



## Kazakhstan: MFF Small and Medium Enterprise Investment Program Tranche 3 (Additional Financing)

Project Name	MFF Small and Medium Enterprise Investment Program Tranche 3 (Additional Financing)		
Project Number	44060-027		
Country	Kazakhstan		
Project Status	Approved		
Project Type / Modality of Assistance	Loan		
Source of Funding / Amount	<b>Loan 3261-KAZ: SME Development Project T3 (Additional Financing)</b>		
	Ordinary capital resources		US\$ 98.00 million
Strategic Agendas	Inclusive economic growth		
Drivers of Change	Private sector development		
Sector / Subsector	<b>Finance</b> - Small and medium enterprise finance and leasing		
Gender Equity and Mainstreaming	Effective gender mainstreaming		
Description	<p>On 29 September 2010, the Asian Development Bank (ADB) approved a multitranche financing facility (MFF) for the Kazakhstan Small and Medium Enterprise Investment Program for an aggregate amount not exceeding \$500 million. This is ADB's first sovereign operation that provides local currency (tenge) fixed interest rate financial intermediation loans which directly mitigate foreign exchange, interest rate and tenor mismatch risks for participating financial institutions (PFIs) and their small and medium-sized enterprise (SME) clients in Kazakhstan. The MFF is structured to have 3 or 4 tranches.</p> <p>On 15 December 2014, ADB approved the tranche 3 project (Tranche 3), a \$130 million financial intermediation loan from ADB's ordinary capital resources, based on the periodic financing request received from the Government of Kazakhstan on 31 October 2014. The borrower, as in previous tranches, is Damu Entrepreneurship Development Fund (Damu), the government entity tasked with SME development. The loan will be guaranteed by the Republic of Kazakhstan. The internal processes to obtain the sovereign guarantee for this project have not yet finalized. Thus, the legal agreements for the Tranche 3 loan have not been executed to date and, accordingly, the loan has not yet been declared effective.</p> <p>Given the deteriorating conditions for SME financing, Damu has requested \$98 million additional financing for Tranche 3, bringing the overall Tranche amount to \$228 million. Deposit dollarization has continued rising, going from 46% at the end of September 2014 to over 56% at the end of January 2015 fueled by fears of a new currency devaluation against the backdrop of the Russian crisis. Commercial banks continue to have a shortage of tenge liquidity and have stopped lending in local currency to SMEs. The Government has made an urgent call to SME development agencies like Damu to raise funding from donors to support SME lending, given the budgetary constraints exacerbated by the decline in the price of oil and the Russian crisis.</p> <p>Tranche 3 will help Damu continue with the implementation of the government's Action Plan to increase access to medium term finance for SMEs. The funds will be relent in local currency (tenge) fixed-interest loans to qualified participating financial institutions (PFIs) to fund their respective market-based loans, leases and other financial products to SMEs.</p>		

Project Rationale and Linkage to Country/Regional Strategy	<p>Access to finance is one of the main impediments to business development, especially for SMEs in Kazakhstan. Most SME investment is financed by internal resources. SMEs contributed 17.3% to GDP in 2012, while the SME loans to GDP ratio was only 4.7%. Lending to SMEs dropped from over 22% of total bank loans in 2008 to less than 15% in 2011. Partly as a result of stimulus packages from government and development partners SME lending is gradually picking up, although it still remains below pre-crisis levels. The key constraint being addressed through this project is the PFIs limited ability to provide medium-term local currency funding for SME clients, in particular outside the bigger cities and to women borrowers. This gap is due to banking sector vulnerabilities, tenge liquidity unpredictability, and high foreign currency risk, with SME borrowers preferring tenge borrowing to match the currency of their revenue streams.</p> <p>Banking sector weaknesses relate to the high level of non-performing loans (NPLs) in the system, as a legacy of the 2008-2009 crisis. The banking sector experienced a construction-related credit boom between 2005 and 2007 that was financed through external wholesale funding. As a result of the global financial crisis, banks lost access to foreign financing, the availability of domestic credit declined, and property prices plunged. The 2009 tenge devaluation aggravated the situation, since both commercial banks and their borrowers had open foreign currency exposures. Banks asset quality dropped severely, with NPLs rising from 8.1% to 36.5% between 2008 and 2009. In response, the government acquired significant stakes in the sector. Since then, the banking sector has stabilized and become less vulnerable to external developments. However, progress towards NPL resolution is has been slow. Low asset quality (system-wide NPLs continue as high as 30% at the end of August 2014), low profitability, and concerns over capitalization hamper banks' capacity to lend to the SME sector.</p> <p>Credit quality is affected by the high indirect credit risk found in banks portfolios, with 38% of loans in foreign currency mainly to unhedged borrowers. Banks lending in local currency is constrained by the rapid increase in the dollarization of time deposits; the weak functioning of the interbank market; and lack of effective central bank monetary policy instruments. Banks are using the foreign currency swap market to manage short term tenge liquidity, but longer-term tenge funding is limited.</p>
Impact	sustained job creation and economic growth.

## Project Outcome

Description of Outcome	SMEs have increased access to medium-term credit on a sustainable basis.
Progress Toward Outcome	
<b>Implementation Progress</b>	
Description of Project Outputs	Medium-term financing to SMEs improved financial sector outreach, with a focus on women entrepreneurs.
Status of Implementation Progress (Outputs, Activities, and Issues)	
Geographical Location	

## Safeguard Categories

Environment	FI
Involuntary Resettlement	FI-C
Indigenous Peoples	FI-C

## Summary of Environmental and Social Aspects

Environmental Aspects	
Involuntary Resettlement	
Indigenous Peoples	

## Stakeholder Communication, Participation, and Consultation

During Project Design	<p>During project design the team held regular consultations with development partners involved in SME and private sector development.</p> <p>The European Bank for Reconstruction and Development, International Finance Corporation, United States Agency for International Development and the World Bank have supported SME development in Kazakhstan through (i) training to nongovernment organization business service providers; (ii) technical assistance to help banks introduce credit scoring and improve SME lending policies; and (iii) FILs to and equity investments in banks that provide loans to SMEs. ADB has worked closely with these partners, mindful of lessons on the need to mitigate foreign exchange and tenor mismatch risk, the importance of developing the local bond markets, and governance issues related to PFIs. Consultations have also taken place with business associations and representatives of the private sector.</p>
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During Project Implementation It is expected that consultation with business associations and development partners (EBRD, WB, IFC) will continue to take place regularly, as part of the review missions.

## Responsible Staff

Responsible ADB Officer	Inmaculada Martinez
Responsible ADB Department	Central and West Asia Department
Responsible ADB Division	Public Management, Financial Sector and Trade Division, CWRD
Executing Agencies	<i>DAMU Entrepreneurship Development Fund</i> <i>BMUKUSHEV@FUND.KZ</i> <i>Gogol St., 111, Almaty</i> <i>Kazakhstan</i>

## Timetable

Concept Clearance	-
Fact Finding	-
MRM	15 Apr 2015
Approval	24 Jun 2015
Last Review Mission	-
Last PDS Update	16 Sep 2015

## Loan 3261-KAZ

Milestones					
Approval	Signing Date	Effectivity Date	Closing		
			Original	Revised	Actual
24 Jun 2015	11 Sep 2015	-	10 Nov 2016	-	-

Financing Plan		Loan Utilization			
	Total (Amount in US\$ million)	Date	ADB	Others	Net Percentage
Project Cost	122.50	Cumulative Contract Awards			
ADB	98.00	24 Jun 2015	0.00	0.00	0%
Counterpart	24.50	Cumulative Disbursements			
Cofinancing	0.00	24 Jun 2015	0.00	0.00	0%

Project Page	<a href="https://www.adb.org/projects/44060-027/main">https://www.adb.org/projects/44060-027/main</a>
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Date Generated	06 July 2017

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