kazakhstan, "Women and Men of Kazakhstan", available at: http://stat.gov.kz/getImg?id=ESTAT086608

A closer look into possible reasons of such imbalance shows striking difference between major obstacles faced by Kazakh firms led by male and female top managers.

Figure 3. Ranking of major obstacles to doing business (sorted by gender of top manager)



As Figure 3 shows, access to finance has become more of a problem in 2013, even when compared to 2009 - the period immediate aftermath of global financial crisis. The problem of access to finance is even bigger for firms managed by female top managers. Such correlation between access to finance and gender deserves further research and analysis in frame of Component 5 of the project. Furthermore, such research could be undertaken relatively easily as PFIs, taking part in the project, have full opportunity to poll final borrowers in detail to reveal impact of gender on competitiveness of SMEs.

Annex 6: Economic and Financial Analysis

KAZAKHSTAN: SME Competitiveness Project

Overview

This economic analysis follows the World Bank guidance note on economic analysis of investment project financing and uses ex-ante cost-benefit analysis framework to assess and monetize costs and benefits of implementation of the proposed project (the Project) and associated externalities. In particular, it looks into direct (financial) costs associated with implementation of Project and indirect costs associated with deadweight losses due to collection of taxes and possible environmental damages. On the benefits side, the analysis covers financial and economic revenues generated by increased SME competitiveness and development of both supply and demand sides of Kazakhstan's financial services market facilitated by the Project. The analysis arrives at Net Present Value of US$ 22.13 million in the baseline case.

Public rationale. Public intervention in increasing SME competitiveness and development of financial sector in Kazakhstan is justified by constraints on both demand and supply sides of SME financing that the market fails to address. Constraints on the demand side are twofold: for micro and small enterprises this is related to financial literacy of borrower, especially rural one. Addressing this usage-related issue would reduce transaction costs that deter majority of lending institutions from entering this segment of the market. The project is aimed to assist Government of Kazakhstan and the state-owned Damu Fund in addressing this issue. For medium-sized entities a considerable constraint is lack of long-term, high value-added projects that can substantiate bank loans. In particular, firms engaged in supplying SOEs and state projects have to rely on procurement tenders of one-year length. This seriously limits their investment and development plans, making them potentially subprime borrower for banks. Due to high upfront costs of complying with international quality standards, the absolute majority of medium-sized entities are neither engaged in supply chains of multinational corporations. What left to majority of medium-sized corporate borrowers are "traditional" services and trade sectors in major cities of Kazakhstan. On the supply side, high transaction costs and risks of small-size lending as well as high share of NPLs in banks' portfolio lead to high collateral requirements that constrain lending to SMEs and rural entrepreneurs. However, these constraints can be overcome by a) improving SME capacity to enter new high-value-added markets, b) introducing new financing instruments that utilize untapped potential of both suppliers and consumers of financial services, c) improving institutional environment to ease the provision of financial services.

World Bank's value added. World Bank actively participated in designing and implementing the Financial Sector Adjustment Loan Project in 1996-1997, and is seen as long-term strategic partner of Kazakhstan in improving capacity of the financial sector in Kazakhstan. The World Bank will be able to draw from the lessons learned of this and similar projects implemented worldwide (e.g. WBG's Business Edge Program) and in resource-based countries akin to Kazakhstan (e.g. Russia, Argentine, Chile, etc.).

Standing. The analysis is carried out from the national perspective of Kazakhstan. The parties with standing are:

a. **Kazakh taxpayers** since reimbursement of the World Bank's loan allocated to the the Project would be financed from the state budget. Kazakh taxpayers are thus affected in two ways: increased direct tax burden and deadweight loss due to distorted decisions caused by taxes. At the same time, this group will benefit from diversification of the economy, increased competition on the goods and services market and creation of new jobs.
b. **Small and medium enterprises** will benefit from increased access to finance to undertake new initiatives, and/or broaden the product or services range, and/or improve the existing product quality and production efficiency. This is likely to trigger positive spillovers for their supplier enterprises and individuals. The impact is expected to be especially important in underdeveloped regions of the country.
c. **Kazakh government, the Damu Fund and National Chamber of Entrepreneurs** will bear indirect expenditures in the form of increased workload of the personnel and/or direct expenditures to hire new employees to maintain activities in the frame of the Project.
d. **Kazakh research institutes, state policy-making agencies** (Economic Research Institute, Kazakh Statistics Agency, National Chamber of Entrepreneurs) will benefit from increased capacity for impact evaluation and policy-formation.
e. **Kazakhstan-based providers of business advisory services, other companies and individuals** involved in design and implementation of the project would receive benefits in form of rents and salaries.
f. **Large Kazakh corporations** who will benefit from efficiency of local suppliers;

Assumptions. The economic analysis will consider costs and benefits of the Project project based on following assumptions:

a. Funds allocated on the project will be disbursed within the period of FY 2016-2020 (the planned lifetime of the Project) according to following projections:

Component	Total spending	Jul-Dec 2015	2016	2017	2018	2019	Jan-Jun 2020
1. SME Capacity Building	$15 mln	10%	30%	20%	15%	15%	10%
2.1 Supplier Development Program	$12 mln	5%	15%	20%	25%	25%	10%
2.2 Competitive Sectors	$6 mln	10%	29%	22%	21%	13%	5%
2.3 Factoring Strategic Assessment	$2 mln	20%	70%	10%	0%	0%	0%
3. Impact Evaluations & Monitoring	$8 mln	5%	15%	20%	20%	25%	15%
4. Project Management	$3 mln	10%	25%	20%	20%	20%	5%

b. The base case considered by the cost-benefit analysis will take 5.5% social discount rate (based on refinancing rate of the National Bank of Kazakhstan) for calculating present values of future costs and benefits as proposed by Government of Kazakhstan (GoK)[18].

However, the latter assumption will be altered to calculate net benefits in the pessimistic case and the worst case scenarios for sensitivity analysis. The timeline of the analysis is limited to 10-year period of FY 2015-2024, including time period of FY 2015-2019 of implementation of the project when major costs and benefits of the project arise and 2020-2024 when residual positive externalities of the project are expected to appear. Limitation of timeline of the analysis to 10-year period is dictated by presence of a large number of contingencies, including possible changes in macroeconomic, demographic and legal environment of the country in the long-run, influence of foreign actors, uncertainties related to nature of subprojects to be implemented by SME established thanks to and/or benefiting from Project . In particular, subprojects launched by SMEs in the frame of the Project may range from projects in public service or social protection (with relatively lower private returns) to projects in mineral extraction (with relatively lower social returns) that have differing rates of return. All present values presented in the analysis are in terms of 2014 US dollars, rounded to nearest decimal, unless noted otherwise. All sums in national currency were translated into US dollar equivalent using official exchange rate of National Bank of Kazakhstan at the date of analysis.

Calculation of Costs and Benefits

The potential costs and benefits of the SME Competitiveness Project project can be divided into two groups: 1) direct costs and benefits associated with launch and administration of the project and 2) side effects (externalities) of the project. These are presented in Table 1 below.

Table 1. List of potential impacts of Project

COSTS		
Group with standing	**Component**	**Description**
Kazakhstan taxpayers (individuals and firms)	Component 1	Direct financial outflows on capacity building of institutions and business trainers
	Component 2.1	a) Direct financial outflows on institutional capacity building; b) direct financial outflows on designing, piloting and scaling up SDP program.
	Component 2.2	Direct financial outflows on establishment and institutional strengthening for cluster development program.
	Component 2.3	Direct financial outflows on conducting strategic assessment for factoring
	Component 3	Direct financial outflows on impact evaluation and monitoring frameworks
	Component 4	Direct financial outflows related to operating costs of establishing and running Project Implementation Unit.
	All components	Distortionary cost of taxation.
	Components 2.1 and 2.2	Environmental impact of new SME activities triggered by the project.
SMEs	Component 2	Administrative expenses incurred by SMEs applying for supply chain linkages program, preparing business plans and performance reports, expenses related to compliance with formal requirements.

[18] As articulated in the joint order of Minister of Economic Development and Trade of the Republic of Kazakhstan of July 1, 2010 No. 102 and the Chairman of Agency of the Republic of Kazakhstan for construction and housing and communal services of June 30, 2010 No. 276. No. 6345. Registered in the Ministry of Justice of the Republic of Kazakhstan on July 23, 2010

Ministry of National Economy, the KIDI, other state agencies, National Chamber of Entrepreneurship	All components	Indirect expenditures in form of increased workload of their personnel and/or direct expenditures in form of hiring new employees to maintain activities in frame of the project.
BENEFITS		
Kazakhstan taxpayers	All components	Economic growth generated by creation of new SMEs/improved access to finance of SMEs. Increased availability of goods and services, increased employment in private sector, the value-added of having more stable financial sector.
Local contractors	All components	Increased rents from activities in frame of the project.
Ministry of National Economy, the Damu Fund, other state agencies, National Chamber of Entrepreneurship	Component 1	Increased institutional capacity for SME support.
Economic Research Institute, National Chamber of Entrepreneurship, Kazakh universities	Component 1	Increased capacity of local research institutions, benefit to economy as a whole from better-informed policies.

As Component 1 of the Project is expansion of the existing SME support programs of the Damu Fund, it can be assumed that these Component of the proposed project has passed the stage of design and regulatory clearance and current analysis will consider costs related to teething stage of this component (costs related to identifying and formalizing application procedures, searching/hiring/training project coordinators, etc.) as sunk.

Calculation of Costs

Component 1. The aim is to introduce a coherent framework of support that will enhance competitiveness of all Kazakhstani firms regardless of size or sector. The primary costs of this component are associated with direct financial outflows on capacity-building trainings for public sector employees, master trainers and business advisors. Here it is assumed that half of disbursements under Component 1 will be made within first two years of the project. This is because capacity-building trainings/pilot program under this Component are prerequisite for successful implementation of remaining components of the project and are expected to be fulfilled at early stage of the project.

Direct discounted cost of capacity-building trainings/CI works that carried out by foreign contractors in frame of the Component 1 is US$ 12.6 mln. Since a negligible proportion of this sum is expected to be spent in Kazakhstan and local firms receiving rents (travel, accommodations, transport firms, landlords) operate in competitive markets, 100% of this sum is counted as cost.

Indirect costs of the component include time spent by trainees (public sector employees, business advisors). Available data suggests that 64,000 person/hours will be spent by participants of capacity-building trainings (please see Table 2 below). As of May 2014 the average monthly salary in Kazakhstan comprised KZT 120,479 or KZT 5,238 per working day (or 8 person/hours). Thus total indirect undiscounted cost of trainees under Component 1 is KZT 41.9 mln (US$ 231,000.0) incurred in first two years of the project.

Table 2. Estimated number of trainees under Component 1 and estimated amount of time spent

Component 1	Number of trainees	Time spent by each trainee (hours)	Total person/hours spent
On-site training of public sector employees, 100 hours of each of 100 trainees	100	100	10,000
Off-site training of public sector employees, 100 hours of each of 100 trainees	100	100	10,000
Identification of training needs of business trainers: 40 hours of each of 50 trainers & heads of consulting firms to be involved	50	40	2,000
Training of business trainers: 40 hours of each of 1,000 trainers & business advisors	1,000	40	40,000
Demand-based training of SME heads: 20 hours of each of 100 trainees	100	20	2,000

Taking into account all above-mentioned assumptions and given 5.5% social discount rate (SDR), present value (PV) of total costs of Component 1 is US$ 13.0 mln.

Component 2.1. The objective of this component is to improve the overall competitiveness of individual SMEs in competitive sectors in Kazakhstan through a focused and comprehensive Supplier Development Program (SDP). The project will establish a Supplier Development Office (SDO), whose role will be to increase market linkages for SMEs with large local and multinational corporations operating in Kazakhstan.

The primary costs of this Component are associated with direct financial outflows on capacity-building to develop and implement a Supplier Development Program and to conduct analyses on competitive industries; developing managing agency; and implementing and scaling-up pilot SDP program. Here it is assumed that disbursements under tasks 1 and 2 of the Component 2.1 will be made within first two years of the project lifetime. It is also assumed here that task 3 of the component will be implemented within remaining yeara of the project lifetime. This is because capacity-building trainings and procurement of goods under this Component are prerequisite for successful implementation of remaining goals of the project and are expected to be fulfilled at early stage of the project.

The analysis does not incorporate cost related to SMEs applying to supplier development program, administrative expenses of multinational corporations in frame of SDP for following reasons: a) predicting such cost may be unreliable due to many contingencies (location and size of SMEs, number of days spent on application/compliance procedures etc.); b) the final number is expected to be negligible compared to scale of the project; and c) most part of such costs are pure transfer of funds and can be discarded from the analysis. Taking into account all above-mentioned assumptions and given 5.5% social discount rate (SDR), present value (PV) of total costs of Component 2.1 is US$ 9.8 mln.

Component 2.2. The objective of this component is to support the development of higher value-added production and increased competitiveness of SMEs in non-extractive sectors. This component will focus on increasing market linkages for SMEs in Kazakhstani sectors that are not yet globally competitive but which have potential for market-based growth. The project will develop a world-class cluster development team that is able to implement best practices, and will result in increased global competitiveness of selected clusters in three regions.

The primary costs of this Component are associated with direct financial outflows on technical capacity-building of the KIDI to develop and implement a Cluster Development Program and support to implementation of the competitive industries approach. A major indirect cost of the component is administrative and time cost of KIDI personnel in carrying out Cluster Development Program. At the same time, this cost is not counted here as it is negligible compared to overall project size and is overridden by the value-added for the KIDI from development of Cluster Development Program and associated technical-capacity gains. Taking into account all above-mentioned assumptions and given 5.5% social discount rate (SDR), present value (PV) of total costs of Component 2.2 is US$ 5.1 mln.

Component 2.3. The objective of this component is to conduct a detailed assessment for development of factoring and reverse-factoring in Kazakhstan. SMEs in the various local supply chains in Kazakhstan face challenges emanating from a lack of collateral to receive loans, delays in receiving payments especially from larger companies, lack of certainty of trade, and a lack of credit from suppliers. Given the nascent nature of factoring in Kazakhstan, the project will include a detailed strategic assessment in which the design of an invoice-based financing platform, as well as a review of the relevant regulations in Kazakhstan will be conducted.

The component envisages procurement of consultancy services, that are assumed to be provided by a foreign supplier. Thus, cost of the component is a pure cost to Kazakh taxpayers and does not have indirect costs. Thus, the only cost incurred by Kazakh taxpayers under this Component is the direct financial outflows in the amount of $2 mln. Thus, taking into account above assumptions and SDR of 5.5%, PV of costs of Component 2.3 amount to US$ 1.8 mln.

Component 3. The aim of this component is to create a sustainable M&E structure that shapes new SME policies, establishes better priorities and achieves more transparency; as well as creating a sustainable third-party monitoring mechanism that increases transparency and participation of the private sector in SME policy design.

There are three groups of costs incurred under this component: spending on technical assistance; procurement of goods (hardware and software, and related integration and maintenance) for call centre and SMS-based feedback system; costs incurred by stakeholders (ERI, Universities and National Chamber of Entrepreneurs) engaged in implementation of the component. It is assumed that technical assistance will be carried out by foreign contractors and goods will be imported. Thus, these two groups of costs are counted fully in this analysis. Current analysis does not count for indirect costs of ERI, universities and National Chamber of Entrepreneurs in form of increased workload as this sums are negligible compared to the project scale. Disbursements under this component are expected to be evenly distributed across the project lifetime. Thus, taking into account above assumptions and SDR of 5.5%, PV of costs of Component 3 amounts to US$ 6.5 mln.

Component 4. Project management. Operation of the project over its five-year tenure will be conducted by an extensive team of technical and fiduciary specialists. In addition to project coordination, procurement, financial management, and monitoring and evaluation specialists, a team of international technical experts will join the PIU on a resident basis. As the component will recruit employees on the competitive labor market, it is expected that the component will not have indirect costs. Based on previous assumption that financial outflows under this component will be evenly distributed across the project lifetime, PV of costs of Component 4 amounts to US$ 2.5 mln.

The CAF project may also cause negative impact on environment due to increased economic activity of new and existing SMEs, including wastes generated during production of goods, field trials of new products and substances etc. However, it is not possible to know beforehand precisely what projects will be given birth under the auspices of the project and the precise, detailed environmental compliance issues will emerge during the course of project implementation. Based on previous experience with similar projects, it is expected that safeguard measures in frame of the project would comply with World Bank safeguard policies and procedures and with best international practices for safety, waste disposal and operating procedures. Thus, potential environmental impact of the project is expected to be modest and is not quantified in this analysis.

A considerable negative externality of the project is the deadweight loss resulting from distorted decisions of economic agents due to collection of taxes to finance the project. Existing literature on distortionary impact of taxes is extensive and estimates of this negative externality to range from 2.5 cents to 30 cents per dollar of public funds raised through taxation[19]. The current analysis takes median of this range at about 16 cents per 1 dollar of tax revenue. Another simplification, which is required here due to uncertainty at this stage of the project, is that taxes will be collected at last year of the project lifetime. Given these assumptions, PV of distortionary impact of taxes amounts to US$5.3 mln.

Calculation of Benefits

As of 2014, 863,185 active SMEs produced goods, works and services worth of KZT 3,289 bln. This implies, revenue by an average active SME is KZT 3.81 mln. The current analysis assumes that pilot efforts to improve supply chain linkages under Component 2.1 will increase sales of participating 100 SMEs at diminishing rate: i.e. by 70%[20] in the first year, by 40% in the second year and by 10% in remaining three years.

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[19] Martin Feldstein, Tax Avoidance and the Deadweight Loss of the Income Tax, 81(4), Review of Economics and Statistics (1999), at p. 674; and Charles L. Ballard, John B. Shoven and John Whalley, The Welfare Cost of Distortions in the United States Tax System: A General Equilibrium Approach, National Bureau of Economic Research Working Paper No. 1043.

[20] Assumption is based on results of the Kazakhstan Small Business Development Program, a joint 4-year program of USAID and GoK. For further information, please refer to http://pdf.usaid.gov/pdf_docs/PDACS632.pdf

The principal benefit of the project comes from sustainable development of private sector in general and SMEs in particular through following vehicles:

- Increased capacity of government agencies, several hundreds of local business advisors and several thousand SMEs;
- Benefit to local SMEs from additional business with national and foreign large companies and enhanced ability to increase exports;
- Greater outreach of an underserved economic sector, i.e., SMEs;
- Several thousand entrepreneurs will have access to finance and financial services;
- Financial inclusion of new SMEs by banks, and MFIs;
- Sustained growth of SME lending portfolio in participating credit institutions;
- Lower collateral requirements per $1 of intermediated funding compared to the baseline;
- Positive spillovers of the program into other lending activities and engagements of the PFIs and the financial sector targeting SMEs;
- Increased PFIs capacity to assess credit risk of SMEs;
- More favorable audit and on-site supervisory assessments;
- Better monitoring and design of SME support policies;
- Better transparency and accountability of SME policies.

This is an incomplete list of extremely important positive externalities and direct impact of the proposed project, though barely quantifiable. This is mainly due to uncertainties related to the scope and scale of expected SME activities, e.g. enhancement of existing and creation of new SMEs in vast array of sectors ranging from agriculture to oil drilling to space & defense will impact different groups of population with differing scale at different time horizons. Given lack of relevant literature and data, monetization of these benefits will also require a large vector of assumptions and simplifications. Thus, monetary value of possible benefits put at micro level is doomed to be highly imprecise. Instead, current analysis tries to analyze macro-level impact of the proposed project based on available literature.

A combined set of 18 case studies shows that every dollar invested in SMEs development generates, on average, an additional 12 dollars in the local economy[21]. At the same time, there is no readily-available study on SME finance multiplier effect, and to arrive at a conservative estimate of the project's benefits it is assumed that the multiplier is 7. Thus, using the well-known formula for multiplier effect[22] the current analysis assumes that approximately 86 cents out of every dollar spent on direct SME support under components 2.1, 2.2, 2.3 and 3 will be reinvested into economy creating new jobs and rents. The multiplier of 7 used in this analysis is conservative compared to multiplier of 12 mentioned above. Moreover, due to 10-year time limit of the analysis, this multiplier is even smaller, which makes estimate of benefits of the project quite conservative. Given these assumptions and using SDR of 5.5%, PV of benefits from SME support under components 1, 2.1, 2.2, 2.3 and component 3 is US$ 45 mln.

Certain components of the project will also generate benefits in form of new jobs and rents to local contractors. The analysis incorporates wages and rents received by local contractors under

[21] http://springhillequity.com/files/From-Poverty-to-Prosperity.pdf
[22] e.g. see http://www.investopedia.com/exam-guide/cfa-level-1/macroeconomics/multiplier-effect.asp for description of the formula

Component 1 (in particular, a part of total of US$ 3.3 mn spending on local contractors to develop consultants database, produce sector studies and conduct TV/radio communications campaign) as benefit. This is based on viable assumption that local consulting market is underdeveloped, while local electronic media ad market is oligopolistic (meaning that that price charged by local companies for the above-mentioned services is twice higher than their marginal costs). Given these assumptions and SDR of 5.5%, PV of this group of benefits amounts to US$ 1.8 mln.

Another group of benefits stem from the value added from capacity-building training of business advisors and SMEs, development of managing agency and enriching the approach to competitive industries. As mentioned above, a considerable share of capacity-building assistantship will be carried out by international contractors. To calculate the value-added of such activities, two simplifying assumptions were made: 1) marginal variable cost of training is equal to marginal benefit received by trainees; 2) travel and accommodation costs of international contractors are assumed to be fixed and amount to 30% of sums spent on capacity building. Given this assumption and SDR of 5.5%, PV of this group of benefits amounts to US$ 19.5 mln.

Calculation of Net Present Value of the Project

Table 3 below presents Net Present Value (NPV) of costs and benefits of the CAF project from the perspective of Kazakhstan from FY 2015 through 2024. All benefits and costs have been discounted by 5.5% SDR over the course of 10 years. According to the results shown in the table, NPV of the CAF project and associated activities is US$ 22.1 mln. in positive benefits (refer to Table 5 below to see a summary of nominal values distributed across 10 years).

Table 3. Present Values of costs and benefits of the Project project, baseline case

COSTS		
Group	**Description**	**Value (mn of 2014 USD)**
Direct financial outflows		
Kazakhstan taxpayers	Component 1	12.6
	Component 2.1	9.8
	Component 2.2	5.1
	Component 2.3	1.8
	Component 3	6.5
	Component 4	2.5
Administrative costs		
Public sector employees	Value of time spent on on-site and off-site capacity-building trainings	0.07
Local business advisors	Value of time spent on capacity-building trainings	0.14
SMEs	Value of time spent on demand-based trainings by about 100 SME representatives	0.007
Negative externalities		
Kazakhstan taxpayers	Negative impact on environment (Components 1,2,3)	not counted
	Distortionary impact of taxes (all components)	5.3
	Total costs	44.2

BENEFITS		
Group	**Description**	**Value (mn of 2014 USD)**
Direct benefits		
Kazakhstan taxpayers	Increased capacity of local research institutions (e.g. ERI), benefit to economy as a whole from better-informed policies (component 3)	Not counted
Workers and entities engaged in design and implementation of the project	Welfare gains in form of wages and rents to local contractors (Component 1)	1.8
Value-added of capacity-building activities	Welfare gains from enhanced capacity of trainees	19.5
Positive externalities		
Kazakhstan taxpayers	Growth of economy from SME support multiplier effect (Component 2 and subcomponent 4.1)	45
	Total Benefits	66.3
	PV of Net Benefits	22.1

Sensitivity Analysis

Although the base case calculations show more than US$ 22 mn of net benefit, this figure may change in following scenarios:

a. a higher SDR is applied;
b. expected impact of the project on economy is in lower end of estimated range.

To test viability of the project against these arguments, the analysis recalculates present values of costs and benefits by using 7.5% SDR (vs. 5.5% in base case) and lowering projected multiplier effect to 5. Application of a higher SDR has net negative effect as all costs of the CAF project occur within first 5 years of the analysis' timeline, while a considerable part of benefits associated with growth of economy occur at a later stage. Meanwhile, lowering expected impact on the economy reduces benefits from the project and does not impact its costs.

Based on these assumptions, two alternative scenarios of evolution of costs and benefits are calculated. One scenario is entitled "Pessimistic Case" and includes only lowering expected impact of the project on economy. The second scenario is entitled "Worst Case" and includes lowering expected impact of the project on economy and increasing SDR. Results of the alternative scenarios along with base case calculations are presented in Table 4 below.

Table 4: Comparison of net benefits in base case and alternative scenarios

PV of costs (in millions of 2014 dollars)			
	Base case (5.5% SDR, multiplier effect of 7)	Pessimistic case (multiplier effect of 5)	Worst case (multiplier effect of 5, 7.5% SDR)

Direct financial outflows	38.4	38.4	3
Value of time spent by public sector employees on capacity-building trainings	0.06	0.06	0.06
Value of time spent by local business advisors on capacity-building trainings	0.14	0.14	0.13
Value of time spent on demand-based trainings by about 100 SME representatives	0.01	0.01	0.01
Distortionary cost of taxation	5.3	5.3	4.8
PV of total costs	44.2	44.2	41.1
PV of benefits (in millions of 2014 dollars)			
Welfare gains in form of wages and rents to local contractors	1.8	1.8	1.7
Welfare gains from enhanced capacity of trainees	19.5	19.5	18.3
Growth of economy from SME support multiplier effect	45.05	38	32.1
PV of total benefits	66.3	59.3	52.1
PV of total net benefits	22.1	15.1	11.0

As seen from Table 4, the CAF project brings positive net benefits in case of lower economic impact and higher SDR. Net benefits of the base case amount to US$ 22.1 mln., the pessimistic case value is positive US$ 15.1 mln. and the worst case scenario gives positive US$11 mln. The main cause of lower NPV in two alternative cases is the significant decrease in social or economic return of SME support spending.

1. **Other considerations.** Due to time considerations and presence of large number of contingencies this cost-benefit analysis did not analyze in detail the “butterfly effect” of advanced approaches to SME support on long-run employment and diversification of the economy in Kazakhstan beyond year 2024. The analysis neither included possible negative impact of boosting the SME sector on environment. Calculation of impacts on micro-level like rents to landlords, construction companies and service providers were also forgone as payments for their services and goods are expected to be negligible and equal to their opportunity cost.

2. **Policy recommendations.** The cost-benefit analysis presented in this analysis supports implementation of the Competitiveness and Access to Finance Project in light of positive net benefits. As an alternative to the project, continuation of the Damu Fund’s capacity-building programs could be considered. Although in this case there would be lower administrative costs and time savings, this avoided cost is much smaller compared to foregone benefits. These

foregone benefits include, among other, economies of scope and strong linkages achieved by Component 2.1, enhanced institutional capacity aimed at by Components 1,2, and 3.

Table 5. Summary of nominal values distributed across 10 years in base case scenario (USD mn)

Description	PV	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Direct financial outflows	75.9	3.8	11.4	9.1	8.7	8.6	0.0	0.0	0.0	0.0	0.0
Value of time spent by public sector employees on capacity-building trainings	0.02	0.01	0.01	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Value of time spent by local business advisors on capacity-building trainings	0.14	0.14	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Value of time spent on trainings by about 100 SME representatives	0.01	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Distortionary cost of taxation	5.3	0.0	0.0	0.0	0.0	0.0	7.4	0.0	0.0	0.0	0.0
Total costs	81.37	4.05	11.41	9.1	8.7	8.6	7.4	0.0	0.0	0.0	0.0

Description	PV	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Welfare gains in form of wages and rents to local contractors	1.77	0.96	0.96	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Welfare gains from enhanced capacity of trainees	19.48	2.7	4.8	4.4	4.2	4.1	0.0	0.0	0.0	0.0	0.0
Growth of economy from SME support multiplier effect	45.05	1.2	6.0	8.6	10.0	10.6	9.5	5.9	3.5	2.0	1.0
Total benefits	66.3	4.86	11.76	13	14.2	14.7	9.5	5.9	3.5	2	1