

Investing in the SME sector

THE CREATION OF A BUSINESS FRIENDLY ENVIRONMENT IS ATTRACTING INVESTMENT



A prosperous SME sector is key for the country's long-term economic stability

Since gaining independence two decades ago, Kazakhstan has been successful in attracting large-scale foreign direct investment, with more than US\$90 billion flowing into the country, the majority of it into the oil, gas, and mining sectors. At the same time, Kazakhstan's transformation into a market economy has brought with it the challenge of shifting from a focus on a small number of large industrial enterprises to boosting bottom-up and small-scale economic dynamism through micro, small and medium-sized enterprises (SMEs).

A prosperous SME sector is key for the country's long-term economic stability. The sector is a major creator of employment and innovation, and is traditionally more responsive and adaptable than larger entities. Small and medium-sized enterprises form the backbone of all successful Western economies: in the EU they make up around 60 per cent of the value of total GDP. In Kazakhstan the figure is considerably lower at 35 per cent, down from 2005's 40 per cent.

One contributor to this widening gap has been the financial crisis, which has penalised the SME sector harder than larger companies. The absence of vibrant local medium-sized companies means that Kazakhstan benefits less from large FDI inflows to enterprises that could be engaged as subcontractors and thus create jobs and benefit from know-how transfer.

Supporting the flow of investment, especially from foreign SMEs to Kazakh small and medium-sized enterprises is therefore crucial. The authorities have been highly successful in attracting big blue-chip investors with targeted benefits. But this is not an approach that works for smaller investors.

The first priority should be to improve the business environment and its predictability. The Kazakh authorities have taken important steps such as the introduction of a new tax code, while lifting the obligation for small businesses to make monthly tax pre-payments. Further improvements could be made by streamlining the procedures for paying taxes to limit the scope for corruption, which remains a high-ranking concern in the latest EBRD/World Bank Business Environment and Enterprise Performance Survey, despite recent improvements.

Fostering entrepreneurship and SME development is a priority for the government of Kazakhstan, and also a major focus of EBRD activities in the country. Under

its Small Business Programme it has extended almost 250,000 loans for a total amount of US\$2.5 billion since 1997. The government also increased its SME support as part of its crisis response.

The Kazyna Fund for Sustainable Development was established on 16th March 2006 to stimulate investment into innovation projects to ensure Kazakhstani economic diversification and to further Kazakhstan's integration and competitiveness in the regional and global marketplace. Kazyna's role is to identify and implement, through government and private sector cooperation, new results-oriented breakthrough projects that have high socio-economic value and provide administrative support and long-term financing in the form of debt and equity.

Kazakhstan's SMEs are also to receive additional medium-term financing from local banks for their much-needed investments through the support of a US\$500 million equivalent facility from the Asian Development Bank (ADB), announced in October 2010.

Given that SMEs mainly invest in geographically close countries, the government of Kazakhstan says that more emphasis should be put on attracting regional players. As many SMEs that invest abroad often start as exporters, foreign companies that currently export to Kazakhstan may be of special interest. They could be targeted, for instance, through export promotion agencies of various countries.

At the same time, the government understands that because of Kazakhstan's relatively small domestic market it is also important to strengthen the export potential of SMEs. It is working to improve infrastructure, reduce administrative procedures, provide equal treatment for all businesses, especially in regards to customs tariffs where administrative interference and impediments have much a bigger impact the smaller a company is.

At the same time, outside observers have highlighted the need to create a business environment and climate that sends a clear signal to the SME sector that the authorities want its success. This also means that SME support must be flexible, pragmatic, and targeted.

The fact that the government is working against the backdrop of a severe global crisis has added to the sense of urgency. Access to finance remains key, but as seen, there are additional important areas where significant progress and impact are being achieved for the benefit of the real economy, where 'small is beautiful'. **F**