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Small and medium-sized enterprise finance in Uzbekistan: Challenges and opportunities

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ADB Working Paper Series

**SMALL AND MEDIUM-SIZED
ENTERPRISE FINANCE IN UZBEKISTAN:
CHALLENGES AND OPPORTUNITIES**

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Abstract

Uzbekistan set an ambitious goal to achieve the status of an upper-middle-income country by 2030, with the focus on growing a large and solid middle-class social stratum. The current reforms in Uzbekistan largely target the development of small businesses and private entrepreneurship (SME) as SMEs have the greatest potential for becoming a real basis for forming a middle class. This paper provides an overview of small business development in Uzbekistan, highlighting the evidence of social economic importance of the SME, and discusses the current status and perspectives of SME policy. The paper also describes the availability of and gaps in SME financing, discusses the key issues of SME finance and current financial literacy programs available in the country, including SME literacy program delivery. Among others, the paper explores the special focus on SME participation in the global value chain and accessibility of value chain financing.

The study results in a set of recommendations aimed to improve access to finance among SMEs and facilitate the development of a more competitive market economy in Uzbekistan.

Keywords: financial inclusion, financial literacy and education, SME, value chain

JEL Classification: G2, G3, G21, G28, O16

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1. INTRODUCTION AND OVERVIEW OF SMES' ROLE IN ECONOMY AND SME FINANCE

1.1 SMEs' Role in the Economy

Uzbekistan is the most densely populated country in the Central Asian region, with one third of the population under the age of 29 and half residing in rural areas. As 800,000 people under the age of 29 join the labor market every year, job generation is an urgent and challenging priority.¹

The development of private micro and small enterprises (MSEs) and entrepreneurship has often been declared as a priority by the Uzbek president currently. It is recognized now that small business is a driving force for economic growth, an increase in GDP and the primary solution to acute social problems such as unemployment, poverty – especially among women and youth – and poor quality of life.

Small businesses in Uzbekistan include individual entrepreneurs and micro and small enterprises². The size of an enterprise is defined by the number of employees, without considering a revenue component or the ownership structure. The threshold number of employees varies by sector (see Table 1).

Table 1: Definition of SMEs³

Category	Number of Employees
Individual	1–3 employees
Micro-enterprises	up to 20 employees
Small enterprises	Up to 200 employees

There is no legal definition for medium-sized enterprises in the legislation. However, according to the draft President Resolution,⁴ the government intends to propose amendments to legislation and expand the scope of prerequisites required to qualify for being treated as a small business, effective from 1 January 2019. According to draft proposals, the following entities will be classified as small and medium-sized businesses⁵:

- ✓ individual entrepreneur;
- ✓ micro-firms with an average annual number of employees of not more than 25;

¹ ADB Sector Assessment <https://www.adb.org/sites/default/files/linked-documents/42007-014-ssa.pdf> (accessed 26 September 2018).

² The definition of small business is stipulated in Article 5 of Law N 69-II, enacted on 25 May 2000 and amended on 2 May 2012, which states that small business includes individual entrepreneurs, microfirms, and small enterprises. (Government of Uzbekistan. 2000. The Law of the Republic of Uzbekistan N 69-II on Guarantees for Freedom of Entrepreneurial Activity. Tashkent; Government of Uzbekistan. 2012. Presidential Decree No. 328 on Measures for Further Improvement of the Business Environment and to Provide Greater Freedom of Entrepreneurship. Tashkent). https://mineconomy.uz/files/prilojenie_1.pdf.

³ https://mineconomy.uz/files/prilojenie_1.pdf.

⁴ <https://regulation.gov.uz/ru/document/639>.

⁵ Draft President Resolution "On measures to further stimulate the expansion of small businesses and private entrepreneurship in order to create competitive companies." See at: <https://regulation.gov.uz/uz/document/639> (accessed 26 September 2018).

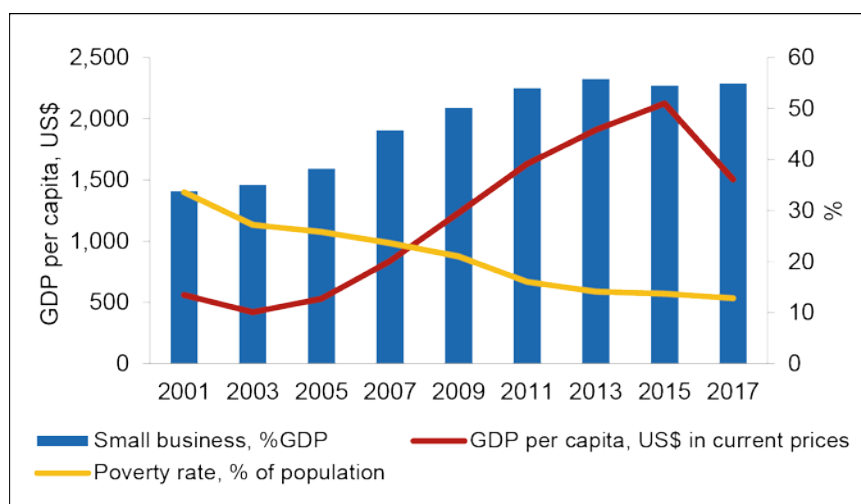
- ✓ small enterprises with an average annual number of employees of not more than 100;
- ✓ medium-sized enterprises with an average annual number of employees of not more than 250.

The criteria for defining small business and private entrepreneurship do not entirely match international practice. In international practice, the definition of SME, aside from the criterion staff size, includes annual turnover/ sales or industry specific. Preservation of the industry-specific differences is necessary subject to certain tax (e.g., stimulation of individual industries) or statistical (e.g., comparison of labor productivity) tasks set by the state.

Using SME definition for tax purposes in Uzbekistan hinders jobs creation and growth. In addition, the definition of SMEs by number of employees has become difficult due to part-time work, casual work or temporary work becoming more widely used by employers.

Figure 1 illustrates the poverty rate decrease from 33.6 % in 2001 to 12.3 % in 2016, which in many ways can be attributed to a rise of small and medium-size businesses, albeit, in the informal sector.

Figure 1: SMEs Contribution to Poverty Reduction in Uzbekistan



Source: State Statistics Committee of the Republic of Uzbekistan.

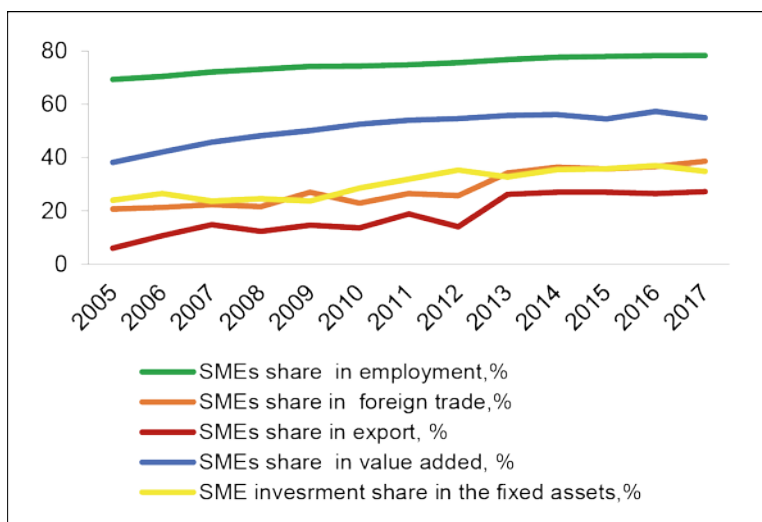
The importance of SMEs in the economy is determined by four commonly used indicators: (i) the number of enterprises; (ii) employment; (iii) domestic output; and (iv) exports.⁶

Uzbekistan SMEs have contributed significantly to job creation and economic well-being since 2000. This trend has further accelerated since 2010, following a new set of presidential decrees and government programs initiated after the financial crisis.

⁶ P. Vandenberg, P. Chantapacdepong, N. Yoshino, "SMEs in Developing Asia: New Approaches to Overcoming Market Failures", ADBI.

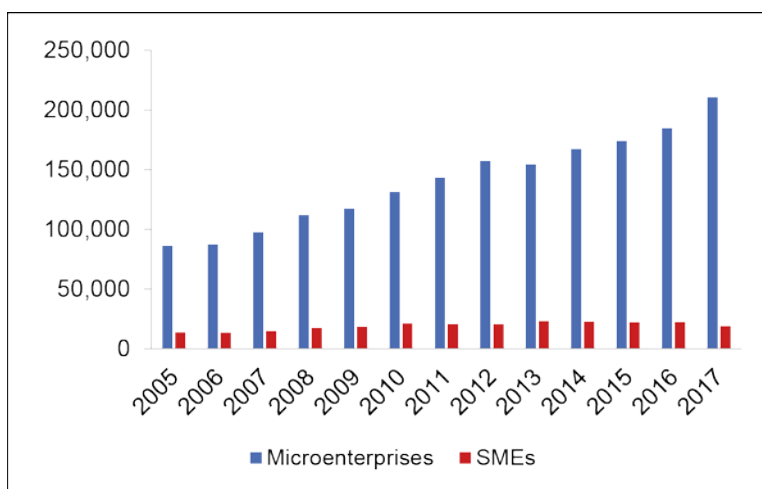
SMEs' contribution to GDP increased to 54.9% in 2017 from 38.2% in 2005, which indicates that SMEs play a significant role in the country's economy. The value added by SMEs in total value added by enterprises rose to SUM120,351.6 billion compared with SUM5,437 billion in 2005. Figure 2. The added value of SMEs in Uzbekistan is less than half than in emerging countries (\$113,000 vs. \$394,000).⁷

Figure 2: SME Sector in Uzbekistan



Source: State Statistics Committee of the Republic of Uzbekistan.

Figure 3: Number of SMEs without Farmers and Dehkan Farms⁸



Source: State Statistics Committee of the Republic of Uzbekistan.

⁷ Uzbekistan <http://uzbekistan2035.uz/uzbekistan-2035/>.

⁸ A dehkan farm is a family small-scale farming enterprise engaged in the production and sale of agricultural products on the basis of the personal labor of family members on the household plot granted to the head of the family for life-time lease. Law on dehkan farm <http://www.lex.uz/acts/6634>.

The share of SMEs' exports in total country export performance increased to 27.2% in 2017 from 6% in 2005. SMEs' imports accounted for 50% of total imports in 2017. The SMEs' share in investment rose from 13.4% in 2001 to 34.8% in 2017. While value figures show positive net exports, the vast majority of SMEs are import oriented (particularly in trade and manufacturing sectors). Figure 2.

As of January 1, 2018, over 229,600 small business entities are registered in Uzbekistan, which constitutes 90% of all registered and functioning legal entities. Taking into account the shadow economy, the number of SMEs may be higher: the share of the shadow economy is estimated to be 50%, which reduces reported GDP by up to \$16 billion–\$17 billion.⁹

Within the SME sector, micro-enterprises make up 91.8% of all registered businesses, and small firms around 8.2% (18,900 units). Between 2010 and 2018, the total number of SME increased by 51% (see Figure 3). The SME development is predominately driven by micro-enterprises. Micro-enterprises employ eight people, on average, and represent an important share of the working population.

A low growth of small enterprises during these years may indicate that SMEs face difficulties in terms of an unfavorable business environment and access to finance. In addition, a significant share of small businesses works under a simplified taxation scheme, which on the one hand facilitates business, but on the other discourages business growth (due to limits on the number of workers).

Uzbekistan has a high rate of unemployment – around 7% in 2017 with an estimated one in ten people aged 20 to 24 not looking for a job because they do not believe they can find one. Unemployment rates for youth are about 18%, twice the overall rate.¹⁰ Low employment prospects have led to high levels of outmigration, with one in five males becoming an international migrant and this rate is even higher among young men.

According to official data, SMEs are the biggest source of employment, as they now provide 78% of jobs, compared to 50% in 2000. Nearly three out of every four employed persons in Uzbekistan work in small businesses and more than 60% of those jobs are in rural areas.¹¹ More than 62% of those employed are individual entrepreneurs, and small businesses and micro firms employ only about 16%. Uzbek migrants are included into sectoral employment data, mainly into the employment in agriculture and other sectors. Most of the migrants (around 70–75%) come from rural areas, and, in some cases, they are counted as employed in the agricultural sector and the migrants from urban areas are accounted in the statistics on “employment in other sectors.”

However, official statistics do not provide all necessary data to provide a more or less credible picture. Therefore, the official data should be assessed critically. For example, a number of individual entrepreneurs are not available, and the State Statistics Committee only collected data on SMEs with legal entity status. Analysis of the open sources did not reveal any data on the number of individual entrepreneurs.

Uzbekistan has a low density of 7.1 SMEs per 1,000 people, lagging behind developed countries 44 SMEs per 1,000 people and developing countries 17 SME per 1,000 people.¹²

⁹ Development Strategy Framework of the Republic of Uzbekistan by 2035.

¹⁰ World Bank Uzbekistan Country Private Sector Diagnostic.

¹¹ <https://www.silkroadstudies.org/resources/pdf/SilkRoadPapers/2018-04-Tsereteli-Uzbekistan.pdf>.

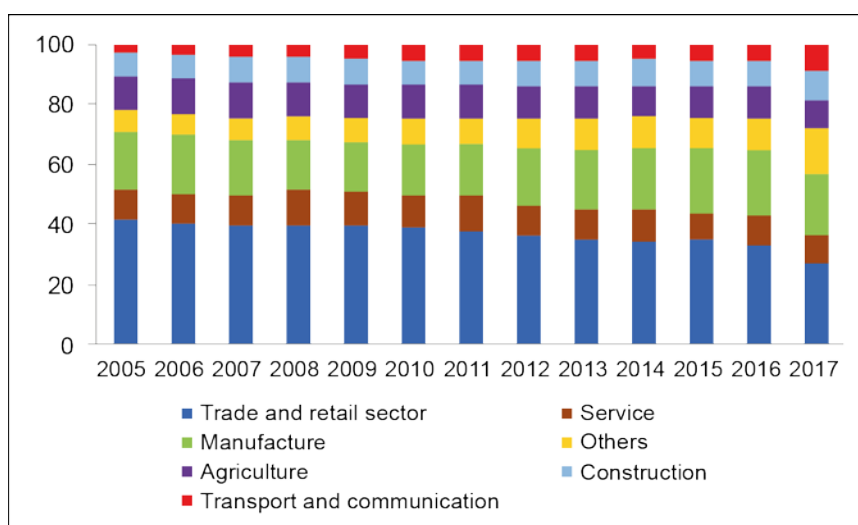
¹² Development Strategy Framework of the Republic of Uzbekistan by 2035.

Figure 4 illustrates that approximately 28% of SMEs are engaged in retail and wholesale trade, followed by manufacturing (20.3%), construction (11%) and transport (9%) and 9% in agriculture. The modest figure of 9% in agriculture is rather controversial, since about 80% of the agricultural sector’s contribution to GDP is accounted for by small-scale entrepreneurship, suggesting that a significant portion of 160,000 collective and dehqan farms are potential small and micro-finance borrowers. Considering individual, small and micro-enterprises and small-scale agriculture the total number of potential borrowers is in the range of 800,000. With fewer than 300,000 borrowers currently served, there is clearly an enormous unmet demand for small and micro-credit financing. The sectoral analysis of small business demonstrates that a long-term trend of reducing SMEs in trade and agriculture is associated with a poor regulatory environment and the impact of economic factors. One of such factors is the ongoing government’s monopoly in the agricultural sector. Since there is still no private ownership of land, so that farmers cannot own agricultural land, nor are they entitled to make their own choices of what to grow, there are not many SMEs involved in this sector. However, if the agricultural sector indeed liberalizes and diversifies, shifting from cotton and wheat monocultures to more diverse agricultural produce, coupled with legal guarantees for private ownership for land, the number of SMEs and value chains in agriculture will soar significantly.

There is an increase in the share of large retail chains, which displace small businesses in retail trade. On the other hand, government regulation gradually limits the list of activities for individual entrepreneurship to conduct trade in construction goods. The share of SMEs in construction has increased significantly in recent years due to the implementation of the State Program of Affordable Housing.

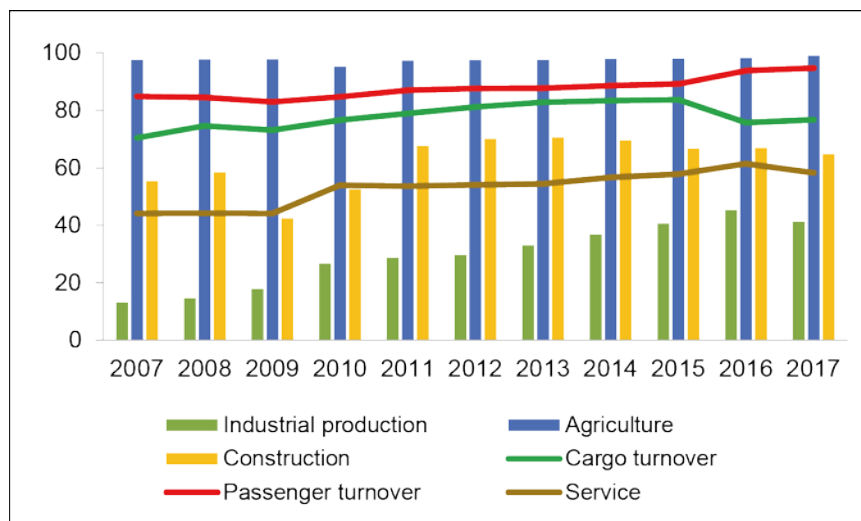
SMEs are also active in the services sector (retail and catering). In foreign trade, the small business share was below 10% in 2007–08, and currently only 4.7% of small businesses participate in foreign trade activities.

Figure 4: SME Distribution by Sector
(%)



Source: State Statistics Committee of the Republic of Uzbekistan.

Figure 5: SME Share in Domestic Output (%)



Source: State Statistics Committee of the Republic of Uzbekistan.

1.2 SME Sources of Finance

There is a limited choice for SMEs in terms of variety of sources of finance. Sources of SMEs' finance in Uzbekistan are classified as informal and formal. Informal sources of financing include personal savings, friends, relatives, business partners and unregistered moneylenders. Primary sources of finance are self-financing, such as the profit of the enterprise, reserve financing and capital increase by the founders' contributions.

Evidence from enterprise-level surveys suggests there is more room for growth to extend financial services to smaller enterprises. According to a World Bank/International Finance Corporation Survey conducted in Uzbekistan in 2018,¹³ 64% of surveyed firms in Uzbekistan reported using bank financing and 8% – having family and friends' support. Nevertheless, a large proportion of Uzbek SMEs finance their growth internally – 64% report self-financing. See Figure 6.

Among micro and small businesses there are low levels of financial leveraging: Almost two thirds of businesses do not attract financing. Banks constitute almost exclusively the only formal source of financing in Uzbekistan. The majority of respondents who participated in the in-depth interview claimed that they would register their informal business in order to take a bank loan, which provides the opportunity to develop this segment.

¹³ Quantitative survey to identify the use and experience of registered small enterprises and individual entrepreneurs with financial services and test their awareness and use of digital financial services + qualitative survey through focus groups to capture the same for unregistered entrepreneurs. Where: four urban and peri-urban areas of Tashkent, Namangan, Samarkand, and Karshi cities. Total sample: 1,026 respondents for the quantitative survey and 16 for the qualitative survey.

Figure 6: Source of Finance

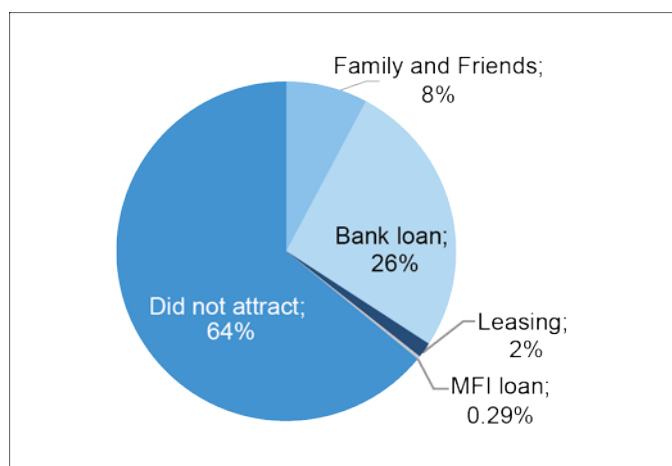
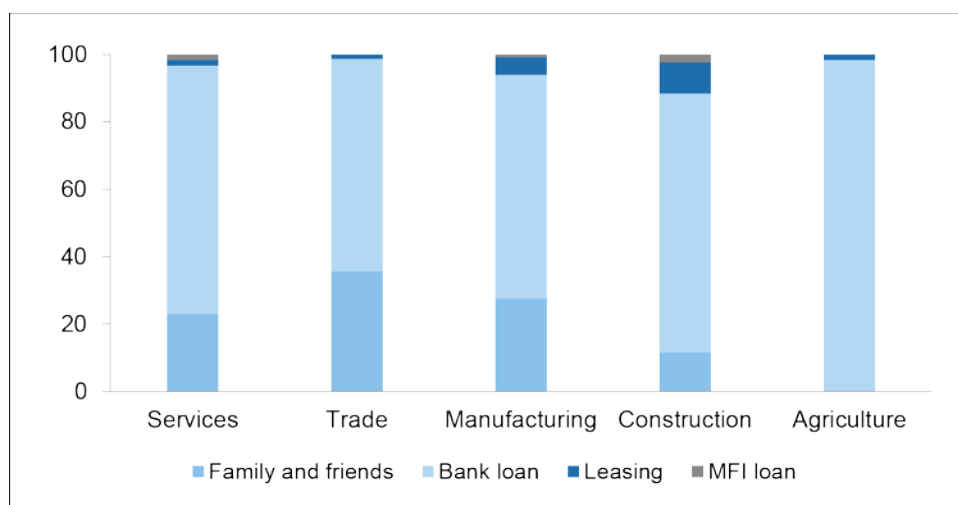


Figure 7: Source of Financing by Sector (%)

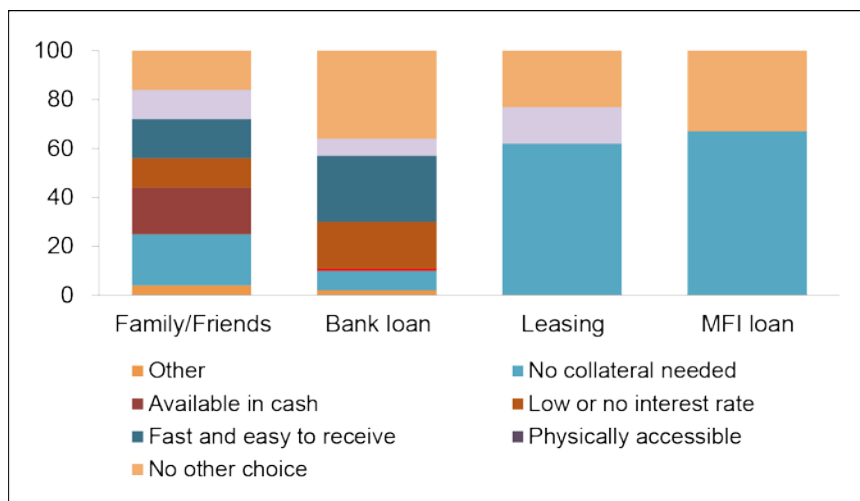


MFI = _____.

Source: 2018 IFC Demand study Micro and Small Business Finance & Digital Financial services in Uzbekistan.

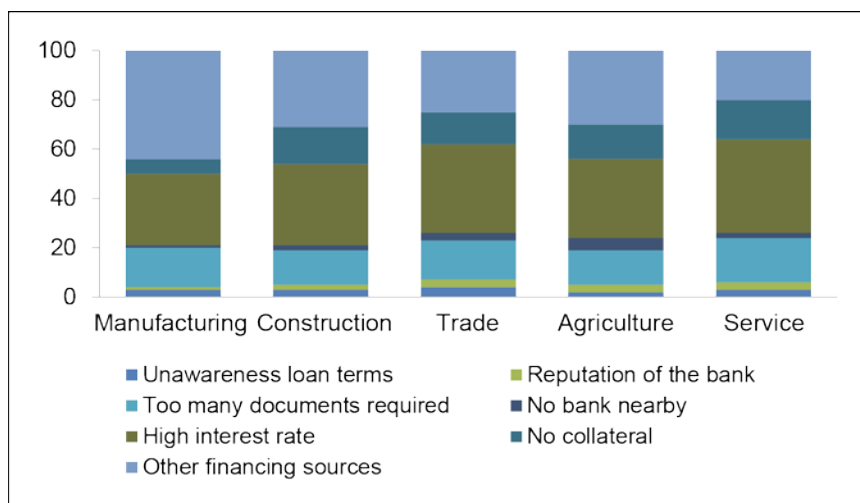
Twenty-one percent of the respondents stated that the biggest reason for choosing family and friends was that no collateral was needed and the money was available in cash (19% of total respondents), 37% of the respondents noted, that they had no other choice than to go to the banks. Respondents noted that only banks can provide the requested amounts. Sixty-seven percent of the respondents used microfinance institutions (MFIs) services because they are fast and easy to deal with, and 33% of the respondents noted there is no choice except an MFI loan. For trade and services, the most important item that was quoted was availability in cash. For agriculture producers, no collateral required and low interest rates are the most important (government-supported programs available). See Figure 7.

Figure 8: Reason for Choosing Source of Financing (%)



Source: 2018 IFC Demand study Micro and Small Business Finance & Digital Financial services in Uzbekistan.

Figure 9: Reason for Not Applying for a Loan from a Financial Institution by Sector (%)



Source: 2018 IFC Demand study Micro and Small Business Finance & Digital Financial services in Uzbekistan.

SME finance is principally performed by two types of financial institutions being channeled through 28 commercial banks, including the specialized Mikrocreditbank and 37 microcredit organizations.

The banking sector’s limited capacity for financial intermediation remains a key barrier to the development of the private sector, and in particular to SMEs. Banking continues to be dominated by a handful of state-owned banks (86% of the assets), and lacks competition and transparency. Government-controlled banks still support the government’s economic priorities through subsidized loans offered to specific sectors and investment purposes. Total bank loans as the percentage of GDP increased from 26.4% in 2016 to 44.4% in 2017. Overall, more than 75% of total sector loans account

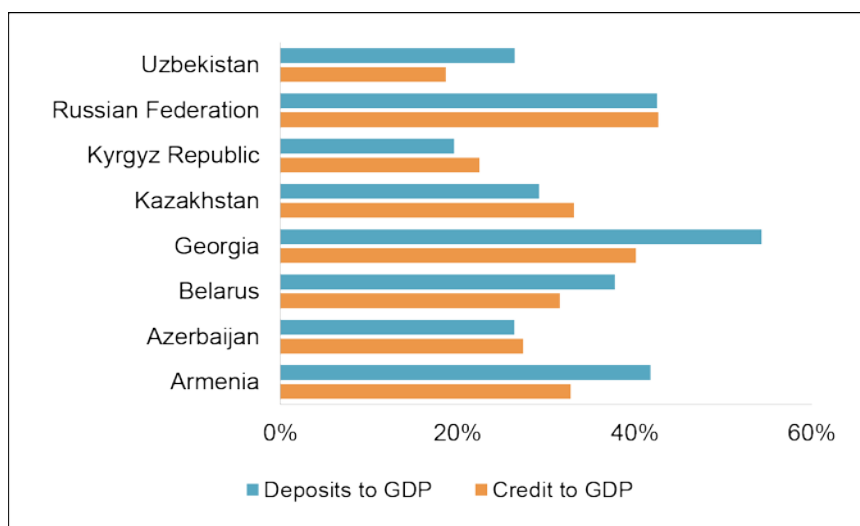
to state-owned banks, focusing on state-owned large corporates and strategically important industries. These banks are controlled and regulated by the state, mainly through the Ministry of Finance, the Central Bank of Uzbekistan (CBU) and the Uzbekistan Fund for Reconstruction and Development (UFRD).

The penetration of banking services is gradually increasing due to the development of infrastructure, but a substantial part of the population is still not provided with basic banking products.

The low level of penetration of banking services in general hinders the development of the banking sector due to the lack of sources of cheap liabilities – the deposits of the population. Currently, only SUM0.55 of deposits of individuals fall on SUM1 of cash.¹⁴ Although there are 36 branch outlets per 100,000 adults,¹⁵ that exceeds the Commonwealth of Independent States (CIS) countries; however, as a ratio to GDP, the level of deposits in Uzbekistan is half that of the Russian Federation or Georgia.

Figure 10 shows that Uzbekistan's financial depth indicators have not improved in 2004–2016, and are very low compared to countries at similar levels of development. Credit to GDP ratio remained intact in 2004–2016. Deposits slowly increased over the same period, and accounted for 22.1% of GDP in 2016 compared to 10.4% in 2004. By comparison with other countries in the region, the level of deposit penetration in Uzbekistan is low.

Figure 10: Financial Depth – Comparison 2016



Source: IMF Financial Access Survey 2017.

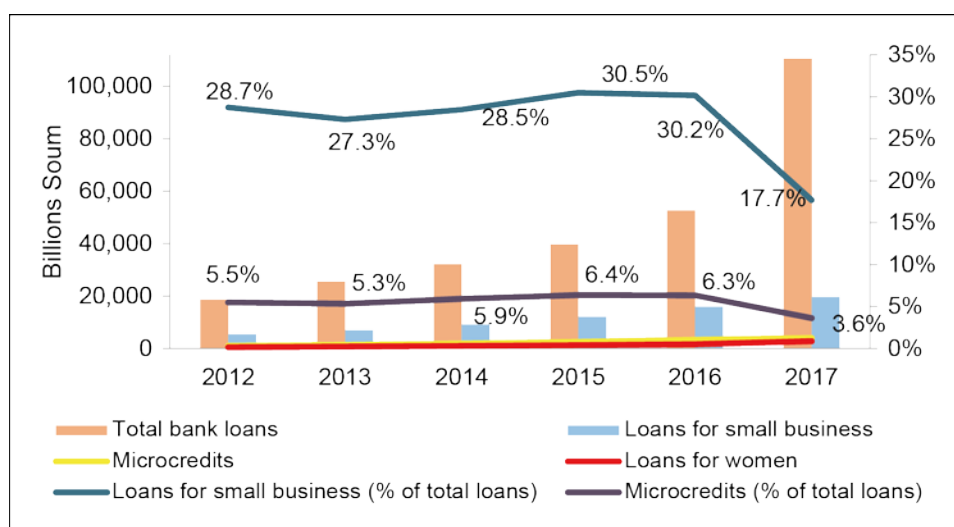
Small business loans and microcredits as a percentage of GDP slightly declined from 8.0% to 7.9% and from 1.7% to 1.6%, respectively. The decline was related to the reduction of shares of the loans for small business and microcredits in total bank loans. The share of small businesses in the loan portfolio is growing due to a decline in the corporate segment and currently accounts for 18% (see Figure 11). The share of small businesses in the loan portfolio is growing due to a decline in the corporate segment and currently accounts for 18%.

¹⁴ Development Strategy Framework of the Republic of Uzbekistan by 2035.

¹⁵ IMF Financial Access Survey 2017. See: <http://data.imf.org/?sk=E5DCAB7E-A5CA-4892-A6EA-598B5463A34C&slid=1460043522778>

The shares of small business loans and microcredits in total bank lending declined in 2017 from 30.2% to 17.7% and from 6.3% to 3.6%, respectively. See Table 2. The decrease was related to a sharp increase in the sum value of loans to large state companies because of revaluation, and the callback of loan applications by small businesses after the sum devaluation in September 2017, due to their business plans having been based on half the FX rate.

Figure 11: SME Finance



Source: Central Bank of Uzbekistan.

Table 2: SME Bank Lending Portfolio

	2012	2013	2014	2015	2016	2017
Total bank loans, SUM billion	18,601	25,562	32,161	39,718	52,611	110,572
Loans for small business, SUM billion	5,346	6,982	9,158	12,113	15,870	19,565
Microcredits, SUM billion	1,023	1,366	1,907	2,527	3,326	4,015
Loans for women, SUM billion	492	698	960	1,255	1,647	2,782
Loans for small business (% of total loans)	28.7%	27.3%	28.5%	30.5%	30.2%	17.7%
Microcredits (% of total loans)	5.5%	5.3%	5.9%	6.4%	6.3%	3.6%

Source: Central Bank of Uzbekistan.

Despite total loan portfolios soaring between 2016 and 2017 by more than double, the increase in the amount of loans for small business and microcredits for that period was less than moderate. Microcredits constitute a significant portion of loans (about 20%), which evidences the impossibility of receiving traditional bank loans.

The hike in the growth rates of small business loans and microcredits was in 2014 at 39.6% and 31.2%, respectively. Then the growth rates plummeted and fell to the levels of 20.7% and 23.3% in 2017 due to the large state banks' increased corporate lending portfolios over that period (see Table 3).

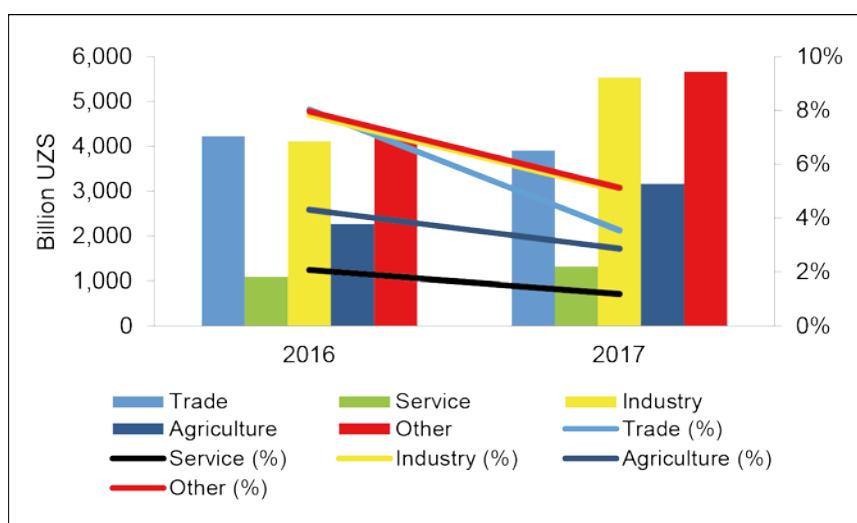
Table 3: Profile of Small Business and Microfinance Lending by the Banks

Small Business and Microfinance Loans as % of GDP	2012	2013	2014	2015	2016	2017
Microfinance (up to \$20,000)	1.1%	1.1%	1.3%	1.5%	1.7%	1.6%
Small business	5.6%	5.9%	6.3%	7.1%	8.0%	7.9%
Small business loans in total loans (%)	2012	2013	2014	2015	2016	2017
Microfinance (up to \$20,000)	5.5%	5.3%	5.9%	6.4%	6.3%	3.6%
Small business	28.7%	27.3%	28.5%	30.5%	30.2%	17.7%
Growth rates of small business and microfinance loans (%)	2012	2013	2014	2015	2016	2017
Microfinance (up to \$20,000)	n/a	33.5%	39.6%	32.5%	31.6%	20.7%
Small business	n/a	30.6%	31.2%	32.3%	31.0%	23.3%
Loans for small business and microfinance (amount), SUM billion	2012	2013	2014	2015	2016	2017
Microfinance (up to \$20,000)	1,023	1,366	1,907	2,527	3,326	4,015
Small business	5,346	6,982	9,158	12,113	15,870	19,565

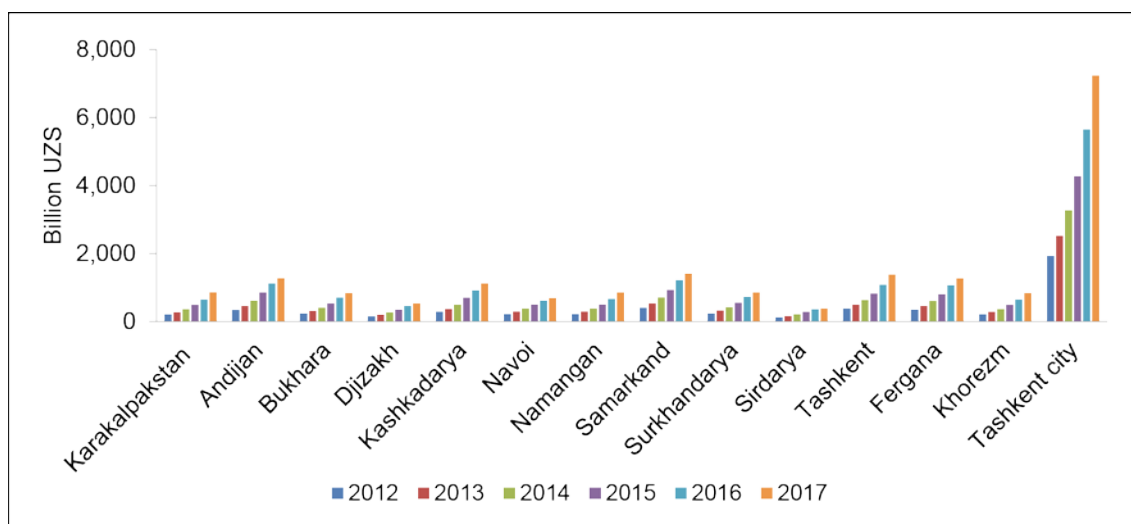
Source: Central Bank of Uzbekistan.

Figure 12 shows that there was almost no change in the sectoral structure of small business loans over 2016–2017. While the share of industry and agriculture increased from 26% to 28% and from 14% to 16%, respectively, the share of trade fell from 27% to 20% and small business loans to the services sector stayed at 7% of total lending to small business.

As Figure 13 illustrates there is a disproportionate regional distribution of SME loans: small business lending in Tashkent city kept its leading position over 2012–2017 due to most small businesses being concentrated in the capital. Following Tashkent city, the significant volumes of small business loans are continued to be disbursed by the Samarkand, Tashkent, Andijan and Fergana regions.

Figure 12: SME Lending by Sectors

Source: Central Bank of Uzbekistan.

Figure 13: Small Business and Microfinance Lending Distribution by Regions

Source: Central Bank of Uzbekistan.

Out of \$13.4 billion in bank loans only \$0.89 billion were allocated in the form of microloans, covering less than one third of an existing demand from micro and small businesses. Based on the survey, the potential market for micro and small business finance can be estimated at \$5.5 billion (see Table 9). This is consistent with the IFC-McKinsey MSME survey, estimating the current MSME financing gap of Uzbekistan at \$11.8 billion (see Table 4).

Table 4: Demand Assessment

	#	% Bankable	Net Demand #	Estimated Average Loan Size (\$)	Estimated Net Demand (\$)
Registered operating SMEs	229,600	39%	89,544	29,086	2,604,500,219
Farm enterprises*	132,356	na	na	na	na
Dehkan farms**	4,769,000	30%	1,430,700	2,000	2,861,400,000
Unregistered individual entrepreneurs minus dehkan farms***	531,000	10%	53,100	1,000	53,100,000
Total					5,519,000,219

Source: 2018 IFC Demand Study Micro and Small Business Finance & Digital Financial Services in Uzbekistan.

Table 5: MSME Demand for Finance in Uzbekistan

Potential Demand for Finance	Micro, \$ million		SME, \$ million		MSME, \$ million	
Current Supply	85	5%	1 647	14%	1 732	13%
Finance Gap	1,631	95%	10,159	86%	11,790	87%
Total	1,716	13%	11,806	87%	13,522	100%

Source: MSME Finance Gap Report 2017.

Microkreditbank. Mikrocreditbank was established in 2006 by a special Presidential Decree¹⁶ with the purpose of “further expanding the provision of financial resources for the development of small business, private entrepreneurship and farming, the creation of new jobs by spurring individual labor activity, family business and home-based business, and the provision of access to microfinance services to broad strata of the population, especially in rural areas.” Due to its large network (85 branches and 110 point of services), the bank was able to increase the total number of customers to 341,607 in 2017.

A new regulation issued in 2018¹⁷ provides for extending Mikrocreditbank’s tax exemption until 1 January 2023 (together with Halq Bank), increasing the Mikrocreditbank’s charter capital in 2018–2019 by SUM600 billion (\$73 million), as well as mandating a number of other exemptions and privileges—for example, free advertisement of Mikrocreditbank’s and Halq Bank’s socially oriented financial products by mass media and 50% discount on the advertisement of commercial products.

Interest rates are very competitive as the bank is mandated by the government to provide preferential loans to SMEs. This has resulted in interest rates averaging 5% per annum, which are well below the inflation rate of 14.4% in 2017, meaning that the bank lends not only below costs but also in negative real terms (see Table 6).

The losses are assumed eventually by state because the government is an ultimate beneficial owner (State Assets Management Agency). By the end of 2017 the number of outstanding loans amounted to SUM1.3 trillion (\$180 million) of which only SUM 313.8 billion was concessional (microfinance) lending, demonstrating that despite specialization, the vast majority of business is not directed at SMEs.

Mikrocreditbank takes various types of collateral, but does not include future cash-flow considerations. The bank offers a narrow range of credit products to SMEs like other commercial banks. Equity finance, factoring, and longer-tenure loans are not offered.

Due to the bank’s collateral requirements, SMEs may be denied credit despite having sufficient cash flow or purchase orders, or may be limited only to short-term credit facilities and not the type of financial products they need.

Microcredit organizations. *Microcredit organizations are regulated mainly by two laws, such as the Law “On Micro-finance” and the Law on “On Micro-credit Organizations”, which were adopted in September 2006.* The framework law “On microfinance”¹⁸ provides key definitions and outlines basic rules for the provision of microfinance services. In particular, it allows the provision of microfinance services to both banks and non-banks: the latter include microcredit organizations (MCOs) and pawnshops.¹⁹

¹⁶ Decree of the President of the Republic of Uzbekistan No. UP-3750 dated 5 May 2006 “On Establishment of the Joint-Stock Commercial Bank ‘Mikrocreditbank’.”

¹⁷ Resolution of the President the Republic of Uzbekistan No. PP-3694 dated 4 May 2018 “On Measures for Improving the Financial Condition and Further Improvement of the Activity of the Joint-Stock Commercial People’s Bank of the Republic of Uzbekistan and the Joint-Stock Commercial Bank ‘Mikrocreditbank’.”

¹⁸ Law of the Republic of Uzbekistan “On Microfinance” No. ZRU-50 dated 25 August 2006.

¹⁹ The law also mentions “other credit organizations”, but currently there are no entities with this status in Uzbekistan.

Table 6: Mikrokreditbank's Programs

Program	Target Group	Size (min. wages)	Term	Other
Mikrokreditbank: Basic program	SME Private business Farmers Individuals Family business Home-based business	500 for microcredit 2,000 for microleasing	24 months	Interest rates based on bank policy
Mikrokreditbank: New jobs creation and low income	Unregistered entrepreneurs Micro-firms Dehkans Low income School graduates	50 for unregistered 100 for microfirms, low-income, graduates 500 for expansion 15 for group loans (to each member)	24 months for all except group loans 1 year for group loans	–
Mikrokreditbank own offering 1: Concessional MSME	MSME start-up	200	18 months	Interest rate 3%
Mikrokreditbank own offering 2: MSME for expansion and working capital	MSME	500	18 months	Interest rate 50% of CBU refinancing rate
Mikrokreditbank own offering 3: Microleasing	MSME	2,000	3 years	Interest rate 5%

In 2017, there were 76 non-banking financial institutions including 30 micro credit organizations (MCOs) and 46 pawnshops operating in the country.²⁰ Microcredit organizations cannot take deposits, and they are allowed to offer three microfinance products namely, microcredit, microloan and microleasing. The differences between these types of services relate to the size of the products and their purpose, as well as microfinance product recipients and a few other conditions; they are summarized in Table 7.

A recent World Bank study of opportunities for enterprise competitiveness in Uzbekistan suggests that smaller enterprises and unbanked markets are finding value from microcredit institution services.

Table 7: Definition of Microfinance Services in Uzbekistan

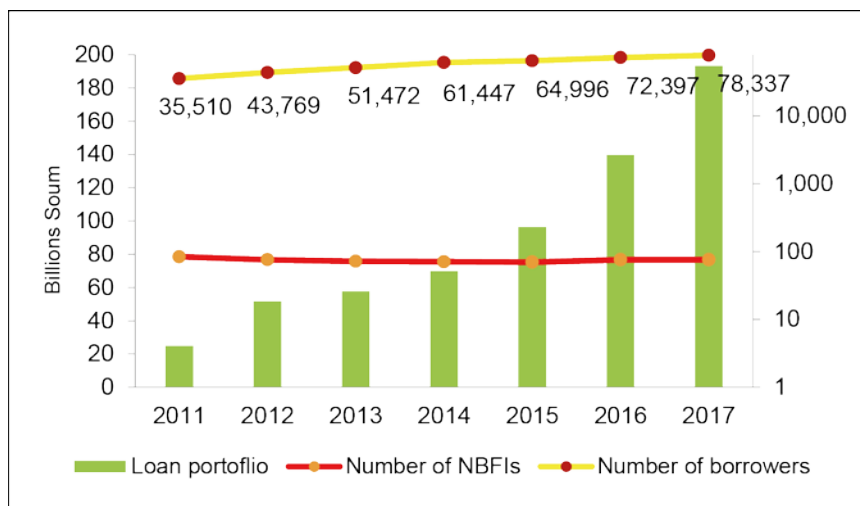
	Microloan	Microcredit	Microleasing
Size	Up to 100 minimum wages ^a (approx. \$3,000)	Up to 1,000 minimum wages (approx. \$22,000)	Up to 2,000 minimum wages (approx. \$44,000)
Purpose	Not defined	Entrepreneurial activity	Entrepreneurial activity
Recipients	Natural persons	Registered businesses/ entrepreneurs	Registered businesses/ entrepreneurs
Conditions	Maturity Returnability May be interest-free	Maturity Returnability Interest-bearing	Maturity Returnability Interest-bearing

From 15 July 2018, the minimum wage size is established at SUM184,300 (approx. \$22).

²⁰ <http://cbu.uz/uzc/kreditnye-organizatsii/mikrokreditnye-organizatsii/>.

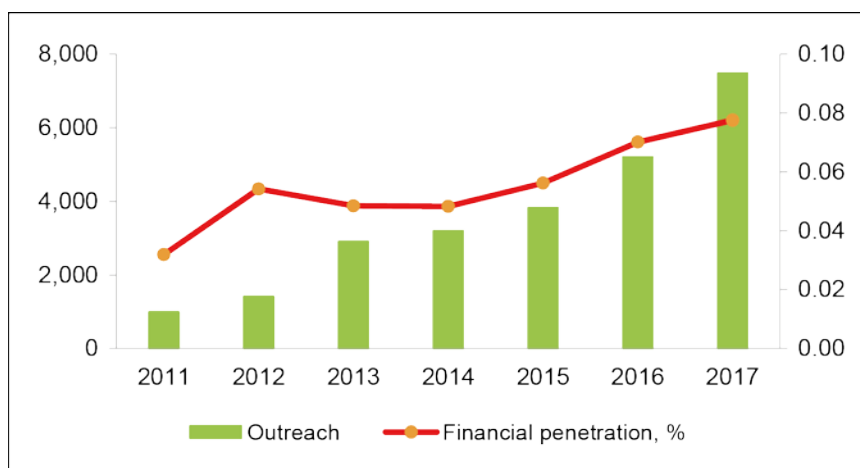
Demand-side analysis of SMEs in Uzbekistan likewise points to limitations in their eligibility and appetite for bank services. A lack of real-estate collateral, limited financial capacity, and lack of credit history constrain these firms' access to formal bank credit, but the need for finance is currently addressed by microcredit institutions.

Figure 14: Non-Banking Financial Institution Lending²¹



Source: Central bank of Uzbekistan.

Figure 15: Microfinance Outreach²² and Financial Penetration²³



Source: Central bank of Uzbekistan.

²¹ Non-banking financial institutions include microcredit organizations and pawnshops registered by the Central Bank of Uzbekistan.

²² In this context, microfinance outreach is considered as breadth of outreach. The breadth of outreach is captured by two variables: number of clients reached and number of loans provided.

²³ MFI penetration: number of borrowers served in a country with the entire population and with a share of the population defined as “poor.”

Commercial banks provide microcredit at concessional rates but require high rates of collateral and provide only noncash credit. Borrower requirements to access bank microcredit seem overly burdensome for the target borrowers, who may not be able to meet these requirements (provide financial statements, a business plan, documented proof of repayment capacity, formal collateral, notarized confirmation of agreement, etc.). Commercial microfinance is not well developed either through banks or MCOs. All microfinance activities, both concessional and commercial, are strictly regulated.

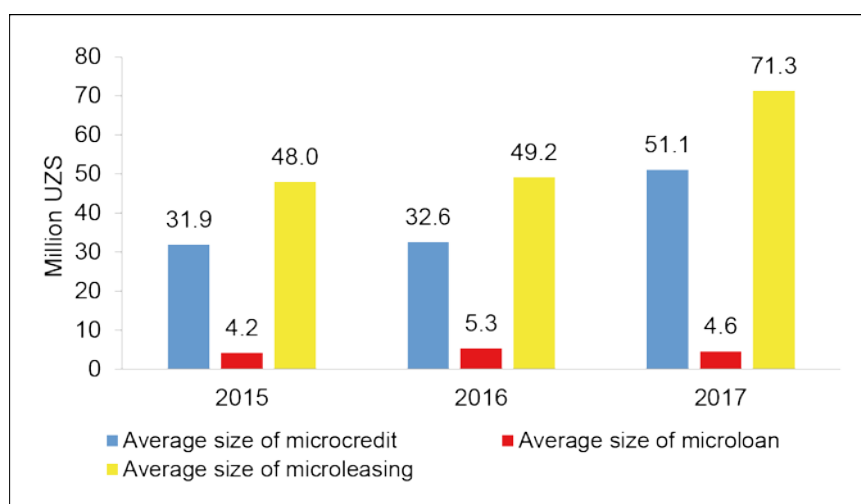
Although MCOs offer simplified credit in cash and without collateral, they have low financial capacity and small loans. There is a gap between these two providers, and hence the financial needs of businesses (small and medium-sized) and entrepreneurs are not currently accommodated.

The microfinance market consists of 78,337 active borrowers. Following the CBU requirement to increase the capital up to SUM2 billion (\$250,000), the MCOs were able to attract more capital financing and doubled their loan portfolio over 2015–2017. The outreach of microcredit organizations has shown a positive tendency since 2012 as well as financial penetration increasing from 5% to 8% over 2012–2017 (see Figure 15).

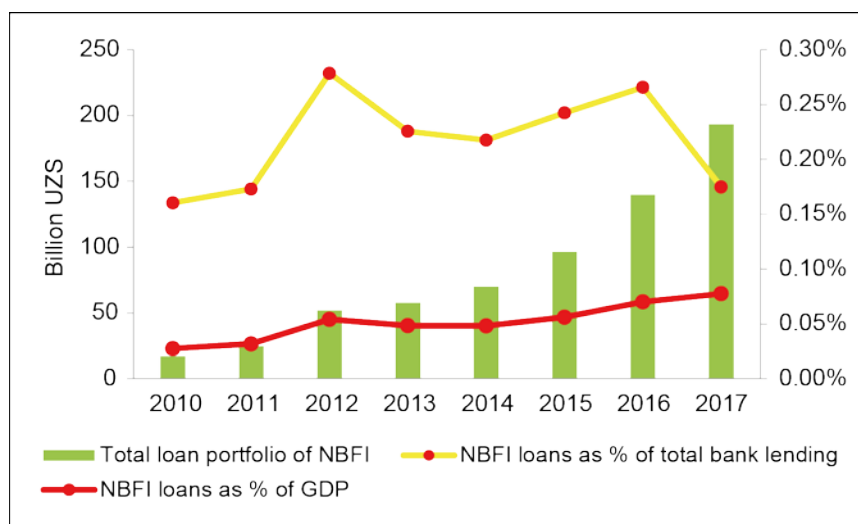
The average size of microloans reduced from SUM5.3 to SUM4.5 million (equivalent to \$662–\$562) due to the growth of outreach in rural areas, while the average size of microcredits and microleasing increased by around 1.5 times from 2016 to 2017, which resulted in the increase of MCOs' capital and encouraged interest from small businesses (see Figure 16).

MCOs are credit-only institutions that are not allowed to mobilize deposits or borrow from the general public, thus they pose no systemic risks for the financial system. MCO regulations focus heavily on prudential requirements, which seems excessive for these institutions. Similarly to banks, borrower requirements to access MCO microfinance products seem overly burdensome (in particular, collateral requirements similar to bank loans). Like banks, MCOs are limited in issuing cash-flow-based and uncollateralized microcredits—the features that are key for traditional microlending. It is an unlevel playing field—MCOs do not enjoy any of the benefits accorded to banks engaged in the provision of microfinance services (such as access to government funding and tax exemptions on microfinance activities with a social focus).

Figure 16: Average Size of Microfinance Services



Source: Central bank of Uzbekistan.

Figure 17: Nonbanking Finance Institution Loans in Bank Lending

Source: Central bank of Uzbekistan.

The government may want to consider developing a mechanism of linking MCOs to banks as MCOs could play a complementary role to that of banks in terms of reaching those types of customers that may not be accessible to banks. Even though MCOs are technically allowed to receive loans from banks for further on-lending, strict collateral requirements limit MCO borrowing from banks, and thus an alternative mechanism may be necessary.

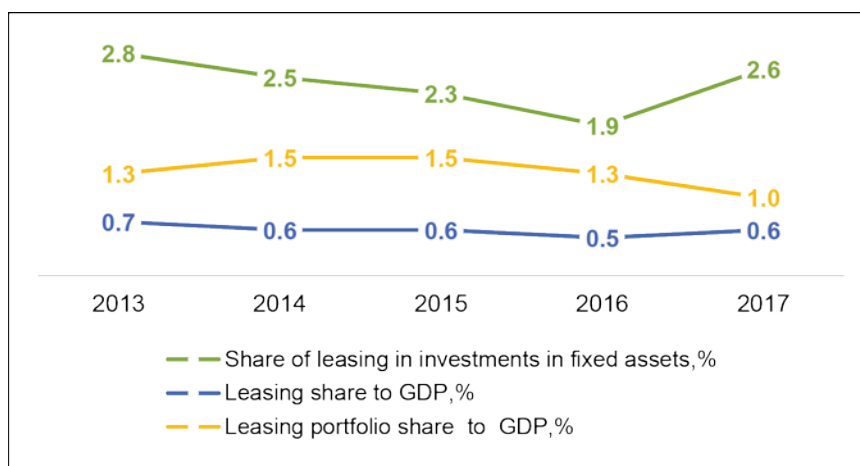
Leasing. *Leasing is another source of SME finance. Leasing provides a viable substitute for loans to finance equipment. Leasing costs more than bank lending but fewer guarantees are required from the borrower.*

As of January 1 2018, there are 126 officially registered lessors of which 104 are leasing companies, the majority of which are state owned and 24 are commercial banks. The largest players in the Uzbek leasing market are state-owned companies. including: “Uzagroleasing,” the largest leasing company focusing on agricultural equipment, “Uzmelyomashleasing” company leases irrigation equipment, and “Uzavtosanoat” involved in leasing commercial vehicles.

The clientele for leasing in Uzbekistan includes a growing array of service sectors including: large construction companies (which are engaged in building construction, power plants, and road development, for example); transport companies; chemical companies; medical service providers; manufacturers; and traders.

The leasing companies primarily focused on providing high-tech equipment as part of the state program implementation of modernization of state-owned industrial enterprises. As Table 8 illustrates, 78.2% of the leasing portfolio belongs to the leasing companies, the volume of leasing transactions in 2017 comprised SUM2.68 trillion (\$337.5 million).

However, the leasing share to GDP during 2013–2017 amounted to less than 1%, that is less than half the median leasing volume of countries in the same income range as Uzbekistan (see Figure 18). In this context, it seems that the sector is underdeveloped for the size of Uzbekistan’s economy.

Figure 18: Leasing Market in Uzbekistan

Source: Association of Lessors of Uzbekistan.

Table 8: Leasing Services Market in 2017

	Leasing Portfolio (billion SUM)	Market Share	Volume of New Leasing Deals (billion SUM)	Market Share
Leasing companies	2,098	78,2%	963.8	62.0%
Commercial banks	585.1	21.8%	589.8	38.0%

Source: Association of Lessors of Uzbekistan.

There is no licensing of leasing services, except for commercial banks that provide leasing services who are licensed as banks. There is no obligatory ratio of leased asset value to collateral value and no regulation on interest rates. Lease objects are exempt from property tax and lease payments are exempt from value-added tax (VAT); small enterprises had a holiday from lease profit tax until January 2017. Leasing contracts must be greater than 12 months' duration.

Although the regulation of leasing companies is fairly light, banks face some constraints in undertaking leasing operations. The Central bank of Uzbekistan limits leasing activity to no more than 25% of banks' Tier-1 capital, making leasing relatively more costly for banks. Many banks split the activity into a child-company to avoid this limitation. Leasing companies owned by banks benefit from easier access to low-cost funding.

At the same time, the leasing market faces some growing pains that require further development, and some improvements in the legal framework would help. Like microcredit organizations, leasing companies often struggle to find long-term funding and there is a disproportional regional distribution of leasing services: compare the share of Tashkent city of 30% with regions that have from 3% to 9%.

In addition, there is a lack of knowledge among many potential customers about how leasing works and its potential benefits. One leasing company has conducted a market analysis and estimates that 80% of the potential market does not understand the product (the same company derives more than a third of its customers through deals with suppliers). Also, clear and comprehensive rules for priority over property are needed.

In order to further promote growth of leasing, it is advised to consider building up a secondary market for leased objects and amending the Leasing Law to allow for secondary leases. Adoption of the law will provide a major boost to the industry. The regulator can support leasing further by relaxing regulations defining eligible lease objects to allow for greater variety of equipment and machinery.

Foreign investments and external assistance programs. International Financial Institutions (IFIs) such as Asian Development Bank (ADB), European Bank for Reconstruction and Development (EBRD), the World Bank, International Finance Corporation (IFC), and KfW (German bank) have been actively providing credit lines to SMEs' lending as well as more targeted business groups such as women businesses and horticulture farms. Given a high interest rate environment, significant unmet demand for SME finance, and limited government subsidy programs, funding from the international financial institutions is very important in Uzbekistan (see Table 9).

Table 9: International Financial Institutions Credit Lines to SME

	Name of the Project	Donor	Time Frame	Budget
1	Small and Medium Enterprise Development Project	Asian Development Bank (ADB)	2001–2006	\$50 million
2	Small and Micro-finance Development Project	ADB	2003–2010	\$20 million
3	Second Small and Micro-finance Development Project	ADB	2010–2014	\$50 million
4	Small Business and Entrepreneurship Project	ADB	2014–2016	\$50 million
5	Small Business Finance	ADB	2017–2021	\$100 million
6	SME Finance – National Bank of Uzbekistan	European Bank of Reconstruction and Development (EBRD)	2017	\$70 million
7	Regional Small Business Program (RSBP)	EBRD	2018	€1.6 million
8	SME Finance – Ipoteka bank	EBRD	2018	\$25 million
9	SME Finance – Hamkorbank	EBRD	2018	\$20 million
10	SME Finance- Ipak Yuli Bank	EBRD	2018	\$20 million
11	SME Finance- Davr Bank	EBRD	2018	\$5 million
12	MSME Finance – Ipak Yuli Bank	International Finance Corporation	2018	\$15 million

Among multilateral donor institutions, ADB is the most active in financing SMEs through two partner commercial banks—"Hamkorbank" and "Ipak Yuli Bank"—over the past decade. Within the framework of these projects with participating financial institutions (PFIs), funds for SMEs' working capital and fixed assets financing were channeled to developing agriculture, production, and service in rural areas to create jobs. The capacity of PFIs in credit underwriting and analysis also improved so that more than 6,000 micro and small enterprises were trained on financial literacy. Capacity building from these projects suggests that PFIs need to be provided with longer term funds for lending to small businesses, rural outreach, risk management, and continuous enhancement of their entrepreneurial capacity.

Currently, the European Bank of Reconstruction and Development (EBRD) is one of the IFIs actively lending to SMEs through commercial banks. The EBRD currently provides five credit lines for SMEs totaling around \$140 million and large-scale technical assistance to strengthen the institutional capacity of the partner banks on MSME lending.

Their support has added impact by encouraging other private banks to continue lending, expanding their portfolios to benefit businesses. The EBRD is involved in improving the competitiveness of small enterprises in Uzbekistan through its Business Advisory Services and the Enterprise Growth Program. The EBRD jointly with the EU launched the Regional Small Business Program in 2018 aimed at transferring know-how in financing micro, small and medium-sized enterprises (SMEs) throughout Central Asia. This is a platform for SMEs and financial institutions to exchange information and knowledge. The project will equip financial institutions in Uzbekistan with new digital business tools for effective work with small businesses

In addition, international financial institutions also consider providing assistance to improve the wider lending environment by supporting regulatory frameworks and developing overall lending infrastructure, and introducing digital technologies to upgrade and expand lending to small businesses.

1.3 Uzbekistan Regulatory Framework, Tax Regimes and Financial Infrastructure

Uzbekistan is in its second year of a wide-ranging market-oriented program of reforms in accordance with the National Development Strategy, a 5-year action plan for 2017–2021 period. The government is making three fundamental shifts to the economy: from a command-and-control to a market-based economy; from a public sector-dominated to a private sector-driven economy; and from being inward-looking and isolationist to becoming outward-looking and open. These reforms are taking place amid growing external imbalances and a youth bulge that cannot be tackled without more jobs from the private sector.²⁴

This initiative sent a clear signal on priorities: the private sector will be the key driver for economic growth and job creation in Uzbekistan going forward. Currency liberalization, as noted above, has been a major step towards an effective and enabling business environment. On 5 September 2017, the Central Bank of Uzbekistan unified Uzbekistan's exchange rates and President Mirziyoyev promised to maintain freely floating market rates thereafter. The Uzbek sum immediately dropped from the official rate of SUM4,210 per \$1 to SUM8,100 per \$1, so that the black market shank, albeit not entirely. If reforms in this area continue to be rigorously implemented, a market exchange rate will remove the single largest obstacle to the efficient operation of a market-based economy in Uzbekistan. While recent reforms to foreign exchange restrictions and the currency devaluation have substantially improved the business environment for SMEs, a number of challenges exist to expanding or establishing new SMEs.

Taxation. The tax system of Uzbekistan is developing in line with the country's course of reforms. Currently, Uzbekistan is implementing tax policy reform,²⁵ the goal of which is to reduce the tax burden on the economy, and eliminate imbalances in the tax burden between small and large businesses. The Tax Policy Improvement Concept aimed at the radical simplification of our extremely complicated tax system by: reducing the number of taxes and tax regimes; unifying tax payment rules for different categories of taxpayers;

²⁴ "Uzbekistan's Development Strategy for 2017–2021 has been adopted following public consultation," *Tashkent Times*, 8 February 2017.

²⁵ Decree of the President of the Republic of Uzbekistan "On Measures to Radically Improve Tax Administration, Increase the Collection Of Taxes and Other Mandatory Contributions" dated 18 July 2017.

Degree of the President of the Republic of Uzbekistan "On Tax Policy Improvement Concept", UP No. 5468 dated 29 June 2018.

simplifying tax reporting; abolishing a number of inefficient tax and customs breaks; and introducing a procedure for permanent benefits in the Tax and Customs Codes. Table 10 describes the tax rate changes in 2019.

Table 10: Taxation System in Uzbekistan

	2017	2018	2019
Profit tax	7.5%	14%	12%
Tax on dividends	10%	10%	5%
Personal income tax	23%	22,5%	12%
Simplified VAT for small business	–	–	4%–15% ^a
Value added tax	20%	20%	20%
Unified social tax	15%	15%	12%
Single tax payment for small business and private entrepreneurship	5%	5%	4%
Property tax for legal entities	5%	5%	2%
Tax on social infrastructure	8%	Abolished	

The tax rate depends on types of activities.

From 1 January 2019, a simplified procedure for calculating and paying value added tax has been introduced for SMEs with a turnover of up to SUM3 billion.

In addition, the procedure is a transitional measure, which will be introduced before 1 January 2021, and the procedure for calculation and payment is voluntary

In addition, Uzbekistan introduced a modern form of tax control—tax monitoring—which provides for an extensive information exchange between tax authorities and conscientious taxpayers with the provision of comprehensive assistance in solving current tax issues.

Due to these efforts, the Uzbekistan tax ranking improved by 14 positions from last year's results: Uzbekistan took 64th place in the Paying Taxes 2019 tax ranking.²⁶

According to the study, the total tax rate of Uzbekistan is 32.1%, which represents the proportion of taxes and contributions to the company's profits.

This indicator is lower than the average for the countries of Central Asia and Eastern Europe (32.8%), and also significantly lower than the average for the countries of the Organisation for Economic Co-operation and Development (OECD) (40.2%).

In terms of the annual amount of time required to tax compliance, Uzbekistan's indicator (181 hours) is inferior to OECD countries (162 hours), but it is ahead of most of the countries of Central Asia and Eastern Europe (the average for the region is 220 hours).

The number of tax payments per year is 10. For the countries of Central Asia and Eastern Europe, this figure is 16 payments, while for OECD countries—11 payments. The world average is 24 payments per year.

²⁶ PwC/World Bank Paying Taxes 2019 November 2018 <https://www.pwc.com/gx/en/paying-taxes/pdf/pwc-paying-taxes-2019.pdf>.

The measures taken to improve taxation have significantly reduced the tax burden on small businesses, which entailed the development of production, expansion of investment activities, increased employment, and not only reduced the taxpayer's compliance, but also increased efficiency of tax administration.

Customs policy. Customs reform in 2018 has significantly simplified and sharply reduced the costs related to foreign trade. Uzbekistan significantly cut its import tariffs, to attenuate the ensuing inflation and enhance competitiveness. As observed earlier, import tariff rates for about 8,000 out of 10,800 items were reduced (for about 5,000 items, tariffs were eliminated) to mitigate the adverse effect on import-intensive companies (and prices) and to improve the competitiveness of the economy. As a result, the simple average tariff was reduced from 15.2 to 6.3%, whereas the trade-weighted average went from 13.9 to 5.9%, as not all groups saw their tariffs reduced homogeneously. This broad reduction in tariffs has provided a strong stepping stone for an ambitious agenda on trade liberalization; the authorities are taking initial steps to broaden their reach and reinitiate their World Trade Organization accession process. The customs procedures will be streamlined and improved to lower costs and administrative burdens for exporting SMEs after the adoption of a new edition of the Customs Code in 2019.

Licenses and permits. Due to the reform,²⁷ new Law on Permit Procedures was adopted, pursuant to which, 7 licenses and 35 permits were abolished. Procedures of issuing licenses and permits were significantly simplified. Fees for licenses and permits decreased significantly.

Public services. Uzbekistan established the Agency for Public Services under the Ministry of Justice in order to provide public services to business entities according to the “One-Stop Shop” principle.²⁸ Small businesses can obtain 16 types of public services, such as business registration, permits and license, through 194 one-stop centers. All these measures were aimed at abolishing the requirement to visit other government agencies, the elimination of red tape and reducing the cost of doing business.

These reforms led to an improvement in Uzbekistan's ranking in the World Bank's 2019 Doing Business Report, from 166th position in 2012 to 76th in 2018. The country has improved its rating in only four indicators. Uzbekistan climbed by one place in Dealing with Construction Permits, two places in Registering Property, and 3 places in Trading Across Borders.

The country also made trading across borders faster by introducing an electronic application and payment system for several export certificates, reducing the time for export documentary compliance. Uzbekistan still needs to improve its ranking in several areas, such as Getting Credit (60th), Resolving Insolvency (91st), Dealing with Construction Permit (134th) and Trading across the Borders (165th).

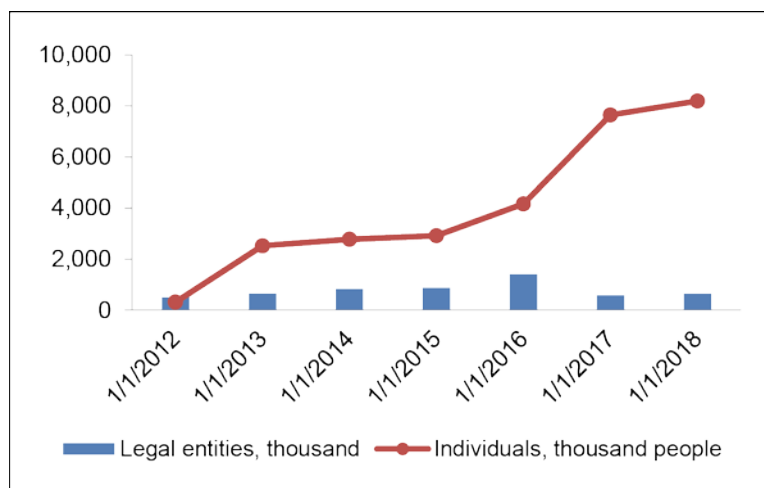
Financial infrastructure. As discussed earlier, the Government of Uzbekistan introduced a number of reforms to enhance the financial infrastructure in the country. Substantial progress was made in upgrading the legal and regulatory framework for the financial infrastructure. Upon adoption of the Law on Sharing Credit Information in 2011,

²⁷ Decree of the President of the Republic of Uzbekistan UP-5409 “On Measures to Further Reduce and Simplify Licensing and Permitting Procedures in the Sphere of Entrepreneurial Activity, and Improving the Conditions of Doing Business” dated 11 April 2018. See at: http://lex.uz/Pages/GetPDFView.aspx?lact_id=3676962.

²⁸ Resolution of the President of the Republic of Uzbekistan PP “On Additional Measures on Improving Mechanisms of Rendering State Services to Business Entities” of 1 February 2017 N ПП-2750. See at: https://www.norma.uz/sobraniya_zakonodatelstva/sobranie_zakonodatelstva_n_5_f_June_2,_2017.

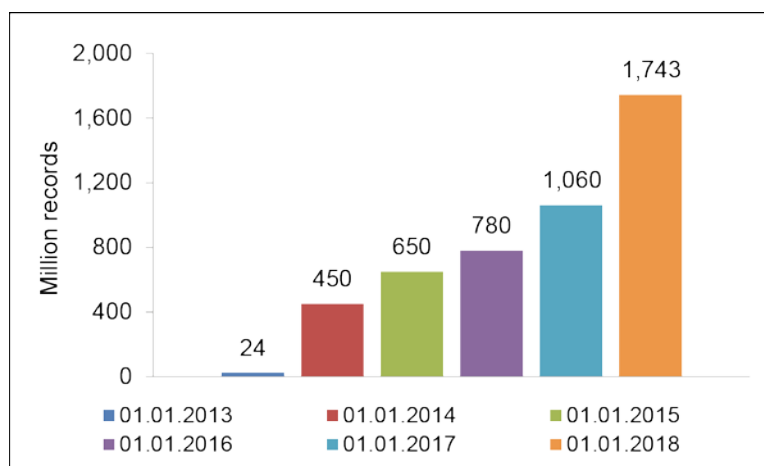
the first local, private credit bureau, the Credit Information and Analytical Center, was established, which is also a positive sign for the development of the financial market. There is substantial empirical evidence that private credit bureaus are correlated with easier access to finance, while the existence of public credit registers does not show an impact on access.²⁹ The Credit Bureau is licensed and supervised by the Central Bank of Uzbekistan, and currently includes information from 28 banks, 76 non-bank financial institutions and one leasing company. Reporting is mandatory, and requires prior consent of the borrower. There is no limit on the size of loans reported. This helps increase the reliability of information on legal entities. The bureau covers 8.1 million natural persons and 647.000 legal entities (see Figure 19).

Figure 19: Credit Bureau Coverage



Source: Credit Information and Analytical Center (CIAC), September 2018.

Figure 20: Database of Credit Histories



Source: Credit Information and Analytical Center (CIAC), September 2018.

²⁹ Love, Inessa, and Nataliya Mylenko. Credit Reporting and Financing Constraints. World Bank Policy Research Working Paper No. 3142. World Bank: Washington, DC, October 2003. See: <http://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-3142>.

In order to realize the potential value of credit information in Uzbekistan, the international credit rating agency (CRIF) (Italy)³⁰ signed a strategic partnership agreement with Credit Information Analytical Center (CIAC) to develop a credit bureau in Uzbekistan.

This initiative is part of the Financial Infrastructure Project in Uzbekistan implemented within the framework of the World Bank Group – IFC Finance & Markets Global Practice. Under the agreement, CRIF owns 35% of the share capital of the private–public partnership company.

CRIF is committed to transferring technology, knowledge and experience to CIAC as well as providing efficient services to improve the credit assessment process in the country. The partnership between CRIF and CIAC aims to facilitate the introduction of state-of-the-art services to analyze credit risks.

Secured transactions. As part of the IFC, the Azerbaijan and Central Asia Financial Inclusion (ACAFI) project on strengthening financial markets infrastructure supported the drafting of a legal framework on a secured transaction system. The Law on Collateral Registry was enacted in 2014. The publicly accessible, unified, online registry was launched in 2015 under the Central Bank of Uzbekistan. This established the types of security and creditors' rights to be notified to the registry, and provides quick notification of secured creditors' status to parties claiming an interest.

Over 418,000 registrations have been made by the users in the Collateral Registry, 157,000 registrations have been made in connection with the fulfillment of the collateral obligations and over 85,000 registrations have been excluded from the Collateral Registry. Also, more than 3.8 thousand statements were provided by the Collateral Registry to its users.³¹

The commercial banks made 94.5% entries in the Collateral Registry and 5.4% were made by microcredit organizations.

2. STATUS OF FINANCIAL INCLUSION FOR SMES

Financial inclusion is crucial to enabling the Uzbekistan population of all backgrounds to have equitable and affordable access to vital credit and savings. However, the financial inclusion sector in Uzbekistan is nascent and remains in the very early stages of progress, with numerous constraints impeding the expansion of access to financial services, particularly amongst households. In September 2018 Uzbekistan joined the Alliance for Financial Inclusion—a global network of financial sector regulators from more than 90 countries.

³⁰ <https://www.crif.com>.

³¹ <https://www.garov.uz/ru/news/otchet-o-deyatelnosti-gosudarstvennogo-unitarnogo-predpriyatija-zalogovyjj-reestr-pri-centralnom-banke-respubliki-uzbekistan-za-2017-god>.

Table 11: Financial Inclusion in Uzbekistan

Indicator (% age 15+)	Uzbekistan		TJ	KYR	KT	ECA	Lower- Middle Income
	2014	2017		2017		2017	2017
Financial institution account	40.7	37.1	47.0	39.9	58.7	65.1	56.1
Saved at financial institution in past year	1.8	2.3	11.3	3.0	13.9	14.4	15.9
Borrowed from financial institution in past year	2.2	2.4	15.5	10.2	28.2	24.2	9.8
Made or received digital payments	37.8	34.2	43.9	36.1	53.9	60.4	29.2
Used mobile phone or Internet to access account	na	6.7	8.3	5.8	18.2	23.1	8.3
Use an account to receive private sector wages	na	3.0	6.3	5.2	16.3	21.2	5.5

TJ = Tajikistan, KYR = Kyrgyz Republic, KT = Kazakhstan, ECA = European Central Asia.

Source: Global Findex 2017.

Strong progress has been made on financial sector development, especially between 2011 and 2014³² but there is still room for development. The Global Findex 2017 demonstrates the low level of access and usage of financial services in Uzbekistan compared to the lower-middle-income countries and Europe and the Central Asia region³³ (see Table 11). It should be noted that 37.1% of the population have a bank account; in reality, they are holders of payroll debit cards. Importantly, the list of transactions conducted by these cards is limited. Inclusion indicators clearly show a lag compared to neighboring countries. Uzbekistan scores significantly lower in crediting, savings, accounts held by the poorest 40%, account remittances and receiving private sector wages. Digital payments have been spurred by distribution of payment cards for government wages; 17% of adults with an account, opened their first account to collect public sector wages. There has been substantial growth in access to credit by SMEs in the past years, approaching the regional average indicators, but demand-side analysis shows that most enterprises in this segment still operate without credit and, according to survey results, only around one quarter of SMEs have a bank loan and more than 80% finance their investments through internally generated funds, a share that is significantly higher than in other countries in Central Asia.³⁴

Lack of public trust in the financial system poses a real threat to its deepening and broadening, as it deprives the system of the funding support required for its development. As the WB/IFC survey³⁵ stated, 72% of micro and small entrepreneurs avoid keeping their savings in a bank, with the main reasons for not using the deposit services of the banks being cited as having no trust in banks (28%) and an inability to draw cash 22% (225). The majority of entrepreneurs stated that they would rather personally monitor their savings than keep savings in banks.

³² Global Findex data 2017.

³³ M. Ahunov Financial Inclusion, Regulation and Literacy in Uzbekistan, ADBI Working Paper Series.

³⁴ EBRD Uzbekistan Diagnostic Assessing Progress and Challenges in Unlocking the Private Sector's Potential and Developing a Sustainable Market Economy May 2018.

³⁵ 2018 IFC Demand study Micro and Small Business Finance & Digital Financial Services in Uzbekistan.

According to the MSME Finance Gap Report 2017,³⁶ credit-constrained firms are classified in two categories: fully credit constrained and partially credit constrained. Thirteen percent of surveyed microenterprises and 10% of surveyed SMEs are defined as fully credit-constrained firms, i.e. those that have no source of external financing. The latter include both those whose applications for loans were rejected and those that were discouraged from applying either because of unfavorable terms and conditions, or because they had no confidence their applications would be approved (see Figures 21 and 22). The terms and conditions that discourage firms include, among others, complex application procedures, unfavorable interest rates, high collateral requirements and insufficient loan and maturity size.

Figure 21: Financially Constrained Microenterprises

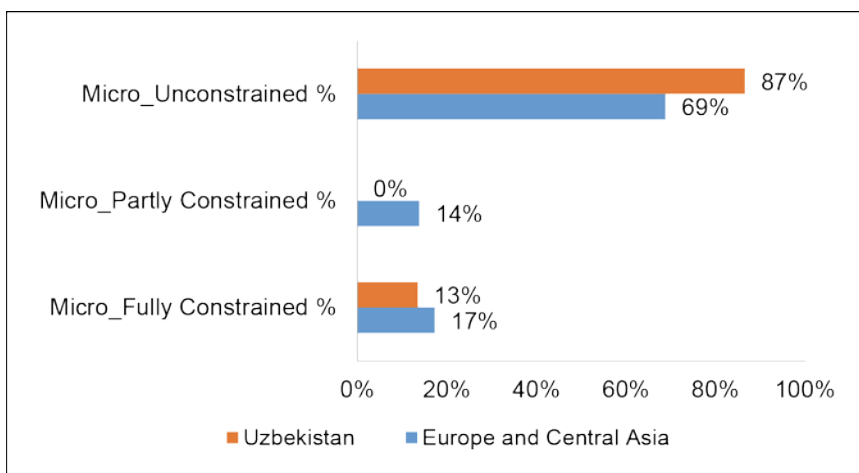
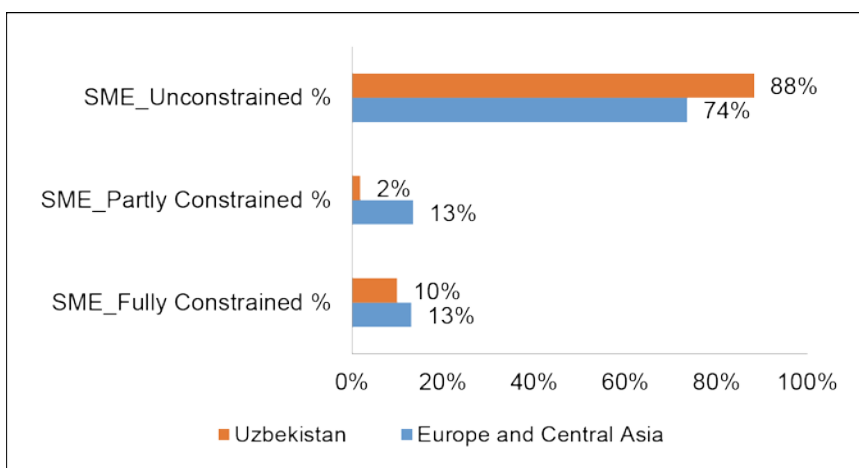


Figure 22: Financially Constrained SMEs



³⁶ MSME Finance Gap Report 2017. <https://finances.worldbank.org/Other/MSME-Finance-Gap/ijmu-5v4p/data> <https://www.ifc.org/wps/wcm/connect/4d6e6400416896c09494b79e78015671/Closing+the+Credit+Gap+Report-FinalLatest.pdf?MOD=AJPERES>.

Two percent of SMEs surveyed are determined as partially credit-constrained firms, e.g., those that have external financing, but were discouraged from applying for a loan from a financial institution and firms that applied for a loan that was then partially approved or rejected. Nearly 87% of surveyed Uzbekistan MSMEs indicated that they do not have any difficulties accessing credit or do not need credit since they have sufficient capital either on their own or from other sources. This also includes firms that applied for loans that were approved in full.

3. FINANCIAL KNOWLEDGE AND SKILLS OF SME ENTREPRENEURS

There has been no study conducted so far on assessing financial literacy in Uzbekistan. The only evidence comes from Standard & Poor's 2014 Global Financial Literacy Survey, which shows that Uzbekistan has a much lower financial literacy rate (21% of the adult population are financially literate) compared to other economies in transition.³⁷

There is no comprehensive financial education program led by a government agency. However, the government has addressed the problem of inadequate financial literacy in some political documents, such as the Welfare Improvement Strategy 2013–2015³⁸ and Strategy for Action 2017–2021.

There have been several initiatives supported by the international organizations to enhance the financial literacy of various groups of the population jointly with non-governmental organizations and commercial banks. These initiatives included a variety of programs at the national level while also targeting specific groups, including students and youth, women, migrant families, small-farm holders, communities in remote areas, and vulnerable groups of the population. However, there is no data, how the project outcomes affected financial behavior of the project beneficiaries and the economy.

During the International Conference “Financial inclusion and financial literacy as a pillar of sustainable economic development,” which was held on 23 November 2018, it was announced that the new project is launched with the support of the AFI and World Bank aimed at supporting the Central Bank of Uzbekistan on drafting the financial inclusion strategy, including the national strategy on financial literacy.³⁹

Recently, a new program was launched by the Chamber of Commerce and Youth Foundation for promotion entrepreneurship among business-minded youth.⁴⁰ The program includes training, coaching, and mentoring, as well as consulting services for youth business startups in business plan development and preparing the loan documentation required by the banks.

The funding provided by the National Project Management Agency to the amount of SUM50 billion (\$6 million) will be channeled through four banks.

³⁷ ADBI Working Paper Series M. Ahunov Financial Inclusion, Regulation and Literacy in Uzbekistan No. 858. August 2018.

³⁸ See at: http://www.nationalplanningcycles.org/sites/default/files/country_docs/Uzbekistan/wis_spb_n_2013-2015eng.pdf.

³⁹ http://www.uza.uz/ru/society/finansovaya-dostupnost-i-gramotnost-factory-ustoychivogo-eko-26-11-2018?ELEMENT_CODE=finansovaya-dostupnost-i-gramotnost-factory-ustoychivogo-eko-26-11-2018&SECTION_CODE=society&print=Y.

⁴⁰ See at: <https://ru.sputniknews-uz.com/society/20180628/8691273/V-Uzbekistane-budut-vydavat-besprot-sentnye-kredity-na-podderzhku-startapov.html>.

4. BARRIERS TO SME FINANCE

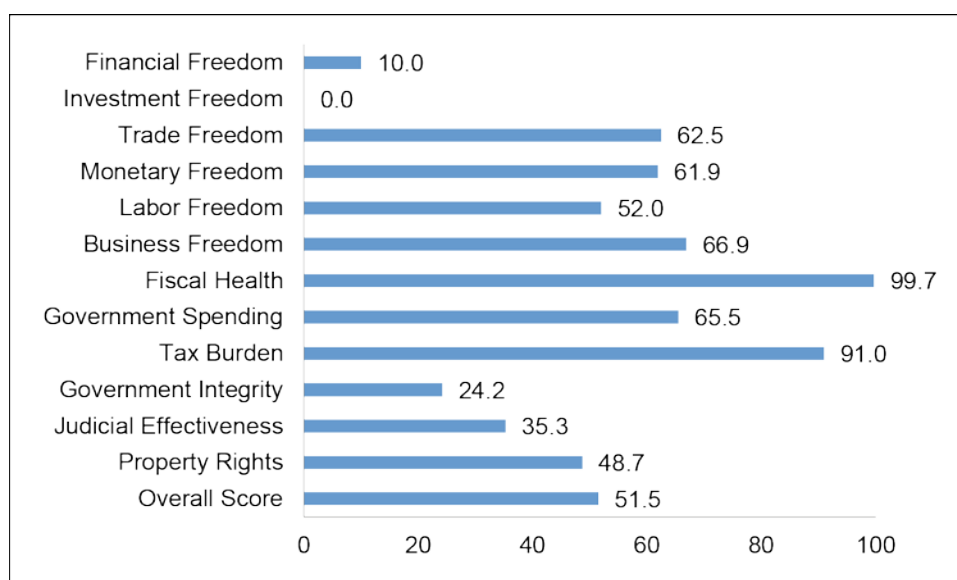
Despite ongoing reforms, the Uzbekistan economy is still viewed as the most restricted economy, and ranks 152nd among 178 countries, according to the Heritage Foundation Index of Economic Freedom 2018.⁴¹ Uzbekistan is ranked 37th among 43 countries in the Asia and Pacific region, and its overall score is below the regional and world averages.

One of the lowest ranks on investment freedom can be explained by insufficient property rights stipulated by obsolete provisions of primary legislation (Constitution, Civil Code, Land Code, etc.) and inadequate regulatory framework for commercial activity. The high corruption⁴² (ranks 154th) and very low rule of law and regulatory quality indicators⁴³ significantly determine the investment climate. Rule of law is a necessary condition to improving financial inclusion and underpins many of the more granular concerns detailed later on. Public trust in an impartial judicial system is crucial to a business environment.

As Figure 23 illustrates, financial freedom is very low due to heavy government intervention in Uzbekistan's financial sector. Large state-owned banks (10 out of 28) hold nearly 85% of industry assets (with the largest state-owned bank holding a 25% share). Until recently, state-owned banks operated mainly as agents of government programs, and disproportionately lend to state-owned enterprises (over 50% of their portfolios).

The Central Bank of Uzbekistan actively regulates the interest rates on loans and "recommends" interest rates on deposits. As a result, bank interest rates are often below real inflation.

Figure 23: Uzbekistan Ranking according to Index of Economic Freedom 2018



⁴¹ See at: https://www.heritage.org/index/pdf/2018/book/index_2018.pdf.

⁴² Corruption Perception Index 2017 <https://www.transparency.org/country/UZB>.

⁴³ World Governance Indicators 2018 <http://info.worldbank.org/governance/wgi/#home>.

Another example of government intervention is supporting economically insolvent enterprises by securing financial recovery from commercial banks.⁴⁴

A number of factors affecting the development of small businesses were highlighted by the SME in Fergana Valley during the focus group discussions in July 2018. Such factors can be summarized as high transaction costs, both formal and informal; lack of financial literacy; difficulties in accessing start-up capital; high cost of banking services; and stringent conditions for loans.

Banks are limited to a narrow range of credit products to SMEs, with many enterprises not seeing banks as relevant to their financing needs. Due to collateral requirements by banks, SMEs may be denied credit despite having sufficient cash flow or purchase orders, or SMEs may be able to access only short-term credit facilities and not the type of financial products they need. For instance, such standard banking services as equity finance, factoring or longer-tenure loans are not offered.⁴⁵

It should be noted that, due to the absence of nationwide data collection and analysis of SME financing needs, the level of government awareness of SME financing needs is quite low. The absence of impartial and professional research/studies of SME financing needs inevitably leads to an untargeted and inadequately allocated state support.

Supply-side constraints affect the willingness to lend to SMEs, the suitability of products and services to meet the needs of SMEs, and the sources of finance in the market. The contributing factors to these constraints are presented below, based on focus group discussions with SMEs.

(i) High cost of bank credit

Eighty percent of the total number of the entrepreneurs interviewed indicated a high lending rate as the main problem for SME development. The market rates of credit for small businesses are in nominal and real terms high, due to high administrative costs of originating loans resulting from overly regulatory requirements for documentation of loans and high credit risk. But given the high deposit rates and the weak currency, nominal rates for small loans in local currency between 28 and 36% are justified. The Central Bank refinancing rate is 16%. There are high rates for foreign currency loans (12%–16%). The interest rates are not affordable for any medium- or long-term production investment.

(ii) Delivery mechanism

The channels for financial service delivery do not meet the needs of small businesses, particularly outside the city of Tashkent. Along with high costs of financing, the banking sector has limited capacity for developing alternative channels for service delivery. The focus group discussions led to an overall view that SMEs would prefer to do most of their banking through online and mobile platforms. During individual interviews, SMEs reported they would like to get loans online, rather than making a trip to a bank branch. Costs of transportation and time spent accessing financial services are additional limiting factors, especially for women entrepreneurs. Due to the lack of ICT infrastructure,⁴⁶ the banks are not able to provide distance services.

⁴⁴ Decree of the President of the Republic of Uzbekistan "On Measures to Further Improve the Financial Stability of Enterprises of the Real Sector of the Economy" № 4053 of 18 November 2008.

⁴⁵ ADB Sector Assessment <https://www.adb.org/sites/default/files/linked-documents/42007-014-ssa.pdf>.
EBRD Country Assessment <https://www.ebrd.com/cs/Satellite?c=Content&cid=1395238453911&d=&pagename=EBRD%2FContent%2FDownloadDocument>

⁴⁶ ICT Development Index 2017 Uzbekistan ranking is 95th. See at: <http://www.itu.int/net4/ITU-D/idi/2017/index.html>.

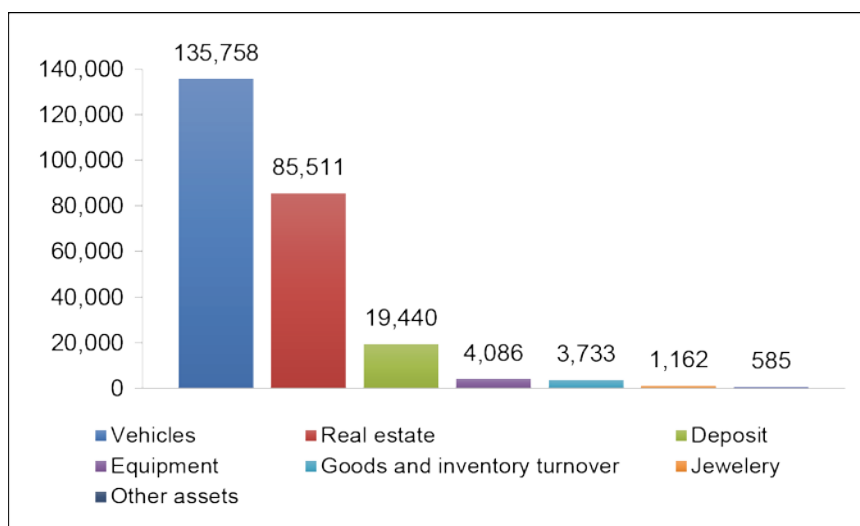
(iii) High collateral requirements and cost to collateral registration

Data from the Collateral Registry suggests that over 98% of all loans issued since 2015 have been secured by hard collateral (real estate, fixed assets – 94% of all loans) or cash deposit (4%). Other forms of loan security have not been widely used. This is especially problematic for microfinance borrowers who do not have acceptable collateral.

According to global statistics⁴⁷ collateral was required in an average of 78.9% of all loans, and in Uzbekistan, collateral was required in 96.5% of loans (international practice is 80% of loans), with an average of 175% loan to value ratio compared with 128% for large companies.⁴⁸

As demonstrated in Figure 24, banks are using the limited range of collateral to secure a loan, which increases the impact of the high collateral requirements on an SME's eligibility to borrow, and the overall process remains time-consuming for the borrower. The process of registering collateral is comparatively hard; for example, the client has to personally register movable collateral, and then leave the original receipt with a notary. Immovable securities need to be notarized, with some notaries requesting proof of insurance and requiring the client to arrange and pay for an evaluation of the collateral's value by a third party.

Figure 24: Assets Used as Collateral in Uzbekistan



Source: IFC Movable assets lending in Uzbekistan, 2017.

Banks offer third-party guarantors, but they are difficult to find for first-time borrowers as they are often considered high risk. Insufficient collateral limits the size of loans and constrains entrepreneurs' access to larger loans for business expansion and capital investments.

ADB Country Gender Assessment Update, 2018. See at: <https://www.adb.org/sites/default/files/institutional-document/479841/uzbekistan-country-gender-assessment-update.pdf>.

⁴⁷ Jamie P Bowman. The Role of Credit Bureaus and Collateral Registry in Uzbekistan, February 2016.

⁴⁸ See at: <https://tradingeconomics.com/uzbekistan/value-of-collateral-needed-for-a-loan-percent-of-the-loan-amount-wb-wb-data.html>.

Alternative sources of collateral and security, such as future cash flows, business reputation, third parties, or group guarantees, are rarely considered acceptable. In stakeholder and focus group discussions, insufficient collateral was cited as the single greatest impediment to borrowing.

(iv) The lack of alternative sources of SME financing

This is a significant factor affecting the credit situation for SMEs. Banks are not able or willing to meet the full demand for enterprise finance and SMEs need different types of finance. A lack of and imperfect legislative and regulatory environment hinder alternative sources of SME finance and the development of the non-bank financial institutions, venture funds, crowd funding, capital markets and inter-firm financing mechanisms. All these institutions could play a larger role in SME financing than they do, operating in underserved areas and filling in important financing gaps based on proximity and flexible operations. The major constraint on these services developing is an excessive government intervention in banks' activities and an overregulated banking system.

(v) Overregulated financial sector

Uzbekistan's banking system is highly regulated through an opaque and complex series of regulations. Many of these regulations are formal legislation from the legislative body, but others are guidance from the executive branch in the form of decrees and proclamations. As a result, loan and credit extension is highly regulated and there is no possibility of financial innovation. Existing regulations and the banknote shortage place legal and practical restrictions on cash transactions while SMEs—mainly individual entrepreneurs engaged in trade—need cash loans or at least loans that can be used for payments at card terminals. Only allowing direct transfers from the bank to the lender's supplier is very inflexible, especially for inventory finance.

(vi) Product and services segmentation is weak

Very limited financial services and products are adapted to different stages of SME growth (e.g., newly established, young and growing, maturing or mature, etc.). SMEs that are using similar products notwithstanding their financing needs are often different. Apart from the fact that start-up financing is extremely limited, so start-ups usually apply to microcredit organizations for microloans or private moneylenders lending at higher interest rates. It can be difficult for SMEs to mature into competitive, growth-focused businesses because financial markets are not particularly well organized to offer a continuum of financing options (e.g., trade credit, factoring, leasing, equity, etc.) that firms can use to develop their business.

(vii) Lack of SME financing expertise

Many state-owned banks have inadequate expertise in analyzing undocumented cash flows of businesses, so their lending processes and products are not adapted for the pattern of those cash flows. The supply side is not the only source of constraints limiting access to finance, and there is no lack of negative sentiment in the SME community about the lack of financing.

4.1 Demand-side Constraints

(i) Low financial literacy and business skills

SMEs lack adequate training, knowledge and skills for effective business management, preparation of realistic business plans and debt management. This leads to weak business risks management, an increase in the cost of doing business, and limits access to bank loans. Small businesses have limited access to business development services that contribute to the efficiency, profitability, and expansion of their activities. Weak financial literacy, especially among women's small businesses and low-income groups, limits their access to financial services and constrains their entrepreneurial capacity.

(ii) Limited knowledge of the availability and impact of business development services (BDS).

Around 60% of surveyed SMEs in Uzbekistan could not name any private BDS provider and almost none were aware of the existence of third-party providers, such as NGOs or business associations.⁴⁹ This is especially true for SMEs operating in the regions, where 70% of SMEs do not know any private BDS providers. Public–private dialogue, and especially the role of business associations in promoting BDS, remains limited. Moreover, the perception of an overall poor quality of services offered by certified BDS providers, as well as of poor capacity of government-related bodies, leads to a limited use of such providers.

(iii) Lack of knowledge on financial products, markets, technology and legislation

This affects the efficiency of SME businesses and limits their access to finance. Misperceptions about the banks, and the financial system in general, appear to have led to a lot of negative sentiment about banks among SMEs. SMEs often lack market information, such as on prices and trading volumes, which limits their ability to prepare reliable business plans and forecast cash flows. This challenge is very significant due to the absence of an online portal for SMEs on new legislative changes or incentives provided by the government.

4.2 Gender Constraints

While access to finance remains a business constraint for both men and women, evidence seems to suggest that women face higher hurdles, particularly for those who own micro and small enterprises. According to the ADB Uzbekistan Gender Assessment Update,⁵⁰ besides existing constraints, women-owned SMEs face a mix of other challenges that combine to make the situation even more aggravated for them.

These include gender bias, socioeconomic constraints, and lack of access to business networks. For example, women can have trouble posting adequate collateral because of the way in which their marital property (collateral) is often registered—e.g., as joint property or in their spouse's name alone. They can face negative prejudice from lenders about their capacity and commitment to succeed in the “tough” world of business. They can sometimes have difficulty in building reputational collateral or demonstrating a consistent track record running their business as a result of family obligations, such as

⁴⁹ CER Entrepreneur Portrait 2013 Tashkent, Uzbekistan See at: <http://www.cer.uz/upload/iblock/236/wndkzngr%20lbpymrjrslnlyimkdjwgpateetdf%20kyboqxuhtoakbajzliia%20ru%208%20o13%2002%202015j.pdf>.

⁵⁰ ADB Country Gender Assessment Update, 2018. See at: <https://www.adb.org/sites/default/files/institutional-document/479841/uzbekistan-country-gender-assessment-update.pdf>.

taking care of children, which may cause them to take a time off. They also lack access to business networks that are often male-dominated and/or poorly organized.

5. STATUS OF DOMESTIC AND GLOBAL VALUE CHAINS IN UZBEKISTAN

Agriculture is one of the sectors of Uzbekistan's economy, contributing 25% to the country's GDP, providing a third of national employment and almost half of total export earnings. Uzbekistan continues to be the major supplier of fresh and processed fruits and vegetables.

Horticulture is an important part of agricultural production, although the subsector accounts for only about 16% of aggregate arable lands, in contrast to grains (47%) and cotton (37% of fruits and vegetables is among the most profitable activities for both *dehkan* (smallholder farms)⁵¹ and more commercial farms. The economic importance of the subsector is therefore significant, considering that it accounts for more than 35% of the agricultural export value. Uzbekistan has become a major producer of horticultural products in the region, placing the country among the world's top 10 exporters in several categories of fruits, vegetables, and nuts. According to the Food and Agriculture Organization (FAO) statistics, Uzbekistan exports of dried apricots are the second largest in the world, while exports of fresh apricots from Uzbekistan are the 4th largest, plums the 7th largest, cabbage the 8th, and raisins the 9th largest worldwide. The country is the sixth largest producer of cherries, and 17th in apple production; production of peaches and grapes from Uzbekistan is the 10th largest in the world.⁵²

Despite delayed returns and higher investment costs, horticultural crops generate revenues to farmers that are significantly higher than wheat and cotton.⁵³

The government has also made further efforts to liberalize the horticulture sector by adopting a new resolution,⁵⁴ which allows horticulture farmers and agricultural enterprises to sell their products directly in domestic and foreign markets. By 2020, the Government of Uzbekistan aims to have converted over 200,000 hectares into horticulture production, away from cotton and wheat.⁵⁵

According to the Ministry of Agriculture, Uzbekistan has trade ties with more than 80 countries and exports 180 different varieties of fresh and processed fruits and vegetables. Uzbekistan annually exports fresh and dried fruits and vegetables products to the amount of about 700,000 tons. Uzbekistan exports only 5%–6% of all produced fresh agricultural products. In terms of value, this indicator varies depending on the conjuncture of the main markets. The main markets for Uzbek products are

⁵¹ *Dehkan* farms (smallholder farms) are small family based agricultural producers, who grow and sell agricultural products, which are produced on a parcel of land allocated to the head of the family for life-time lease as the personal merit. *Dehkan* farms account for 4.8 million as at 1 January 2019.

⁵² FAO 2018 Organic agriculture in Uzbekistan <http://www.fao.org/3/i8398en/i8398EN.pdf>

⁵³ World Bank 2017 Strengthening the Value Chain of Horticulture in Uzbekistan, reference document 94281.

⁵⁴ Resolution of the President of the Republic of Uzbekistan №PP-3077 dated 21 June 2017, "On Measures on Further Supporting Domestic Exporter Organizations and Improvement of External Economic Activity" had opened up a new stage in the advancement of production and exporting the agricultural output in Uzbekistan.

⁵⁵ Decree of the President of the Republic of Uzbekistan No. PP-2460 of 29 December 2015 "On Measures for Further Reforming and Development of Agriculture for the Period of 2016–2020."

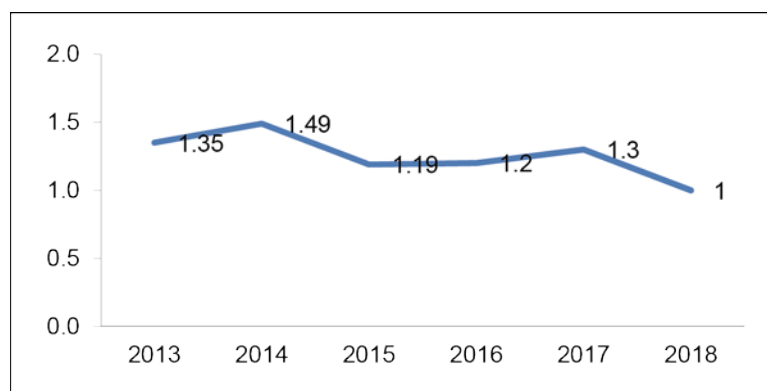
Kazakhstan (67% of total exports), the Russian Federation (17%), Afghanistan (5%), the Kyrgyz Republic (2%), and other countries (9%). Horticultural export revenues have more than tripled, from about \$500 million in 2006 to almost \$1.2 billion in 2016.⁵⁶ (see Figure 25).

Uzbekistan exports to the Russian Federation and Kazakhstan because of proximity and lower quality thresholds, though margins are far higher in Europe and East Asia. Uzbekistan aims also to expand the marketing of fresh and processed horticulture products to other countries, including Japan, the Republic of Korea, Saudi Arabia, United Arab Emirates, as well as EU countries.

During the period 2017–2021, the production of food products is expected to increase by 140%, including fruit and vegetables and grapes by 140%.

Export of fruit and vegetable products in 2021 will increase by 230% compared to 2016, and the export of fruit and vegetable processed products by 200%.

Figure 25: Value of Exports of Horticulture Produce Nationwide
(\$ billion)



Source: Ministry of Agriculture and State Committee of Statistics.

Main players of the horticulture chain include growers, market consolidators or brokers, wholesalers or traders, exporters, processing companies, supermarket chains, retail markets, transportation enterprises, market administration, and others.

Growers include: (i) a large group of rural smallholding households (dehkans); (ii) private (or commercial) farms; and (iii) agricultural enterprises (agrofirms). Dehkan farms, according to the State Statistics Committee, account for more than 90% of horticulture production while occupying 65% of total sown area under vegetables (excluding melons), 43% under melons, and 20% under fruit crops (including grapes).

Brokers or consolidators: They are responsible for properly harvesting, sorting, grading, and packing as per customers' demand.

Wholesalers: Local wholesale markets, specialized trading companies wholesale logistics centers to collect and transport products to the chain supermarkets in the cities.

Exporters: National and private enterprises.

⁵⁶ World Bank Uzbekistan: Agricultural Trade Policy Report 2018. <http://documents.vsemirnyjbank.org/curated/ru/745361544159774580/pdf/132758-AgTradePolicyUzbekistan-August-16-2018.pdf>

Processing companies: Horticulture products processing companies, specialized in either extracting, drying, caning, and processing.

Supermarket chains: Food supermarket enterprises and large retail networks (Korzinka, Makro, etc.)

Transportation: Large to single-owner transportation enterprises are involved in the transportation of horticulture products from sites of production to processing centers, wholesale markets, and then to retail distribution and export terminals.

Table 12 presents the strengths, weaknesses, opportunities, and threats (SWOT) analysis of the horticulture value chain based on survey of value chain players.

Table 12: SWOT Analysis of Horticulture Value Chain

Strengths	Weaknesses
Different varieties (22 species of fruit, 37 varieties of grapes and 17 species of vegetables)	Unstable supply of gas and electricity to the production lines of agro-processors
Abundant fruits and vegetables for further processing	Lack of auxiliary inputs, such as packaging and label.
Opportunity to produce organic fruit	Lack of quality control, certification and market research
Lower cost of main inputs, including fruits and vegetables	Low availability of adequate infrastructural facilities
Favorable climatic conditions for growing fruits and vegetables. 300 sunny days per year	Outdated irrigation systems
	Limited access to good-quality land, specialized horticulture machinery, appropriate inputs, access to either equity or long-term debt financing
	Lack of refrigerated facilities and logistics
	Lack of agriculture insurance scheme
	Lack of effective transport links to the potential world food markets.
	Difficulties with implementation of quality control in the processing sector
Opportunities	Threats
Areas significantly increased due to gradual shift from the traditional crops (cotton and wheat)	Lack of vertical and horizontal cooperation among value chain participants
Large production base offering a vast potential for agro-processing activities	High inventory carrying cost and high package cost
Economic growth of potential importer countries and increased demand for organic food will enhance export potential	Possible natural disasters, particularly seasonal droughts, aging cost
Economic relations with developed countries can help to receive advanced technologies	Climate change
Implementation of tax benefits will help to get access to new export markets via attracting large foreign companies	
Improving the attractiveness of rural areas through the development of infrastructure will boost transfer of business in rural areas	

There is a need to support the existing initiatives and to further facilitate the development of different promising sericulture and cotton value chains, the livestock value chain (meat and dairy production), the bee-keeping value chain, all of which are expected to contribute to the significant growth of rural jobs, food security, and exports.

6. VALUE CHAIN FINANCING ANALYSIS

“Value chain finance” refers to the flows of funds to and among the various links within a value chain. It relates to any or all of the financial services, products, and support services flowing to and/or through a value chain to address the needs and constraints of those involved in that chain, be it to obtain financing, or to secure sales, procure products, reduce risk and/or improve efficiency within the chain.⁵⁷

Due to a lack of expertise in value chain financing of the commercial banks and existing regulatory limitations, the ability of SMEs to integrate into global value chains is limited.⁵⁸ The international financial institutions initiated value chain financing on the request of the Government of Uzbekistan aimed at developing several agriculture value chains. According to the World Bank estimates, the demand for investments in the horticulture value chain is of \$1 billion⁵⁹ while there is also a high demand for credit in the livestock value chain.⁶⁰

As mentioned earlier, the key problems for development of the horticulture value chain as well as other agricultural produce value chains (like meat and milk, processed food, water, juices and beverages, etc.) lie in very poor progress in the change of policies in the agricultural production sector. A lack of market mechanisms on the one hand, such as government monopoly over agricultural land and absence of efficient reforms of the entire sanitary phytosanitary (SPS) system. The absence of efficient food chain practices based on international standards and the New and Global Approach “from field to fork,” deters the process of the development of the VC in the agricultural sector. Yet, the prospects for development are quite high, provided that the government takes concrete steps towards the modernization of the SPS system, revising its SPS laws and removing prevailing government intervention in production processes. The private sector cannot develop with such a dominant government role, and as a result, no real prospects for value chain financing will emerge.

The list of the projects described in Table 13 focuses on developing the business models of value chains, improving the quality and volume of agricultural production and post-harvest handling and production, facilitating market linkages, and linking educational institutions with private sector demand.

⁵⁷ See at: <https://www.marketlinks.org/good-practice-center/value-chain-wiki/value-chain-finance>.

⁵⁸ OECD. 2013. Policy Handbook. Improving Access to Finance for SMEs in Central Asia through Credit Guarantee Schemes.

⁵⁹ International Bank of Reconstruction and Development (IBRD). Project appraisal document on a proposed loan in the amount of \$150 million to the Republic of Uzbekistan for a horticulture development project. 2014.

⁶⁰ International Development Agency (IDA) and IBRD. Project appraisal document on a proposed credit in the amount of \$120 million equivalent and a proposed loan to the amount of \$30 million equivalent to the Republic of Uzbekistan for a livestock sector development project. 2017.

Table 13: The IFIS Project financed Value Chain Development

IFI	Target Groups	Timeframe	Budget
The International Fund for Agriculture Development Horticulture Development Project	Smallholder farmers, processors, and service providers in the horticultural subsector	2013–2017	\$30 million
The World Bank Horticulture Development Project	Small dehkan farms with up to 5 ha of household plots per farm, and private farms with land size not less than 5 ha per horticultural farm	2015–2021	\$183 million
The World Bank Horticulture Development Project phase 2	Small dehkan farms with up to 5 ha of household plots per farm, and private farms with land size not less than 5 ha per horticultural farm	2018–2021	\$500 million ^a
ADB Horticulture Value Chain Development Project ^b	Farmers and large agriculture enterprises	2017–2021	\$154 million
ADB Horticulture Value Chain Development Project phase 2	Farmers and large agriculture enterprises	2018–2021	\$198 million ^c
ADB Horticulture Value Chain Infrastructure Development Project	Horticulture clusters	2019–2023	\$197 million ^d
World Bank /EU Livestock Value Chain Development ^e Project	Smallholder farmers (farming households and dehkan) and private farms and firms engaged in livestock production and processing.	2017–2023	\$150 million
IFAD Dairy Value Chains Development Program	Small dehkan farms and commercial dairy farms.	2016–2023	\$24 million
The United States Agency for International Development Agriculture Value Chain Development Project	Farms, dehkan farms	2007–2011 2011–2015 2015–2018	\$14 million

^a See at: <https://www.uzdaily.com/articles-id-45518.htm>.

^b See at: <https://www.adb.org/projects/47305-002/main>.

^c See at: <https://www.adb.org/news/adb-strengthens-support-uzbekistans-horticulture-sector-198-million-additional-financing>.

^d See at: <https://www.adb.org/projects/documents/uzb-51041-002-rrp>.

^e See at: <http://documents.worldbank.org/curated/en/128331504722189404/Uzbekistan-Livestock-Sector-Development-Project>.

7. POLICIES TO PROMOTE SME FINANCE

The Government of Uzbekistan is committed to SME development, and as was discussed in earlier sections, has undertaken significant reform measures to improve the enabling environment, and encourage its expansion with the objective of creating jobs. Efforts have been exerted to address the various challenges confronting SME development, as the main creators of new jobs and employment opportunities. Improving their access to finance as well as their access to business development services have been a key priority on the government's agenda.

Government programs supporting SMEs include the interest rate subsidies on loans and fiscal incentives (tax holidays, tax and customs duties exemption), as well as direct lending to targeted industries such as manufacturing. An example of such a program is the State Program on Localization for the production of quality competitive import-substituting products.

State support for SME development including access to finance is specified in the “Law on guarantees of freedom of the entrepreneurial activity” (new edition)⁶¹ of 2 May 2012 №328 and the “Law on family business”⁶² of 26 April 2012 №327. According to these laws, main areas for SME state support are as follows:

- Formation of favorable legal and regulatory business environment;
- Financial and investment support and provision of subsidized lending and guarantees;
- Assistance for creation and development of support infrastructures;
- Business information and consultancy support;
- Export promotion:
- Support for introducing innovations and modern technologies;
- Support for participation in public procurement.

Despite the efforts of the government over the past years to increase private sector participation in the economy, there is still no comprehensive SME support policy framework. Current SME support policy measures are based on 138 President Resolutions and Decrees, 280 Resolutions of the Cabinet of Ministers and 646 legal acts of various ministries and government agencies. As survey participants noted, they encountered situations of legal collisions when one legislative act contradicts another, thereby reducing the effectiveness of state support measures. Therefore, there is a need for an SME development strategy that will stipulate state support measures and indicate the responsible institutions for implementing them.

The current SME support ecosystem in Uzbekistan involves many stakeholders representing public institutions, NGOs, and international development organizations.

Several government agencies are responsible for formulating, financing, and implementing policies and activities aimed at supporting the development of SMEs in Uzbekistan. See Table 14.

Table 14: SME Support Institutions

Policy Level	Institutional Level	
Government institutions	SME support government institutions	Business Support organizations
Ministry of Economy and Industry	Entrepreneurship Development Support Fund	SME Support Institutions (financial and technical assistance)
Ministry of Investment and Foreign Trade	UzTrade	International organizations (ADB, EU, EBRD, UNDP, WB, USAID, etc.)
Ministry of Innovation Development	Export Promotion Fund for SMEs	Business NGOs, such as Chamber of Commerce, Business Women Association
National Agency for Project Management	Export Promotion Bureau under Uzstandard agency	
State Committee for Competition	UZAgroexport	

⁶¹ See at: <http://lex.uz/docs/2006777>.

⁶² See at: <http://www.lex.uz/acts/2004954>.

The local governance offices (*khokimiyats*) are responsible for implementing SME policy at regional and local levels. It is acknowledged that the coordination of SME policies is weak at both national and regional levels. Duplication of functions and overlapping initiatives are very frequent. Resources to the SME sector are being directed through various channels: Apart from the special State Fund for Entrepreneurship Development, the Ministry of Innovation Development and Mirzo Ulugbek Innovation Center⁶³ are conducting a program on promoting entrepreneurship in scientific, technical and innovative fields and creating the conditions for entrepreneurs to carry out research and innovation activities concerning innovative business.

Such state trading enterprises and entities as “Uztrade,” “Export Promotion Fund for SMEs,” and Export Promotion Bureau under “Uzstandard” Agency provide assistance to the SMEs in looking for international clients, export marketing, certification of products, and conducting the banking and customs formalities for export. The Ministry of Economy and Industry is implementing the SME development at regional and local development, including introducing innovations: products, technologies, etc. Recently, the State Committee on Investments launched the first online survey⁶⁴ to monitor the efficiency of government measures to improve the business and investment climate.

All of these agencies deal with different aspects of SME development, so there is a lot of overlapping. In addition, due to a lack of donor coordination, overlapping technical assistance is also observed at the national and regional level, where it affects international assistance. However, the institutional framework lacks a comprehensive mandate for an SME development agency to be the transmission chain of policies to SMEs – including, for example, facilitation.

One of the supporting policies and measures carried out by the Government of Uzbekistan in 2017, is setting up the Entrepreneurship Development Support Fund,⁶⁵ which basically established the framework of the credit guarantee system for SMEs in supporting lending to SMEs and improving the financing environment. The guarantee fund will be placed in the State Fund for Support of Entrepreneurship Development, which was established under the auspices of the Cabinet of Ministers in August 2017 and became operational in early 2018.

During nine months of 2018, the credit guarantee provided 418 SMEs with a credit guarantee amount of SUM269.6 billion for loans disbursed to the amount of SUM740.2 billion. These partial guarantees are provided for up to 50% of the loan amount, which should not exceed SUM2 billion (equivalent to \$250,000).

The Fund charged the commission 1% of the loan amount as a one-time payment for issuing the guarantees.

It is premature to make an assessment as to whether the operation of the credit guarantee system is effective, since the credit guarantee provided for subsidized loans disbursed through state-owned banks and the absence of an operational plan for ensuring the guarantee scheme sustainability.

⁶³ See at: <https://muic.uz/>.

⁶⁴ See at: https://docs.google.com/forms/d/e/1FAIpQLSdaYG8Zfuq9SWs3HscpleRUKquDjL2o8sGMIw16oXUqUGAJ_w/viewform.

⁶⁵ Resolution of the Cabinet of Ministers of the Republic of Uzbekistan № 195 dated 19 May 2000. “On Additional Measures to Promote Participation of the Commercial Banks in Small Business Development.”

The results of the study demonstrate that the current approach to SME development lacks strategic focus and the institutions supporting SMEs lack coordination and have a limited understanding of stakeholders' roles and actions regarding implementation, monitoring, and evaluation policy objectives due to the lack of a single SME development strategy.

The state financial support to SME is translated in subsidizing interest rates according to the Law "On guarantees of freedom of the entrepreneurial activity." The government has made several subsidized financing vehicles available for SMEs since 2000. The first vehicle is known as the "Fund for Preferential Crediting." The Government of Uzbekistan required state-owned and private banks to create this fund. To create it, the bank reserves up to 25% of its profits to be used for this purpose. The Fund for Preferential Lending permitted loans up to five years at 50% of the refinancing rate established by the Central Bank. In return, the government provided tax exemptions and other privileges for commercial banks to compensate for foregone revenues when interest rates on loans are subsidized.⁶⁶ The second vehicle is known as "banking micro-credits." The concept of micro-credits was introduced by the Central Bank in 2002. They set the maximum amount of a micro-credit available to an SME both in local and foreign currency to \$5,000 for individual entrepreneurs and dehkan enterprises without legal entity status, and to \$10,000 for an SME with a legal entity status. Regardless of the source of financing (i.e., even if this is the bank's own capital not set aside for preferential lending) the rate on all micro-credits cannot exceed the Central Bank's refinancing rate. One of the positive features of micro-credits is that they may be issued up to 50% in cash. While micro-credits may be attractive for an SME, they are not, however, very attractive for the bank: typically when making loans with their own resources.

There is no available data that show how SME access to finance has improved due to the government policy measures, the number of beneficiaries of subsidized lending programs, how this subsidized lending program impacted SME access to finance, and how demand and supply have changed over time. The lack of data also makes it difficult to monitor the effectiveness and efficiency of government reform measures—for instance, whether they have reached targeted beneficiaries and/or alleviated core barriers. As stated in the World Bank⁶⁷ note, there is no evidence that subsidized loan programs have been effective in targeting low-income households, and there is the possibility that, in some cases, subsidized loans are being allocated to those who need the loans least.

According to the last IMF report,⁶⁸ about 60% of credit was allocated at preferential terms. The Central Bank of Uzbekistan's refinancing rate reliably affects the terms of credit extended at commercial terms to the domestic-currency segment; this segment accounts for only about 20% of the outstanding credit stock. Lending at preferential terms depresses banks' profitability, and a less segmented credit market would therefore reduce the need for regular capital injections to maintain banks' capital buffers.

⁶⁶ <http://lex.uz/docs/312605#694347>; <http://lex.uz/docs/312605>.

⁶⁷ World Bank Technical Note Microfinance Development in Uzbekistan. <http://documents.worldbank.org/curated/en/964701485149743125/Microfinance-development-in-Uzbekistan-technical-note>.

⁶⁸ <https://www.imf.org/en/News/Articles/2018/11/20/ms112018-uzbekistan-staff-concluding-statement-of-an-imf-staff-visit>.

The existing practice of providing preferential loans creates unequal conditions for doing business, contributing to the destruction of the competitive environment. After all, enterprises that receive loans on preferential terms have competitive advantages over enterprises that are forced to pay very high interest rates for loans, or are forced to abandon borrowing, because they can't afford such expensive loans.

In 2017 the Government of Uzbekistan abolished the previous practice that had been taking place since 2000. Currently, preferential loans are allocated to the amount of up to 150 times the minimum monthly wage (equivalent to \$3,420) as the start-up capital for newly registered individual entrepreneurs and family businesses without legal entity status in remote and inaccessible areas, as well as in areas with excess labor resources. The subsidized lending programs set interest rate benchmarks on loans that are below inflation rates. The Government of Uzbekistan launched the state program "Every Family is an Entrepreneur." The first stage has started in the Andijan region.⁶⁹ This new program is making a significant push for low-cost credit to households to spur economic activity that leads to self-employment and micro-entrepreneurship (see Table 15).

The approaches are strongly focused on the supply of credit to asset and equipment induced entrepreneurship, including the supply to agribusiness-related home-based businesses (greenhouses, pedigree cattle, sheep, catfish fingerlings) as well as sewing machines and other equipment involved in small manufacturing of consumer products. The Central Bank of Uzbekistan sets up the targets for SME financing under this program.

Table 15: Financing Scheme under State Program Every Family is an Entrepreneur

Beneficiary	Purpose	Loan Amount	Interest Rate	Term and Grace Period	Security
Individuals	Family business organization	Up to 150 times minimum wage (\$3,420) ⁷⁰	8% ⁷¹	Up to 3 years/ with a grace period of up to 6 months	Recommendation of the head of the self-governance bodies. Banks insure the risk of loan defaults by themselves
SMEs (individual entrepreneurs, microfirms and small enterprises)	Business start-up development and expansion	Up to 1,000 times minimum wage (\$22,810)			The guarantee of a third party or the State Fund for the Support of the Entrepreneurship Development under the Cabinet of Ministers, an insurance policy, a pledge, etc.
		Over 1000 times minimum wage		Up to 5 years/ with a grace period of up to 2 years	The list of security determined by the legislation

⁶⁹ Resolution of the President of the Republic of Uzbekistan PP 3777 dated 07.06.2018. <http://lex.uz/docs/3772866>.

⁷⁰ Minimum salary as of 1 October 2018 – SUM184,300; exchange rate \$1 – SUM8,079.28. <http://cbu.uz/uzc/arkhiv-kursov-valyut/>.

⁷¹ [https://nrm.uz/contentf?doc=580536_postanovlenie_pravleniya_centralnogo_banka_ot_16_02_2019_g_n_310_o_vnesenii_izmeneniya_v_punkt_4_polozeniya_o_poryadke_vydeleniya_kreditov_v_ramkah_programmy_kajdaya_semya_-_predprinimatel_\(zaregistrovano_myu_26_02_2019_g_n_3022-1\)](https://nrm.uz/contentf?doc=580536_postanovlenie_pravleniya_centralnogo_banka_ot_16_02_2019_g_n_310_o_vnesenii_izmeneniya_v_punkt_4_polozeniya_o_poryadke_vydeleniya_kreditov_v_ramkah_programmy_kajdaya_semya_-_predprinimatel_(zaregistrovano_myu_26_02_2019_g_n_3022-1)).

The significant amount of low interest credit flowing to households under the program offers both an opportunity and a challenge to ensure that the program leads to the development of the micro-enterprise support ecosystem in addition to credit. It should be noted that nonfinancial services, such as advisory services, business development, incubation, and market support, are underdeveloped—especially in rural areas. In addition to access to finance, available nonfinancial services are an important balance to the current efforts of the government's support to SMEs. The State Committee on Investments allocated \$200 million to this program by attracting credit lines from international financial institutions. The funds are distributed to commercial banks through the National Bank of Uzbekistan.

As stated by the Chairman of the Central Bank of Uzbekistan,⁷² the government plans to establish the special development, which will be financed by all state programs and perform subsidized lending, and the current practice of providing subsidized credit through commercial banks will be abolished.

In an effort to boost SME exports, the Government of Uzbekistan created the Export Promotion Fund for Small Business and Private Entrepreneurship (EPF) under the National Bank of Uzbekistan (NBU) in 2013. The EPF provides the following services: Export marketing; support for the registration of export contracts with Uzbekistan's authorities; research on standards in target markets; legal services; and loans and financial services.

Taking into account the current economic reform, it is necessary to revise the SME finance policy framework and to provide tangible support to meet SME financing needs.

8. CONCLUSION AND RECOMMENDATIONS

SMEs are recognized as a “thrust sector” because of the contribution of this sector to jobs creation, ensuring social stability and economic growth. Despite being highly labor intensive, still a major portion of job opportunity is generated by SMEs. It plays a vital role in the balanced development all over the country. Despite the government's positive attitude toward SME financing in Uzbekistan, SME lending is still below the international level.

The regulator should consider allowing for larger loan sizes and relaxing rules about cash disbursement, and allow greater flexibility for MCOs in their sources of funding. The regulator could reinvigorate competition and increase the physical distribution of MCOs by allowing more market entry and permitting branching by MCOs. On their part, MCOs need to develop more efficiency to drive down operational costs and use credit.

The key barriers to SME access to finance can be summarized as the following:

- Deficiencies in a country's enabling environment in terms of both (i) SME development infrastructure (business development services, business incubators and business accelerators) and (ii) the overall legal and regulatory framework for financial institutions and SME alternative financing instruments and delivery channels; these are potentially the most significant impediments to unlocking substantial SME finance

⁷² See at: <https://www.gazeta.uz/ru/2018/11/24/banks/>.

- Market distortion due to a high-level state presence in the banking sector and a prevalence of subsidized lending practices, which hinder commercial microfinance and SME finance
- Inadequate capacity of financial institutions to serve the financing needs of SMEs due to a lack of effective instruments to assess SME creditworthiness and offer specific lending products such as factoring, trade credit, leasing and asset-based lending.
- Low level of SMEs' financial literacy
- High SME commercial lending rate
- High collateral requirements for SMEs
- Gender issues

To further increase SME access to finance the following recommendations are proposed:

- Improve the effectiveness of government SME financing support through the restructuring and consolidation of subsidy programs in the government's development bank, and eliminate the interest rate subsidies for existing and sustainable enterprises;
- Build a whole ecosystem of SME finance, which includes venture capital companies, business angels, platforms for the emergence and communication of start-ups, incubation and acceleration platforms;
- Improve access to finance for small businesses through regulatory reform, including addressing cash-flow-based lending, collateral alternatives, lending in cash, and better use of credit histories (develop credit scoring). In particular, removing certain prudential requirements for MCOs may include relaxing collateral requirements and removing the 10% of charter capital threshold on uncollateralized loan portfolio services. Providers should also be explicitly allowed to use such types of loan security as goods for sale and future harvest (currently, collectively used for less than 0.1% of all loans)—as these may be suitable options for many micro and SME finance borrowers;
- Optimize regulations to the development of digital services for SMEs;
- Support the development of a sound legal environment and institutional strengthening for effective functioning of partial credit guarantee fund;
- Design and implementation of SME financial literacy program to improve SME capacity to acquire finance;
- Partnership with international finance institutions to design the capacity building for commercial banks and microfinance institutions to serve SME market efficiently;
- In parallel, there is need for fundamental institutional and legislative reforms, including liberalization of land ownership, reduction of governmental intervention in agricultural production and marketing processes. In order to boost value chains besides horticulture, such as meat and dairy production chain, it will be necessary to introduce international SPS standards and principles and a change of philosophy in food safety and food security.

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