



PEER REVIEW NOTE

Enhancing access to finance for micro, small and medium-sized enterprises in Mongolia

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FOREWORD

The diversification of Mongolia's economy is a policy priority for the government. Micro, small and medium-sized enterprises (MSMEs) are the backbone of all Mongolian economic sectors except mining. To diversify its production structure, Mongolia needs to create the conditions for them to thrive.

In particular, access to finance has been identified as a major barrier currently facing MSMEs. An OECD Public Private Working Group was created at the beginning of 2016 to help design the right policies to address this barrier; it met three times in 2016 (Annex B). Chaired by Mr. Luvsandash Dashdorj, the Economic Advisor of the President of Mongolia, it brings together the government, the Bank of Mongolia, the Financial Regulatory Commission, public institutions such as the Mongolian Credit Guarantee Fund and the SME Development Fund, banking and business associations, private financial institutions, NGOs and other development partners.

This peer review note reflects the collective work of the Working Group, as well as the contribution of international experts, in particular from BPIfrance (France), DAMU (Kazakhstan's Entrepreneurship Development Fund), and from the OECD itself. The final recommendations presented in the note were endorsed during the Working Group meeting in October 2016 and will be peer reviewed during the Eurasia Competitiveness Roundtable at Eurasia Week 2016 in Paris, in the presence of international experts, representatives from OECD member countries and other Central Asian countries.

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ACRONYMS AND ABBREVIATIONS

ADB	Asian Development Bank
BoM	Bank of Mongolia
BPIfrance	Banque publique d'investissement
CAGR	Compound annual growth rate
CGF	Credit Guarantee Fund
DAMU	Kazakhstan's Entrepreneurship Development Fund
EBRD	European Bank for Reconstruction and Development
EU	European Union
EUR	Euro (currency)
FRC	Financial Regulatory Commission of Mongolia
GDP	Gross domestic product
IMF	International Monetary Fund
JICA	Japan International Co-operation Agency
MCGF	Mongolian Credit Guarantee Fund
MNT	Mongolian Tugrik (currency)
MSMEs	Micro, small and medium-sized enterprises
NBFI	Non-bank financial institution
OECD	Organisation for Economic Co-operation and Development
OSS	One-stop-shop
SMEDF	SME Development Fund of Mongolia
SDC	Swiss Agency for Development Cooperation
UNDP	United Nations Development Program
WB/IFC	World Bank/International Finance Corporation

MONGOLIA: KEY INDICATORS

Country profile	
Population, 2015	2.96 million
Surface area, 2015	1 566 000 km ²
GDP (USD, current prices) 2015	11.76 billion
GDP per capita (USD, current price), 2015	3 974
Real GDP growth (USD, constant prices) 2015	+2.3%
Inflation (average consumer prices, y-o-y change), 2015	5.8%
Exports of goods and services (% of GDP), 2015	44.9%
Imports of goods and services (% of GDP), 2015	42%
FDI, net inflows (% of GDP), 2015	1.66%
General government net lending/borrowing, percentage of GDP, 2015	-8.3%
Unemployment (% of total labour force), 2016	11.6%
Percentage of GDP in main sectors, 2014:	
- Mining	17%
- Agriculture	14%
- Wholesale trade and retail	12%
- Manufacturing	8%
- Construction	4%
Micro, small and medium-sized enterprises statistics	
Total number of businesses	65 711
Businesses with fewer than 50 employees	63 303
Percentage of MSMEs in selected sectors (out of total MSMEs):	
- Mining	0.9%
- Agriculture	5.4%
- Manufacturing	8.0%
- Construction	8.1%
- Wholesale trade and retail	36.1%
Access to finance statistics	
Outstanding loans (MNT, current prices), 2016 (July)	12 093 trillion
Average lending rate for loans in MNT, 2016 (July)	19.2%
Central Bank policy rate, 2016 (August)	15.0%
Deposit rate, 2016 (July)	13.2%
Outstanding loans to MSMEs (% of total loans), 2014 (December)	17.4%

Notes: MSMEs: Micro, small and medium-sized enterprises. The MSME definition according to the National Statistical Office of Mongolia is companies with no more than 49 staff members (see Figure A.1 in Annex A). MNT: Mongolian Tugrik (currency). USD: United States dollars (currency)

Source: National Statistical Institute of Mongolia official website, www.1212.mn (accessed 25 August 2016); Bank of Mongolia official website, <https://www.mongolbank.mn/eng/liststatistic.aspx> (accessed 25 August 2016); World Economic Indicators, World Bank, <http://data.worldbank.org/indicator> (accessed 25 August 2016).

EXECUTIVE SUMMARY

1. Mongolia's real gross domestic product (GDP) grew at an average annual rate of 11% during 2010–2014, driven mainly by rapid growth in the mining sector. However, slowing Chinese demand for mining products and falling commodity prices saw Mongolia's growth rate drop to 2.4% in 2015. Growth is projected to be flat in 2016, revealing the vulnerabilities arising from this dependence on a single sector. Diversifying economic activity and reducing exposure to commodity price fluctuations have thus become top priorities for the government. As most value added across non-extractive sectors is created by micro, small and medium-sized enterprises (MSMEs), their development will be critical to achieving these aims.

Access to finance is one of the major barriers to MSME competitiveness in Mongolia

2. While Mongolian MSMEs face numerous challenges, they consistently report access to finance as a major barrier to investment and growth. In 2015, domestic credit to the private sector as a percentage of GDP was 54.8%, compared with averages of 95.7% for Europe and Central Asia, and an OECD average of 146.5%. Loans to MSMEs accounted for less than one-fifth of the total (17%).

Five policy measures are suggested to help mitigate market failures affecting MSME access to finance

3. On the basis of its in-country missions and interactions with local public and private stakeholders (detailed in Annex B), the OECD has identified five major steps that Mongolia might take to improve MSMEs' access to finance. These recommendations draw on international experience in and support for SME promotion bodies in countries such as France and Kazakhstan, as well as on OECD tools and networks:

- 1) **Enhancing the quality of data on MSMEs** and adhering to the OECD Scoreboard on SME and entrepreneurship finance would foster an all-encompassing approach to collecting reliable and coherent statistics. At present, the various public institutions use a wide range of definitions, methods and measures. Greater consistency of SME definitions and data would help ensure that policies were based on sound analysis and evidence.
- 2) **Improving the product offer and scope of the SME Development Fund (SMEDF)** to enhance loan conditions for MSMEs. This would help close the gap between the existing loan offer and MSMEs' financial needs, particularly in terms of interest rates and duration.
- 3) **Improving the Mongolian Credit Guarantee Fund's risk assessment techniques and operational reliability** would make it more effective in reducing the need for high and systematic collateral requirements, which currently average close to 200% of the value of MSME loans and are applied in virtually every case (99.7%).
- 4) **Establishing one-stop shops for MSMEs and streamlining the process between SMEDF and banks** would make it easier for MSMEs to access loans. This would be a major improvement on the current very cumbersome loan application processes, requiring MSMEs to provide 25 to 30 different documents and to visit up to 6 different government institutions.
- 5) **Joining the OECD International Network for Financial Education and adding MSME-specific actions to the National Strategy for Financial Literacy** would strengthen firms' capabilities. Better understanding of financial concepts by MSME owners would help improve the quality of financial documents as well as MSMEs' ability to compare financial products across banks. This will in turn boost competition in the banking sector.

THE IMPORTANT CHALLENGE OF GIVING MICRO, SMALL AND MEDIUM-SIZED ENTERPRISES ACCESS TO FINANCE

Mongolia's micro, small and medium-sized enterprises (MSMEs) generate 25% of the country's GDP and 52% of its employment across a wealth of sectors. Nurturing and growing this important segment could help the country diversify its economy away from dependency on mining-based exports. This first section of this peer review note focuses on the main barrier to MSMEs' growth: access to finance. It outlines five main challenges faced by MSMEs in accessing loans. These include lack of data for sound policy making in favour of MSMEs, loans which are not adapted to MSMEs' needs, ubiquitous and restrictive collateral requirements, cumbersome application processes and poor financial literacy.

Context: Mongolia's undiversified economy is vulnerable

4. In 1990, Mongolia's peaceful revolution put an end to 70 years of one-party communist rule, opening the doors to the democratic multi-party system that has since been in place. The ensuing economic transition proved extremely difficult. In 1987 around 97% of Mongolia's trade was with Soviet-bloc countries (Earnshaw, 1987), so when the Soviet Union collapsed, a severe contraction followed: real GDP fell by more than one-quarter over four years. The country turned to the international financial institutions for help and for a time Mongolia became the fifth-highest recipient of international aid per capita in the world, while undertaking deep and wide-ranging market reforms in order to secure multilateral support.

5. After the recession bottomed out in 1993, Mongolia's economy started growing again, driven mainly by the mining sector. Growth averaged 3.2% per year from 1994 to 2000, rising to 7.2% per year from 2001 to 2008 on the back of rising global commodities prices. Following a brief contraction in 2009 (-2%), Mongolia's economy became one of the fastest-growing in the world with +11% per year from 2010 to 2014, largely driven by rapid growth of its mining sector – before slowing sharply to 2.3% in 2015. Declining Chinese demand for mining products and falling commodity prices, however, slowed real GDP growth to 2.3% in 2015, and it is expected to fall still further – to 0 % in 2016 (IMF, 2016).

6. Today the mining sector accounts for 17% of Mongolia's GDP. Most of the coal, copper and ore dug from the country's vast mineral reserves are exported to China, which is the destination for 87.9% of all Mongolia's exports. This dependency on a single sector and export destination is a crucial economic challenge for the country. Diversifying the economy is an urgent priority for achieving sustainable growth.

7. Most of the large companies operating in the country are concentrated in the mining sector, while micro, small and medium-sized enterprises (MSMEs) are the main players in all other economic sectors, especially agriculture, wholesale trade and manufacturing. Overall they generate 25% of GDP and 52% of employment (Mongolia National Statistical Institute, 2016). Policies to build their educational and financial capacity could therefore be one key to diversifying the economy.¹

8. A 2015 Bank of Mongolia (BoM) survey of MSMEs revealed that their main constraints were related to their "social, political and macroeconomic environment" (Bank of Mongolia, 2015b): 1) the limited purchasing power of the majority of the population;² 2) political instability, which has been the norm since 1990, with a new government every two years on average; 3) widespread mistrust of state institutions, which are often perceived as corrupt by the population and by MSMEs;³ and 4) high vulnerability to external economic conditions. Along with these macro-level issues, access to finance was reported by MSMEs as the main micro-level constraint to doing business (Bank of Mongolia, 2015). A

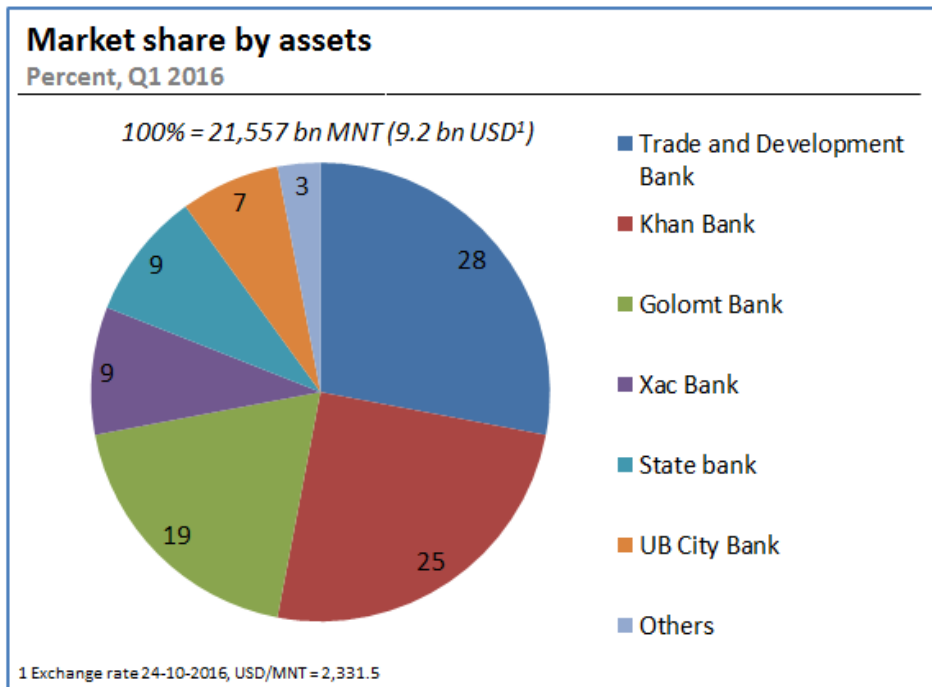
recent joint survey by the European Bank for Reconstruction and Development (EBRD) and World Bank also found that access to finance was the barrier most frequently cited by MSMEs (31% of respondents), followed by tax rates (12%) and inadequate education of the workforce (9%; EBRD and World Bank, 2015). In 2015, domestic credit to the private sector as a percentage of GDP was 54.8%, compared with averages of 95.7% for Europe and Central Asia, and an OECD average of 146.5%. Loans to MSMEs accounted for less than one-fifth of the total (17%), compared to 39% in Turkey and a median value of 44.2% in OECD countries (OECD, 2016; Bank of Mongolia, 2015c; World Bank, 2016).

9. Credit conditions and access to finance in Mongolia are naturally influenced by the monetary policy set by the BoM. The monetary base expanded rapidly in 2013-14, when the BoM directly injected liquidity into both the financial and corporate sectors. The share of BoM credit among total liabilities for commercial banks rose to 21% in 2013, from 2% in 2012. However, this share had fallen to less than 10% by the end of 2015, partially because of the phasing out of the Price Stabilisation Programme (PSP)⁴ and the tapering off of the BoM's quantitative easing programmes. At the same time, the role of local currency deposits as an alternative source of funding for banks has weakened, showing negative growth in the second half of 2015. This has further strained banking sector liquidity. The rapid growth of non-performing loans – from 4.3% of outstanding loans at the end of 2012 to 8.6% in the second quarter of 2016 – is an additional indicator of a substantial deterioration in credit conditions that has been particularly detrimental to MSMEs.

10. The Mongolian financial sector consists of 14 commercial banks, 17 insurance companies, 271 credit unions, 434 non-bank financial institutions (NBFIs) and 58 securities and brokerage firms as of the first quarter of 2016. The banking system provides 97% of total lending and 93% of MSME lending. Alternative sources of financing in Mongolia have a very limited role.⁵ While the number of NBFIs has grown considerably since the late 1990s, they remain very small, accounting for just 2% of financial sector lending; savings and credit co-operatives account for another 1%.

11. The banking sector is not particularly concentrated. The top five banks (all privately owned except State Bank, the smallest of the five) held 90% of the sector's total assets of USD 9.2 billion, and 90% of the loans (out of the total USD 5 billion) as of the first quarter of 2016 (Figure 1; EPCRC, 2016). The Herfindahl-Hirschman index (HHI),⁶ calculated as the sum of the squares of the market shares, is equal to 1 985 (in a scale from 0 to 10 000), which indicates only moderate concentration.⁷ Indeed, it might be argued that concentration is lower than one would expect for such a small economy, given the economies of scope and scale in banking. In any case, bank concentration is not considered to be a reliable proxy for (lack of) competition. The theory of contestable markets in fact suggests that the main players can be non-collusive and compete with each other and act in an environment with prospective new entrants (Box 1). This could lead to desirable outcomes from a consumer welfare perspective (OECD, 2011).

Figure 1. Mongolia's banking sector is not too concentrated



Note: MNT: Mongolian Tugrik (currency); Q1: first quarter; USD: United States dollars (currency)
Source: EPCRC (2016), *Mongolia: Banking Sector Overview*

Box 1. Competition in retail banking

In the absence of market imperfections, competition should drive the market towards efficiency by allocating resources in the most profitable market segments, thus encouraging agents to enter them. Banking competition should play a role in improving the loan offer for MSMEs, such as lower interest rates for loans or a lower degree of collateralisation. However, some research suggests that market power can in fact be associated with easier access to credit and better terms for small new and unknown firms. This is because large banks have the resources to create private information about borrowers that is unavailable to other players, which makes them able to lend over time on better terms and conditions (reducing the high default premium/rationing in the absence of that information). In a competitive market with frequent switches, this long-term, mutually beneficial relationship between large banks and small clients would be rarer, with increased costs for the latter.

Moreover, prudential regulation often conflicts with the aim of promoting competition. The banking business is inherently based on the trust of the consumers/clients in the financial system as a whole being stable. This means that allowing retail banks to fail, as would be necessary in a truly competitive environment, may make contagion more likely than in other sectors. An individual bank's failure to internalise risks imposes an externality on all other banks, as a run on one bank can spread fear about all the others, including healthy ones.

That is why the OECD Competition Committee has concluded that a focus on barriers to entry would moderately strengthen competition in the market without putting stability at risk. In particular, a main determinant of entry barriers is consumer behaviour. Inelastic consumer demand is often directly caused by lack of understanding of complex products, of credit conditions and of financial concepts that reduce consumer confidence and raise switching costs. The OECD suggests that the most effective ways of supporting competition would be to take steps to increase clients' financial literacy and simplify the administrative procedure for switching (see recommendations to improve financial literacy in this note).

Source: OECD (2011), *Bank Competition and Financial Stability*, <http://dx.doi.org/10.1787/9789264120563-en>; OECD (2008), *Competition and Regulation in Retail Banking 2006*; Policy Roundtable of the OECD Competition Committee, OECD Publishing, www.oecd.org/regreform/sectors/39753683.pdf; Petersen, M. A. and Rajan, R. G. (1995), "The effect of credit competition on lending

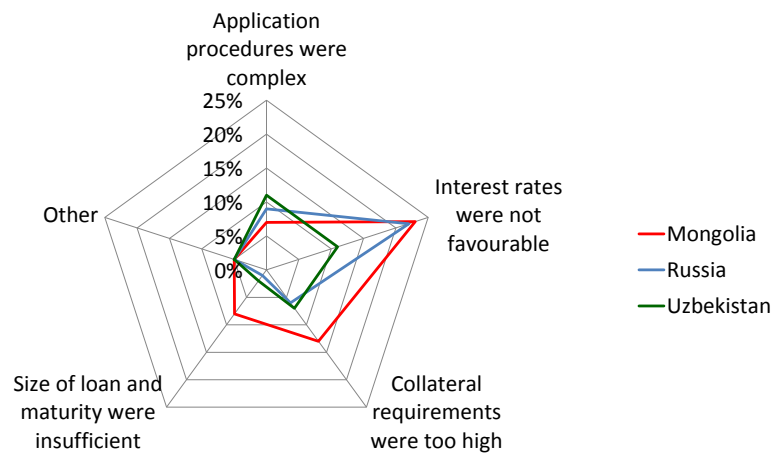
Overall objective: Diversify and grow the economy by enhancing MSMEs’ access to finance

12. To create a better business environment for MSMEs, Mongolia should focus primarily on enhancing access to finance by leveraging the role of the banking system. A system offering better loan conditions and guarantees would help to build trust among the players involved: MSMEs, financial institutions, individuals, and public institutions, such as the Mongolian Credit Guarantee Fund and the SME Development Fund. Easier credit would allow MSMEs to invest and expand both in internal and external markets, with positive effects on growth and employment.

Challenges: Credit is constrained by a variety of factors

13. The latest Business Environment and Enterprise Performance Survey (BEEPS V) found that 56% of Mongolian MSMEs do not apply for loans because they are discouraged by the credit conditions (EBRD and World Bank, 2015). MSMEs face a wide range of difficulties when accessing finance, including high interest rates (23% of respondents), collateral requirements (13%), size and maturity of loans (8%), and complex application procedures (7%, Figure 2). Moreover, interviews with financial institutions operating in the market show that MSMEs’ lack of financial knowledge hinders their ability to trust MSMEs and extend credit (EBRD and World Bank, 2015).

Figure 2. Mongolian MSMEs have some major problems in accessing finance



Source: EBRD and World Bank (2015), *Business Environment and Enterprise Performance Survey (BEEPS) V Country Profile: Mongolia*, <http://ebrd-beeps.com/countries/mongolia/>

14. Overall, these constraints can be categorised either into supply side or demand-side problems. The main supply-side issues include unattractive and costly loans, the high and ubiquitous requirement for immovable assets to be used as collateral, and the overly complicated administrative procedures. Low financial literacy is the main demand-side problem. This assessment was also confirmed in analysis by the Economic Policy and Competitiveness Research Centre (EPCRC), a Mongolian think-tank that carried out a horizontal policy assessment for the OECD in 2015-16.⁸ Moreover, the lack of coherent and accessible data on MSMEs and on their financing is an additional general issue for policy makers. These issues are

discussed in turn below, and Box 5 uses the example of Mongolia’s cashmere and textile sector to illustrate their impact on a sector with diversification potential.

Data on MSMEs are fragmented and lack coherence

15. Data on Mongolian MSMEs are gathered by a number of public institutions with limited or no co-ordination amongst them. Responsibility for data collection and analysis is currently shared by the Bank of Mongolia (e.g. data on financing, but also on behaviour and perceived difficulties of MSMEs), the National Statistical Institute (e.g. number, size, sector, geographical location) and the line ministries and their agencies, such as the Mongolian Credit Guarantee Fund (e.g. loan guarantees, SME guaranteed loans) and the SME Development Fund (e.g. financial needs, participation in government programmes). Additional data on MSMEs are gathered by the Chamber of Commerce through surveys among its members and by international organisations, such as the BEEPS survey conducted by the EBRD and World Bank. These independent surveys offer a specific service, disseminating data to the public and to researchers; they should be encouraged.

16. This lack of co-ordination makes it difficult to present a clear, transparent picture of MSMEs’ situation. Moreover, institutions gather data based on different definitions of MSMEs, thus creating inconsistency among data on the various aspects of their activities and structure. The SME law of 2007 defines MSMEs on the basis of staff headcount, sector of activity and turnover, while the National Statistical Institute focuses exclusively on staff headcount (Annex A). By comparison, the EU definition uses staff headcount and turnover but it does not differentiate by sector. To the extent possible, the data pulled together from different sources for this report have been selected to reflect the OECD Scoreboard on SME and Entrepreneurship Finance, which provides a comprehensive framework for assessing the financing needs of SMEs and entrepreneurs and the degree to which these are being met (Box 2).

Box 2. Key indicators for MSMEs’ access to finance in Mongolia

The OECD Scoreboard on SME and Entrepreneurship Finance currently covers 37 countries, and contains data on debt, equity, asset-based finance and framework conditions. These data are complemented by an overview of policy measures to ease SMEs’ access to finance (OECD, 2016). Figures related to the loan offer, collateral and loan application (complexity of application procedures and financial literacy) contribute to the main challenges faced by MSMEs in Mongolia and are addressed in the next sections. Table 1 contains some of the data on Mongolia based on the OECD Scoreboard on SME and entrepreneurship finance.

Loan offer	14.4%	share of SME loans in total business loans
	19.2%	average SME lending rate (July 2016)
	USD 50m	SME direct government loans (annual average, 2011-2015)
Collateral	99.7%	percentage of SMEs required to provide a collateral on their last bank loan
	200%	median collateral value required for a loan
Loan application	14%	SME rejection rate

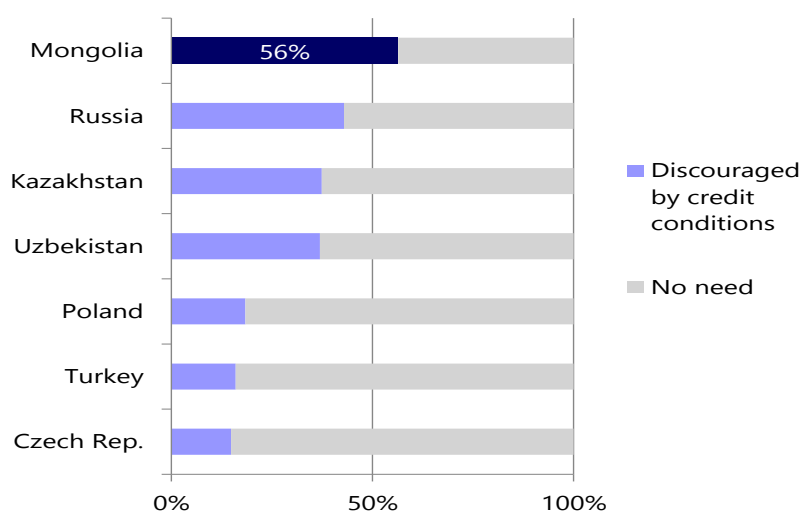
Source: EBRD BEEPS (2015), Bank of Mongolia, <https://www.mongolbank.mn/eng/news.aspx?id=1270> (2016), SME Development Fund and Mongolian Credit Guarantee Fund (direct interviews, 2016), OECD (2016)

The loan offer is not suited to the needs of MSMEs

17. Most MSMEs report that the loans on offer from banks and NBFIs do not meet their needs in terms of interest rates and duration. Interest rates are considered too high (average 19.6% in 2016), their maturities are too short (less than a year on average) and while the loans are large enough to provide working capital, they are usually insufficient to finance investment. The BEEPS V survey confirms that the share of MSMEs discouraged from seeking loans is the highest in the region (Figure 3).

Figure 3. Credit conditions in Mongolia are the most discouraging in the region

Share of MSMEs put off from applying for a loan because of credit conditions



Source: EBRD and World Bank (2015), *Business Environment and Enterprise Performance Survey (BEEPS) V Country Profile: Mongolia*, <http://ebrd-beeps.com/countries/mongolia/>

18. Undoubtedly, macroeconomic conditions influence the high rates and the profitability of lenders. With a base rate set by the Bank of Mongolia of 12% (increased again to 15% in August 2016), the interest rate spread for bank loans in Mongolia was 6.6% in 2015. This was in line with that of Russia (6.5%), but below the average for low and middle-income countries (6.9%). Moreover, since the tapering off of quantitative easing by the BoM, banks have been financing themselves with short-term, volatile and costly deposits (close to 12% on average in 2015). Their liquidity management is thus challenging, and explains their limited options for offering MSMEs the long-term loans required to invest and expand.

19. Mongolia has established the SME Development Fund (SMEDF) to support financing for MSMEs. Its role includes providing long-term concessional loans for MSME operations, helping MSMEs to access production equipment through financial leasing, promoting the activities of subsidised MSMEs, organising workshops and training, and offering double guarantees for credit. However, following every election the new government changes the status, location and responsibilities of the SMEDF which leads to instability in its function and structure. Prior to 2012 it was an agency within the Ministry of Agriculture and Light Industry, while from 2014 it was a department within the Ministry of Industry. Today it operates from the Ministry of Food, Agriculture and Light Industry.

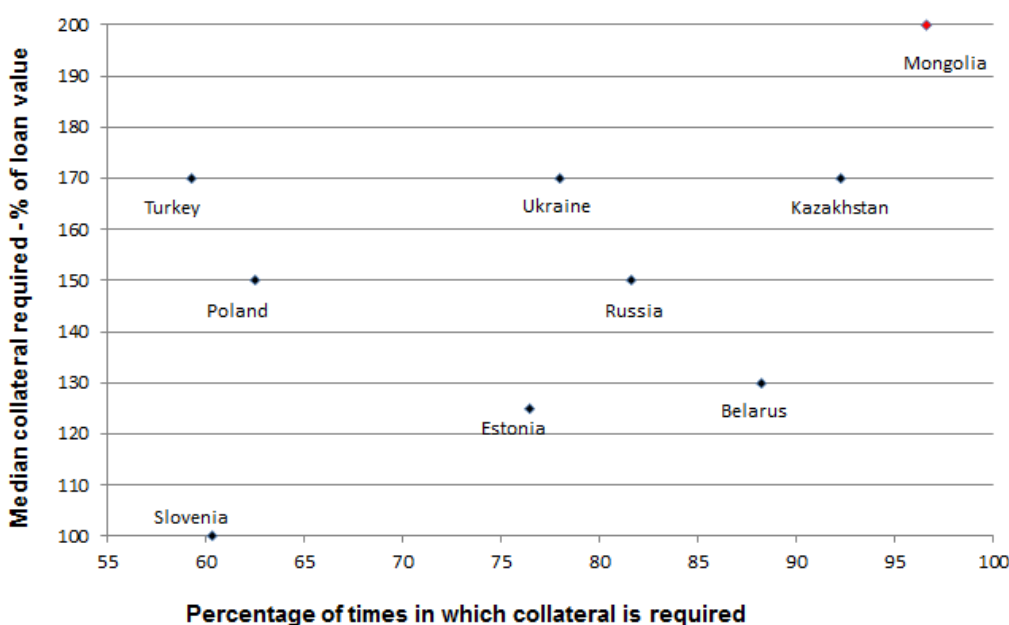
20. Between 2013 and 2016 the SMEDF provided MNT 276.1 billion in loans (USD 142 million) to 1 864 MSMEs. The government has recently approved another MNT 200 billion allocation to the SMEDF.

However, compared to similar funds in other countries, the SMEDF has a limited portfolio of products and is less developed. Most OECD countries have set up similar public funds to finance MSMEs and to compensate for market failures. These tend to provide a better loan offer to SMEs, including credit interest rate support.

Collateral requirements are ubiquitous and restrictive

21. In 99.7% of cases in Mongolia, banks require collateral to guarantee a loan. This is the highest percentage in Central Asia and far higher than the median of OECD countries (where only 40% of SME bank loans require collateral). Furthermore, Mongolia has the highest median collateral value required in the region, at 200% of the value of the loan. In OECD member countries the median value is 148% (OECD, 2016; EBRD and World Bank, 2015) (Figure 4).

Figure 4. Mongolian MSMEs face tough collateral requirements



Source: EBRD and World Bank (2015), *Business Environment and Enterprise Performance Survey (BEEPS) V Country Profile: Mongolia*, <http://ebrd-beeps.com/countries/mongolia/>

22. These tough requirements reflect the deep distrust by financial institutions when lending to MSMEs. Means of enforcing creditor rights are not particularly strong in Mongolia. The World Bank’s Doing Business 2015 rankings give Mongolia a score of 7 out of 8 for the strength of its credit reporting systems, but only 5 out of 12 for the effectiveness of collateral and bankruptcy laws in facilitating lending (World Bank, 2016a). The same study finds that the recovery rate for creditors in Mongolia is 17.4 cents on the dollar over four years,⁹ compared with an average in Europe and Central Asia of 38.3 cents over 2.3 years, and 72.3 cents over 1.7 years in OECD countries (World Bank, 2016a).¹⁰ Moreover, the World Bank’s survey on financial literacy reveals the inability of Mongolian MSMEs to present reliable accounts of their financial history (World Bank, 2012). This is exacerbated by banks’ and MSMEs’ reported difficulties in assessing the value of their assets.

23. As an additional constraint, only immovable assets (e.g. real estate, plants) are accepted as collateral, since they are the only goods properly registered in the credit registry managed by the Bank of

Mongolia. Although Mongolia lacks a registry of movable assets, a joint International Finance Corporation/World Bank project is currently developing one in co-operation with the government, through the *Law on Movable and Intangible Property Pledges* (MIPP law) and the *Law on the Implementation of the MIPP Law*. These were approved in July 2015 and due to come into force on 1 September 2016.

24. Information asymmetry is the core reason that commercial banks ration credit to MSMEs.¹¹ In this context, credit guarantee schemes (CGSs) can help banks accurately identify lending risk and improve their ability to make appropriate lending decisions (Levitsky, 1997). Public intervention is justified, because weak co-ordination among private sector providers may prevent them entering the market for credit guarantees (de la Torre, Gozzi and Schmukler, 2008). There is some evidence that CGSs are a cheaper way to expand access to finance than direct lending. CGSs are also market friendly, as the lending institution usually has sole responsibility for deciding whether to issue the guarantee (Beck et al., 2008). Moreover, CGSs can be a mechanism for risk transfer and diversification – by covering part of the default risk, the lender’s risk is lowered. CGSs are particularly relevant in emerging markets and developing economies as they can encourage banks and NBFIs to get into the MSMEs market, thus improving the institutions’ lending technologies and risk-management systems (World Bank, 2015c). Provision of credit guarantees is also the most widely used policy instrument in the 34 countries included in the OECD Scoreboard on SME and entrepreneurship finance which reviews policy measures to support SME finance (OECD, 2016).

25. The Mongolian Credit Guarantee Fund (MCGF) was established in 2013. It is the main institution in charge of providing guarantees to MSMEs in Mongolia. From 2013 to 2015 it issued guarantees to the tune of MNT 31.2 billion (USD 16m), unlocking a total of MNT 76.2 billion in loans (ADB, 2015). However, limited resources and unreliable operations have hindered its capacity to support the credit market, and operations have halted since mid-2015 due to the limited guarantee funds available and the decrease in applications sent by banks (Box 3). Banks have lost confidence since some guarantees were not re-paid by the MCGF; during interviews with the OECD they underlined that no guarantee was paid by the MCGF in 2016.

26. MCGF representatives also stated that fees amount to 3% of the loan and coverage is up to 60% of the total amount borrowed; this is in line with the OECD average. However, at 11.8%, defaults appear to be higher than similar schemes in other countries, such as Turkey’s Credit Guarantee Fund (around 5%), and Estonia’s KredEx (around 2%). This is even more striking given MCGF’s high rejection rate for applications (26.3% vs. KredEx’s 20%¹²). The OECD has carried out a short analysis of the MCGF’s risk scoring tool. While the tool appeared robust, staff’s lack of practice and capacity to use the tool to reduce the rejection and default rate appear to be a substantial problem. The fund’s team is currently working on improving internal operations with the support of international organisations.

Box 3. MCGF’s protocol for working with banks

The MCGF has a bilateral agreement that governs its relations with the banks. It also has an operational protocol with banks based on the following procedure. The MCGF establishes a co-operation agreement (called a framework agreement) with banks prior to operation. Once a bank submits an SME-borrower’s loan guarantee application to the MCGF for approval, the MCGF will revise the loan application as necessary, assess the risk and decide whether to provide the guarantee. Based on the decision of the MCGF Committee, which includes representatives from banks, the MCGF establishes a tripartite agreement with the bank and the borrower. After the guaranteed loan is issued, the MCGF conducts monthly monitoring and evaluation of loan utilisation, business operations and the repayment process. The bank subsequently submits monthly reports to the MCGF on loan repayment.

Source: OECD interviews, 2016

27. OECD interviews with banks suggest that there is limited trust in the guarantees offered by the MCGF. There are reported cases of the MCGF refusing to pay out the guarantee and preferring to go through trial instead. Without examining the specifics of these cases, it is apparent that trust in the MCGF can be heavily undermined in such circumstances, reducing the institution's effectiveness in sustaining the credit market. This is also confirmed by the results of the OECD survey on MSMEs, which indicates that bank officers are often not interested in the possibility of a guarantee by the MCGF as a substitute for collateral.

The administrative process to obtain a loan is cumbersome

28. Cumbersome procedures were the fourth most important reason given by Mongolian businesses for not applying for a loan (Figure 2): 7% of Mongolian businesses declare that they were discouraged from applying for a loan because of the procedures involved (EBRD/WB, 2015). This is similar to Kazakhstan (8%) and Russia (9%), but higher than some OECD countries, including Poland (4%) and the Czech Republic (2%). MSMEs and business associations interviewed by the OECD confirmed that MSMEs need to submit five different administrative documents, often involving multiple interactions with several public agencies and certification bodies (including the tax administration, local administration, and environment agencies). According to an OECD survey of MSMEs, the complexity of this process stems from insufficient co-ordination among and within government agencies, and with the SMEDF and banks; unnecessary documents being requested; the same documents being asked for several times; the requirement for burdensome and costly notarial seals; limited knowledge by agency staff; and lack of information provided by the administration.

29. MSMEs also face a complex process when applying for a subsidised loan from the SMEDF. The overall process takes between six and nine months according to MSMEs, and the uncertainty surrounding the various steps can be discouraging and make their application irrelevant. With very limited support, MSMEs must prepare a total of 30 documents for the two institutions (the private bank and SMEDF). Of these, seven are actually administrative documents that the MSME must submit to different public agencies (Table 1). Most official documents are available as online forms, except the social insurance statement which requires additional documents to be presented in person.

Table 1. Documents required by MSMEs for applying for a subsidised loan

Key:	Purple: Duplicated document	<u>Underlined: Document from public agency</u>
	Mongolian bank	SMEDF
Entrepreneurs	<u>A copy of citizen identification card</u>	Civil documents
	<u>Statement of Residential Khoroo¹</u>	<u>Statement of residential Khoroo¹</u>
	<u>Collateral information (copy of certificate)/inquiry whether it is already collateral</u>	<u>State registration certificate of rights to the collateral property</u>
	Application of executive official	
	Photo size 3x4	
Project	Business plan (extensive)	Business plan (extensive)
	Agreements related to the main operations (supply, purchase...)	Proposed sale plans and contracts
	Calculation of loan profit and repayment source	Loan repayment graphics
	Photos related with the main operations.	List of photos of equipment
	Ordering agreement	
	Official letter for the loan request	
	Shareholders' meeting resolution	
	Calculation of loan disbursement	
Company	<u>State Registration Certificate of Enterprise</u>	<u>State Registration Certificate of Enterprise</u>
	<u>Statement of Tax Administration</u>	<u>Statement of Tax Administration</u>
	Company charter	Company charter
	Brief introduction of the company	Information about current business
	Number of employee	Structure, number of employees
	Financial statements of previous years (by quarter)	Financial statement of previous year
	<u>License for manufacturing and services</u>	
	List of work done in the past, and estimated profit	
	Audit of financial statement	
	Annual report of 2012, 2013	
	Other/finance and statement related decomposition	
		<u>Social insurance statement, record</u>
		Location of enterprise
		Employees' major and professional qualification
		Annual turnover, sales, percentage of export
	Name, type and photos of products to produce	
<u>Total administrative documents required, of which overlapping</u>	<u>6</u>	<u>6</u>
	<u>5</u>	<u>5</u>
Total other documents, of which overlapping	19	12
	8	8
Total	25	18
Total overlapping	13	13
Total of 7 administrative docs + 23 additional docs = 30 total documents to be presented by SMEs		

Note: ¹Administrative subdivision of Ulaanbaatar

Source: OECD interviews with Mongolian banks (March 2016); Mongolian SME Development Fund official website, <http://smefund.gov.mn/32.html> (accessed 27 June 2016)

30. This administrative process is costly for companies in both time and resources. This is particularly acute for MSMEs which do not have dedicated staff and time to deal with these procedures. Interviews conducted by the OECD suggest that in some cases the complexity of the process discourages MSMEs from even attempting to access the financial system.

31. Various bank officials complained about the poor quality of the projects submitted to them during interviews with the OECD, but also reported a reluctance to refuse projects that had been approved by the SMEDF. They also said that the quality and robustness of loan applications supported by the SMEDF were questionable, and they underlined the lack of transparency of the process leading to this list (Box 4). The overall process takes between six and nine months according to MSMEs and the uncertainty regarding the various steps can make their application irrelevant and discourage them.

Box 4. The SMEDF's operational protocol

In the current setup, loan applications are assessed by the SMEDF, approved by the Ministry of Industry and submitted to banks as a list of selected loan applications. Following a decree issued by the ministry, the SMEDF and ministry's SME policy officers in district offices prepare the tenders and disseminate information to the public. MSMEs prepare applications and send them to district offices. District offices select those that meet the requirements and submit them to the Project Selection Committee (and Sub-committee) of the SMEDF. These committees, mainly composed of representatives of the SMEDF and the local administration (but not of banks), review and submit the list of selected projects to the Minister of Industry for approval. After receiving the approval, this list is transferred to the commercial bank or NBFIs (Ministry of Industry, 2016).

32. Since 2007, Mongolia has established 41 one-stop-shops (OSS) for citizens, with support from the Swiss Development Cooperation (SDC). These aim to increase the accessibility and transparency of public services related to social services, land, employment and notary procedures and programmes in all regions and most districts of Mongolia (ILO, 2016). In the first half of 2014 they served 845 000 customers, and the rate of satisfaction was high (SDC, 2014). However, they do not include business-relevant information and business associations; MSMEs interviewed by the OECD had little or no knowledge of these one-stop-shops. Various partners of the OSS have identified areas for improvement, including streamlining bureaucratic procedures further, improving co-ordination with local authorities, and giving the OSS a wider remit than simple information provision (ILO, 2016).

Understanding of complex financial concepts is limited

33. A financial literacy survey carried out by the World Bank in 2012 revealed that Mongolian adults had limited understanding of basic financial concepts, although the vast majority of the population was aware of financial products and had mastered basic arithmetic (World Bank, 2013). For example only 39% understood inflation correctly, in contrast to an average of 44% in the other countries included in the survey and 60% in advanced economies (World Bank, 2013). Another survey found that agricultural SMEs (mostly herders) were less familiar with financial concepts than firms operating in Ulaanbaatar and in regions with mining activities and companies. The Financial Regulatory Committee (FRC), the Bank of Mongolia and the Ministry of Finance have prepared a National Strategy for Financial Literacy that was approved in 2016; however, it does not include provisions explicitly designed for MSMEs. In addition, the strategy does not map the various initiatives around the country to expand financial literacy (such as the Banking Academy on the supply side and the National Incubation Centres Association on the demand side). Having an overview of these initiatives would allow them to be leveraged to unlock possible synergies and could avoid overlap (Bank of Mongolia, Financial Regulatory Commission, Ministry of Finance, 2016).

Box 5. Poor access to finance undermines the potential of the Mongolian cashmere and textile sector

Cashmere is a key resource for the Mongolian economy. The country produces about 2 500 tons of raw cashmere each year, making Mongolia the world's second largest producer of raw cashmere (15% of global production) after China (75%). The sector is the top non-mining related sector in Mongolian exports, representing 6% of national exports. Annual export revenues from cashmere and textiles are close to USD 300 million but they could be higher – a significant share of production is smuggled into China. Mongolia is currently concentrating on the production and export of raw cashmere – it would benefit from further developing local manufacturing of textiles and garments, and from targeting exports of higher value-added cashmere products. Only an estimated 30% of raw cashmere is converted into finished products in Mongolia (National Statistical Office of Mongolia, 2015).

Cashmere and textiles could play an important role in the diversification of the Mongolian economy. However, access to credit is holding them back. The Mongolian government has distributed USD 68.8 million to the sector in the form of Chinggis Bonds – state-issued bonds distributed through Golomt Bank. However, this approach, while benefiting SMEs, risks crowding out private investors and distorting market competition. The difficulties faced by businesses in the cashmere and textile sector when accessing finance reflect the four issues faced by MSMEs across the economy (the fifth issue – data quality – is only indirectly relevant for MSMEs):

- 1) **The loan offer is not suitable.** Loans have relatively short maturities and capital is expensive. For example, herder loans are provided for a maximum of two years. Interest rates on domestic currency loans fluctuate around 20%, twice the rate of foreign currency loans. Textile and garment manufacturing companies also face high interest rates, and the small sizes of loans prevent them from upgrading their equipment.
- 2) Herders and manufacturing companies in the cashmere sector also **lack collateral.** Herders face high risks due to climate vulnerability, nomadism and the absence of real property. Their lack of immovable collateral leads banks to undervalue assets and eventually stop lending to herders. Manufacturing companies also complain of undervaluation of their fixed assets, especially factories used as collateral. Banks interviewed by the OECD underlined the difficulty of valuing assets on the fluctuating real estate market. MCGF intermediation is therefore crucial to sustain lending to both targets. The cashmere sector represents 5% of MCGF users and 8% of guarantees, but is over-represented for high-risk loans (17%) compared to its share in national production (close to 10%). The MCGF also records a relatively high rate of non-performing loans (28%) in the cashmere sector.
- 3) **The procedure for obtaining a loan** can also be a barrier both for herders and textile manufacturing firms. More than 30 documents are required, and the process can take between two and nine months. More specifically, herders suffer from a lack of clear information and the difficulty of providing proof of permanent residence. Manufacturing companies interviewed by the OECD reported a lack of training and information on the part of both banks and public agencies.
- 4) The cashmere sector suffers from **low financial literacy.** There is a correlation between low financial literacy scores and high presence of herders in several regions (World Bank, 2013). Financial literacy difficulties vary along the value chain. While herders lack basic financial education, especially to make savings and investment decisions, manufacturers and exporters need training in advanced financial auditing and reporting, as well as developing a global financial strategy for their expansion.

Sources: OECD analysis, questionnaires and interviews; World Bank (2013), *Paving the Road to Better Financial Decision-Making in Mongolia*, <http://responsiblefinance.worldbank.org/~media/GIAWB/FL/Documents/Surveys/mongolia.pdf>; Bank of Mongolia (2015); National Statistical Office of Mongolia (2015), *Mongolia Monthly Statistical Bulletin*, December 2015; UNESCO (2013), UNESCO (2013), UNESCO Institute for Statistics, database, www.uis.unesco.org/DataCentre/Pages/default.aspx (accessed 7 July 2016).

Notes

¹ Government policies to facilitate diversification and quality upgrading include many areas than other access to finance, such as infrastructure, accumulation of human capital, establishment of trade networks, functioning of factor markets etc.

² Rising inequality due to fast economic growth is fuelling social tension, even if poverty is being reduced (World Bank, 2015b; Theunissen, 2014).

³ Mongolia ranked 72nd out of 168 countries in Transparency International's Corruption Perception Index in 2015 (Transparency International, 2016). Mongolia is part of the OECD Anti-Corruption Network for Eastern Europe and Central Asia. The country has started a number of important reforms including in the anti-corruption area, but they are still far from producing sustainable results (OECD, 2015a).

⁴ The PSP aimed to decrease supply-driven inflationary pressure, especially for the main consumer goods such as meat, flour, retail gas and apartment construction. It did so by directly financing SMEs operating in the sectors. The outstanding programme loans amounted to MNT 714.1 billion at the end of 2013, MNT 633.8 billion at the end of 2014, MNT 232.3 billion at the end of 2015 and are forecast to be down to MNT 27.3 billion at the end of 2016 (Bank of Mongolia, 2014).

⁵ Mongolia's experience with microfinance has a long history, being developed in the late 1990s with the support of international organisations. In 2002 the Mongolian Parliament enacted laws to define the roles and responsibilities of non-bank financial institutions and legalising savings and loan co-operatives. In 2001, a consortium of these institutions became XacBank They also created the specialised division XacLeasing, which is introducing the practice of leasing in the SME market. The penetration percentage for leasing as a means of financing in the equipment sector is still low. The EBRD's SME Leasing Policy Initiative has been designed and implemented to support the development of the practice in the country (UNDP, 2016).

⁶ In the literature, there are other more direct measures of bank competition, such as the Panzar and Rosse H-Statistic, the Lerner index and the so-called Boone indicator. These indicators try to represent actual player behaviour in the market, but their fragility resides in the necessity for very reliable firm-level statistics that can allow the researcher to calculate input costs precisely. This leads to very restrictive assumptions about banks' cost functions.

⁷ According to the US Department of Justice and Federal Trade Commission 2010 Horizontal Merger Guidelines, the agencies will regard a market in which the post-merger HHI is below 1 500 as "unconcentrated", between 1 500 and 2 500 as "moderately concentrated", and above 2 500 as "highly concentrated".

⁸ The EPCRC analysis focused on four dimensions: access to finance for MSMEs; institutional and regulatory framework for SME development; skills for SME development; and SME internationalisation tools.

⁹ This takes into account the time, cost and outcome of the most common insolvency proceedings and their regulation.

¹⁰ In particular, Mongolia was ranked 59th out of 182 countries in the "Getting Credit" ranking and 89th in the "Resolving Insolvency" ranking, scoring 11 out of 16 for the "Strength of the Insolvency Framework" index.

¹¹ Gathering information to assess the credit worthiness of MSMEs is challenging and costly for banks, and this leads to strong uncertainty when calculating the expected rate of returns from the loan. Stemming from this imperfect information, the interest rate a bank charges may itself affect the riskiness of the pool of loans by sorting potential borrowers (adverse selection effect) and affecting the action of borrowers (incentive effect; Stiglitz and Weiss, 1981).

¹² These data refer in particular to the construction sector.

RECOMMENDATIONS TO ENHANCE MSMEs' ACCESS TO FINANCE

The Government of Mongolia has a key role to play in ensuring easier access to loans for MSMEs. This section makes five main recommendations and details the eight steps needed to diversify the loan products on offer, improve the risk assessment tools of the Mongolian Credit Guarantee Fund, streamline the administrative procedures involved in applying for a loan and build the financial literacy of MSMEs. It also applies these recommendations to the case of the cashmere and textile sector.

34. In 2015, the OECD adopted the G20/OECD High-Level Principles on SME Financing, following a request from the G20 Finance Ministers and Central Bank Governors (G20/OECD, 2015). These principles form the basis for much of the analysis in this chapter, and the Mongolian government could consider them when developing its long-term strategy for SME development, as they give an all-encompassing view of the most relevant policy areas. These include improving the evidence base; strengthening SME access to bank financing; promoting financial inclusion; improving transparency in SME finance markets; including risk-sharing principles in publicly supported SME finance instruments; and the best way to monitor government programmes.

35. In particular, in order to improve the ability of MSMEs to obtain loans for their working capital and investment projects, it is recommended that the Government of Mongolia design and implement a consistent plan aimed at streamlining the loan offer and making them more affordable. At the same time, the government also has a fundamental role to play in providing entrepreneurs and MSMEs with a stronger grounding in financial planning to ensure that loans can be repaid thanks to companies' healthy financial management. Credit conditions and accessibility (especially in rural areas) should be tackled with a comprehensive national strategy that should be included in the next national SME strategy.

36. Specific recommendations are as follows:

- gather and disseminate more coherent and reliable data on MSMEs through a co-ordinated approach by the Bank of Mongolia, National Statistical Institute and line ministries, while also leveraging the OECD Scoreboard on SME and entrepreneurship finance
- develop the conditions for a better and less costly loan offer to MSMEs by diversifying the products offered by the SME Development Fund (SMEDF)
- overcome the collateral issue by improving the Mongolian Credit Guarantee Fund's risk appraisal techniques and building the trust of banks
- make it easier for MSMEs to request loans by streamlining the banks' and SMEDF's administrative processes through a one-stop-shop backed up by support and training, and enhancing the co-operation between the SMEDF and partner banks

- increase financial literacy through public-private co-ordination, including activities for MSMEs in the National Strategy for Financial Education, and creating tailored tools to meet MSME needs, also leveraging the expertise of the OECD International Network for Financial Literacy.

37. The remainder of this chapter provides more details on each of these recommendations, and Figure 5 at the end of the report provides a roadmap/timeline for their implementation. The chapter also applies these recommendations to the case of the cashmere and textile sector.

Develop and disseminate coherent data on MSMEs

38. Reliable and coherent data are a necessary precondition for effective policy design. It is recommended that Mongolia increase co-ordination across the various institutions in charge of MSME data collection. To this end, the OECD Scoreboard on SME and Entrepreneurship Finance could provide a comprehensive and internationally comparable framework.

Action A: Develop a co-ordinated approach among public institutions and consider joining the OECD Scoreboard on SME and entrepreneurship finance

39. The varying definitions of MSMEs used by the various state institutions, in some cases differing from the 2007 SME law, should be harmonised. A whole-of-government approach will help to overcome the lack of co-ordination among the public bodies collecting and working on MSMEs data. The OECD Scoreboard could provide a basis for not only ensuring harmonisation of practice across government bodies, but also for enabling Mongolia to develop data better suited to international comparisons. A list of core indicators is presented in Table 3.

Table 2. Core indicators of the OECD Scoreboard on SME and entrepreneurship finance

Core indicators of the OECD Scoreboard	Data availability (Y/N)	Mongolia: Source of Data
1 - Share of SME loans in total business loans	(Y)	Bank of Mongolia
2 - Share of SME short-term loans in total SME loans	N	Not published (Bank of Mongolia)
3 - SME loan guarantees	(Y)	Not published (Mongolian Credit Guarantee Fund)
4 - SME guaranteed loans	(Y)	Not published (Mongolian Credit Guarantee Fund)
5 - SME direct government loans	Y	SME Development Fund
6 - SME rejection rate	(Y)	BEEPS – EBRD/World Bank
7 - SME loans used	(Y)	BEEPS – EBRD/World Bank
8 – SME NPLs / SME loans	N	Not published (Bank of Mongolia)
9 – SME interest rates	(Y)	BEEPS – EBRD/World Bank
10 – Interest rate spread between large and small enterprises	N	Not published (Bank of Mongolia)
11 – Percent of SMEs required to provide collateral	Y	BEEPS – EBRD/World Bank
12 – Venture and growth capital	(N)	Various private equity funds
13 – Asset-based finance	N	-
14 – Payment delays	N	-
15 - Bankruptcies	N	-

Source: OECD (2016), *Financing SMEs and Entrepreneurs 2016: An OECD Scoreboard*, http://dx.doi.org/10.1787/fin_sme_ent-2016-en.

Diversify the products offered by the SME Development Fund

40. The SMEDF is best placed to support a better and more extended loan offer to MSMEs through direct lending and co-financing with banks. The operations of the fund are being re-organised, and the Department for Coordination of SME Policy Implementation is now under the Ministry of Food, Agriculture and Light Industry. This is expected to ensure greater stability of resources and governance, which would allow continuity in the operations and more reliability for all its partners, especially banks and MSMEs. A good example for Mongolia to follow is that of KOSGEB, the Turkish SME development organisation (Box 6). KOSGEB supports loans to SMEs through credit interest subsidies and has a diversified loan offer which responds to the needs of MSMEs.

Box 6. Tailoring financial services to SMEs in Turkey

According to the OECD Scoreboard on SME and entrepreneurship finance, SME loans in Turkey increased by 22.7% in 2014 compared to 2013, to reach a total of 38.2% of total business loans. Non-performing Loans (NPLs) have remained limited since 2010 and were recorded at 3.4% of total loans (OECD, 2016). Public support for access to finance for SMEs in Turkey is mainly provided by KOSGEB, the Turkish SME development organisation affiliated to the Ministry of Science, Industry and Technology. It supports the development of more than 850 000 registered SMEs in the country. KOSGEB offers a wide range of financial products to improve access to finance for SMEs, including credit interest support, guarantees, training and equity.

Regarding credit interest support, KOSGEB works in close co-operation with banks. KOSGEB pays the loan interest for SMEs which receive loans from banks under a contractual agreement with KOSGEB. Loans supported by KOSGEB cover various SME needs, such as working capital, exports, investment, new employment and energy efficiency. Since 2003, more than 214 000 SMEs have benefited from the programme, representing USD 370 million in loan interest support and USD 4 billion of credit volume created.

To enhance SMEs' access to its services, KOSGEB has an extensive network of branches, 88 service centres and 33 technology development centres. It is present in all Turkey's provinces. This large network is also leveraged to offer many different forms of non-financial support to MSMEs: from enabling Turkish companies to take part in international trade fairs, to training and mentoring – especially through the adoption of the "Entrepreneurship Support Programme". KOSGEB has also signed 83 research and development innovation protocols.

KOSGEB also offers a very interesting example of financial literacy promotion. It has established e-learning infrastructure called "SME Campus", a dedicated platform for SME e-training. Moreover, an agreement between KOSGEB and the Council of Higher Education underpins university-business co-operation involving a dedicated platform (USIMP).

Sources: OECD interviews with the KOSGEB; OECD (2016), *Financing SMEs and Entrepreneurs 2016: An OECD Scoreboard*, http://dx.doi.org/10.1787/fin_sme_ent-2016-en

Action B: Diversify SMEDF's products

41. Currently the SMEDF's offer through the partner banks is limited to a few types of loans and leases. SMEDF's management should expand this offer to better address the needs of MSMEs throughout their life cycles (e.g. seed capital, export, cash flow, long-term investment). According to international experience, the loan portfolio should therefore include: new start-up loans, express loans (cash flow), fixed capital loans, international development loans, green loans, innovation loans and export loans, among others. Double guarantees should be designed in mutual partnership with the private sector, also including the MCGF when necessary. A single MSME should be able to request more than one type of loan, depending on the goal of its project or investment plan. Each type of loan should vary in its maturity, size, rates and collateral requirements (ideally none) to tailor it to need. In addition, specific loan programmes could be created to target priority MSME types, such as start-ups. As start-ups are particularly sensitive to

external financing conditions, they may benefit strongly from programmes such as seed financing and long-term innovation loans, as well as possibly equity financing.

42. BPIfrance, the French public bank for SMEs, gives access to a vast portfolio of loans from which SMEs can select through the website or directly in agencies. Moreover, BPIfrance has recently incorporated a Private Equity division that focuses on French companies with good growth potential. DAMU, the SME fund in Kazakhstan, has organised its loan offer by sector, regional presence, and target (e.g. programme to support the manufacturing industry, programme to support regional priority projects, microcredit for women's entrepreneurship).

Ease collateral demands by making the Mongolian Credit Guarantee Fund more effective

43. In order to reduce the need for overly demanding collateral requirements, the Mongolian Credit Guarantee Fund (MCGF) needs to improve its risk assessment techniques and product offer. It also needs to increase co-ordination with and build the trust of private sector players. This may require modifying the provisions in the current law on the Credit Guarantee Fund. International experiences may offer viable models for increasing reliability for all stakeholders (government, banks and MSMEs). Most successful CGSs in OECD countries involve frequent visits to banks' offices and exchanges with management and loan officers. For example, broad international experience in CGS management, especially appropriate funding and best practices for monitoring the fund, could be drawn on, especially the World Bank's high-level *Principles for Public Credit Guarantee Schemes for SMEs* (World Bank, 2015c). The MCGF should expand its operations to support development, and could consider including banks on its board and involving them in the guarantee appraisal. Finally, the MCGF should improve its claims management.

Action C: Strengthen trust relations between MCGF and banks by including bank representatives on MCGF's board, by implementing financial agreements and by sharing risk assessments

44. The MCGF could update its operational protocol and start co-operation with banks on risk procedures prior to drafting the framework agreement, in order to reflect agreed upon practices in the agreement. In addition, it is recommended that the MCGF engage in frequent interactions with banks to discuss and adjust risk assessment policies and to share practices and views on applications. This would ensure a mutual understanding of the guarantee assessment and provision, and better management of default. Including banks on the board of the MCGF would increase trust and allow the financial sector to have shared ownership of the instruments, with positive effects on MCGF's expansion and effectiveness. International experiences like those of DAMU and BPIfrance have illustrated the positive impact of this arrangement. This would be complementary to the financial capacity needed to implement the financial agreements with private players.

45. BPIfrance has a network of regional offices which include banks on the governing board so they can participate in decisions on loan and risk assessment policies. Moreover, BPIfrance loan officers are required to show a good understanding of the sector and the business operations of the SME, in addition to having loan assessment skills. The staff always visit the SMEs' facilities when assessing the loan, sometimes jointly with banks. Moreover, BPIfrance meets with partner banks almost weekly to agree on the loan assessment and ensure that its processes and policies are aligned with those of each partner bank.

Action D: Enhance risk appraisal using risk assessment tools from banks and institutions with international experience

46. The MCGF could improve its risk assessment tools by leveraging international experiences. Most of the operational indicators of the fund are in line with international experience: the share of total MSME loans covered by guarantees is, at 1.4%, similar to DAMU's and higher than Estonia's KredEx

(0.5%) and Turkey's CGF (0.2%). Pricing mechanisms should be linked to risk exposure, usually charging a guarantee commission fee covering administrative and management costs.¹³ The MCGF's fees can go up to 3% of the value of the guarantee, comparable to Turkey's CGF, while KredEx's go up to 1% and DAMU's to 0.1%. Coverage of the guarantees is up to 60%: this is somewhat lower than, but still in line with, international players (DAMU, KredEx and CGF of Turkey are at 70%, 75% and 85% respectively). A comparison of 70 schemes worldwide revealed an average coverage ratio of 80%, although coverage is lower for more risk-averse schemes (without public funds) or schemes exposed to higher risks (Beck, 2010).

47. The MCGF could benefit from further capacity building and support in implementing risk assessment tools and procedures. It should also consult with banks before and during the risk assessment to align methods, and to agree on the risk-scoring results and the decision on providing (and later paying) the guarantee. This will be key for building the trust of the banks. In principle, all parties involved (SMEs, banks, credit guarantee schemes) should retain a sufficient share of the risk and responsibility to avoid moral hazard (OECD, 2013a). Concerning the late payment of the guarantee, the World Bank's *Principles for Public Credit Guarantee Schemes for SMEs*, especially Principle 13, give general guidelines for structuring an efficient claim management process, providing incentives for loan loss recovery and aligning with the legal and regulatory framework (World Bank, 2015c).

48. BPIfrance uses a dedicated computerised instrument for risk assessment, which assigns a score to counterparty risk, project risk and transaction risk. The rating obtained is only a support to decision making, which also takes into account immaterial elements, such as qualities and weaknesses of the project, the entrepreneur profile, market perspectives and others. BPIfrance also leverages its extensive experience by combining statistical data on defaults of past projects, observed over long periods, to infer the most appropriate multiplier for each fund.

Streamline administrative procedures for loan applications

49. The government could undertake several actions to simplify the administrative process of obtaining key documents for loan applications to banks and the SME Development Fund and make it more business friendly, not least by reducing the number of required documents and making them more easily accessible.

Action E: Increase co-ordination between SMEDF and partner banks

50. The SMEDF should allow banks to join the decision-making process at the earliest possible stage by organising regular knowledge-sharing meetings. It may consider including them on both the loan selection committee and the board (possibly as rotating members, to ensure the independence of the institution). While loan applications are currently first assessed by the SMEDF and then by banks, the SMEDF has indicated that it might change its process for spending new funds allocated for 2016 so that loan applications would be assessed by banks before being reviewed by the SMEDF, a practice that offers considerable advantages. The review would involve regular discussions and knowledge sharing between the banks and the SMEDF. The SMEDF should hold discussions with the banks to agree on the documents and forms to be requested by each partner bank. The procedure could be aligned with that of partner banks, so that the MSME does not need to produce additional documents for the bank and for the SMEDF. This practice would not only strengthen trust relations with banks, it would also simplify the process and reduce the number of administrative documents required to apply for subsidised loans. It could mean that at least 13 documents would only have to be submitted once (instead of twice as is currently the case – see Table 2). It would also better align the procedure to reduce the remaining 17 documents that need to be submitted (see next action point).

51. BPIfrance’s more established practice allows SMEs to negotiate either with the bank or with BPIfrance – the application is sent to the other co-financer once approved by the first institution. As the documents required by the banks and BPIfrance are similar, they are requested only once by the first institution in contact with the MSME to avoid duplication of procedures. This model requires deep trust between banks and BPIfrance. In the case of DAMU, the bank receives and analyses the request, and transmits it to DAMU if the case is strong enough. DAMU checks the quality of applications and either accepts or rejects the co-financing. DAMU’s board membership includes its partner banks.

Box 7. DAMU’s support for SME development in Kazakhstan

The role of SMEs in Kazakhstan’s economy has become more and more important in recent years. The number of SMEs more than doubled between 2005 and 2014. In the same period, SMEs’ share of employment increased from 25.8% to about 32%. Similarly, whereas in 2005, SMEs generated 10.5% of Kazakhstan’s GDP, by 2014 this figure had risen to about 25%. Kazakhstan’s Entrepreneurship Development Fund (DAMU) was established in 1997 by the Government of the Republic of Kazakhstan. To start with, DAMU mainly managed state budget funds for the programme of measures to support domestic commodity producers. It was only in 2002 that the fund started to provide small businesses with financial resources.

DAMU has two key goals. The first is to ensure and strengthen financial support for SMEs. The increase in the volume of financial support for SMEs is achieved through co-operation with second-tier banks, the recourse to a subsidised fee rate for credits, the provision of loan guarantees, the development of the microfinance sector, and the attraction of extra funding from domestic and external markets (e.g. ABR Fund, National Fund of RK etc.). Secondly, DAMU aims to promote SME competencies. It pursues this goal by offering training opportunities to entrepreneurs, extending the outreach of consulting services (more than 200 centres have already been set up all around Kazakhstan), and introducing new forms of distance consulting methods, such as call centres and business portal services.

DAMU provided financial support to 23 995 borrowers for a total amount of KZT 1 391 billion (USD 4.2 billion). Furthermore, 1 484 projects for a total loan amount of KZT 293 billion (USD 885 million) were financed from the National Fund in the manufacturing and services sector.

Sources: DAMU (2014a), “Development strategy of “DAMU Entrepreneurship Development Fund” JSC for 2014-2023 years”, presentation, DAMU, Almaty, www.damu.kz/content/files/Presentation_FundDamuStrategy2014_2023.pptx; DAMU (2014b), Report on the status of development of small and medium enterprises in Kazakhstan and its regions, www.damu.kz/20664; DAMU (2016), History and key milestones, webpage, www.damu.kz/239 accessed 17 October 2016.

Action F: Reduce the number of documents required by banks

52. In order to stimulate demand for loans, the government could consider reducing the number of official documents required by banks from MSMEs. In France, the number of documents required by banks is generally slightly lower, with up to 18 documents related to the project, the entrepreneur and the company. In particular, French banks only require three administrative documents to be submitted, compared to five in Mongolia (see Table 4).

Table 3. Documents required to obtain a loan

	Mongolian Bank	French bank
Official documents required	A copy of citizen identification card	Identification
	Statement of tax administration	Recent fiscal statements / tax bill
	State Registration Certificate of Enterprise	Recent Kbis (state registration of enterprise)
	Statement of residential Khoroo ¹	
	Licence for manufacturing and service	
TOTAL	5	3

Note: ¹Administrative subdivision of Ulaanbaatar

Source: OECD interviews with Mongolian banks (March 2016); OECD interviews with French banks (April 2016)

Action G: Consider implementing one-stop-shops for MSMEs

53. The principle of a one-stop-shop is to bundle in a single physical/online space all the procedures required for business administrative processes. The gain in efficiency is two-fold: a one-stop-shop should not only simplify the procedure for the entrepreneur, it should also help co-ordinate the various ministries involved in the process. Creating one-stop-shops for businesses would save the MSMEs a considerable amount of time. By providing a single interface for questions and clarification, this would strongly simplify the administrative part of the process, avoid contradictions and make the timings more predictable. It would also optimise costs for the public administration. Georgia provides a good example of a successful one-stop-shop for businesses (Box 8).

54. Mongolia could extend its current citizens' OSSs to include services to businesses. New OSSs may also be needed. To set these up, the government could consider the following steps:

- Secure high-level political support and buy-in through discussion and government endorsement. The launch of this project will also require a wide media campaign by the government to inform businesses, and will also require the support of business associations including the Chamber of Commerce and Industry.
- Give a clear mandate to the Ministry of Food, Agriculture, and Light Industry to co-ordinate the work with other administrations, and to identify which administrative processes should be handled by the one-stop shops. This could be done by selecting the processes and documents which are the most used by MSMEs, and by leveraging the procedures currently supported by the existing OSS.
- Consult widely to identify the needs, key missing procedures and access limitations for businesses in the current OSSs. Identify those procedures that can be dealt with by the OSS on behalf of businesses, revising and simplifying protocols and guidelines with the relevant administrations, and agreeing on the transfer of authority from the administration to the one-stop-shop for approving and rejecting applications.
- Agree on clear, transparent and shared business pricing and location of the shops, potentially in different locations from the existing OSSs (OECD, 2013b).
- Staff the OSSs by detaching staff from line ministries and providing additional staff (OECD, 2010).
- Establish information technology tools and a database to address and store requests (ILO, 2016).
- Launch two pilot OSSs – one in Ulaanbaatar and the other in a district outside the capital – to test the robustness of the model in two different contexts.

55. In the future, the government could also consider launching an electronic one-stop shop to allow businesses to conduct all procedures online, as was done in Kazakhstan. Kazakhstan has also developed an efficient e-government system that delivers all licenses electronically through a single website. Most administrative procedures can now be conducted online, which saves time and resources for businesses (OECD, 2014).

Box 8. One-stop-shops for businesses in Georgia

In 2012, the Georgian government introduced a “single window principle” by creating the Public Service Hall; a large centre where all certificates needed to launch a business are provided. After creating the first one-stop-shop in Batumi, Georgia replicated this initiative across the country – to 13 other cities and regions. The large diversity of services provided, 400 in total, as well as the effectiveness of this organisation, explain its success.

Starting a business in Georgia now only requires two procedures and takes on average two days. In 2012, the Public Service Hall was awarded the United Nations Public Service Award in the category “Improving the Delivery of Public Services”. The World Bank Doing Business report 2016 ranked Georgia 6th in 2016 for its ease of starting a business.

Sources: Government of Georgia (2016), Public Service Hall website, <http://psh.gov.ge>; OECD/European Union/EBRD/ETF (2015), *SME Policy Index: Eastern Partner Countries 2016: Assessing the Implementation of the Small Business Act for Europe*, <http://dx.doi.org/10.1787/9789264246249-en>; World Bank (2016a), *Doing Business Indicators*, <http://www.doingbusiness.org/rankings> (accessed 1 August 2016).

Improve financial education by ensuring the national strategy is tailored to MSMEs

56. Good financial literacy is an important element in improving access to finance. It is defined as the ability of individuals to make informed judgements about financial products and behaviour and to take part in financial decisions (OECD, 2013a). A high level of financial literacy not only contributes to financial well-being and to financial market stability, it also helps improve access to finance through a better understanding of financial products. Low financial literacy remains a major obstacle for MSMEs in Mongolia to access finance, because they are generally considered un-bankable due to their weak management skills and poor financial reporting (World Bank, 2012).

57. In 2016 Mongolia started to implement a national strategy for improving citizens’ financial literacy, further building their capability to make sound financial decisions, increasing long-term saving, and enhancing trust in the banking system and promoting long-term, sustainable economic development in the country (Bank of Mongolia, Financial Regulatory Commission and Ministry of Finance, 2016). The structure of the strategy follows quite closely the High-level Principles on National Strategies for Financial Education developed by the OECD International Network on Financial Education (Box 9). The strategy has been approved and is now being implemented. Mongolia has set up permanent public-private co-ordination working groups, which are critical to avoid unnecessary overlap and to ensure effective and sound implementation.

58. The country now needs to ensure that the structure of the national strategy involves all relevant stakeholders and addresses all relevant target groups: currently it focuses only on personal and household finances. Although younger people and rural dwellers are addressed as target groups, the national strategy does not refer to entrepreneurs or MSMEs. This would also encourage competition in the banking sector, as more informed customers (citizens and MSMEs) would be able to assess more precisely which offers might be the most convenient for them and if and when it is worth switching banks/financial provider. It may also push commercial banks to develop “switching packs” that allow a smooth transition between different bank accounts.¹⁴

Box 9. OECD/INFE high-level Principles on National Strategies for Financial Education

Within a fast-evolving financial landscape, where access to financial services is made easier as more risks are being transferred to citizens, financial literacy has become a key life skill for individuals. Financial education can help enhance financial literacy and contribute to individuals' participation in financial, economic and social life. As a complement to financial inclusion and financial consumer protection policies, financial education is also important to restore confidence and trust in financial markets, and can support financial stability. An increasing number of countries have started developing nationally-coordinated financial education policies as a way to bring together the relevant stakeholders, avoid duplication and save resources.

Mongolian public institutions involved in financial education should consider joining the OECD International Network for Financial Education (INFE). In 2012, the OECD/INFE (comprising representatives from over 110 countries, including all G20 members, and relevant international organisations) developed high-level principles addressing governments and public authorities and providing non-binding international guidance and policy options for the efficient development of national strategies for financial education. The principles provide guidance on the preparation, governance, roadmap development and implementation of national strategies. These principles were endorsed by the G20 leaders at the 2012 Los Cabos Summit.

As a follow-up to the High-level Principles, in 2015 the OECD/INFE developed a *Policy Handbook on National Strategies for Financial Education* to support governments and key stakeholders in addressing challenges linked to the implementation of national strategies for financial education. It provides an overview of the status of national strategies worldwide, an analysis of relevant practices and case studies and identifies key lessons learnt.

Sources: OECD/INFE (2012), *OECD/INFE High-Level Principles on National Strategies for Financial Education*, August 2012, www.oecd.org/daf/fin/financial-education/OECD-INFE-Principles-National-Strategies-Financial-Education.pdf; OECD/INFE (2015), *National Strategies for Financial Education: OECD/INFE Policy Handbook*, November 2015, www.oecd.org/daf/fin/financial-education/National-Strategies-Financial-Education-Policy-Handbook.pdf

Action H: Build synergies by mapping and co-ordinating all existing initiatives on financial literacy for MSMEs

59. The government should create a precise map of all the main initiatives carried out by public and private players in the country. These players should be involved in implementing the national strategy in order to empower them, increase their effectiveness within established structures, and find the most appropriate approach for each target group.

60. Several organisations are offering financial literacy training but with little (or no) co-operation with other institutions such as the SMEDF, the MCGF or the working groups on financial literacy set up by the Bank of Mongolia and the Financial Regulatory Commission:

- Many banks have launched numerous initiatives to support financial literacy – these need to be better co-ordinated. This would ensure public participation and supervision.¹⁵
- The Banking and Finance Academy was established in 2010 with the participation of the country's eight largest banks and supported by the Mongolian Banking Federation. In 2012 it absorbed the Bank Training Institute of the Bank of Mongolia. It aims to increase education by providing training services and certification for Mongolian banking and finance professionals, including specific training for dealing with MSMEs. The academy could also expand its operations by "training trainers": training current or former banking officials, as well as employees from relevant ministries and government agencies so they can in turn train MSMEs.
- The Mongolian National Business Incubator Federation, established in 2008, includes 12 business incubators funded by the Ministry of Labour and Social Welfare. Its aim is to

generate employment opportunities and alleviate poverty through financial education and support to Mongolian MSMEs. In addition, another four Small to Medium Enterprise Development Centres are funded by the Department of Agriculture.

Action I: Include financial education for MSMEs in the national strategy and consider joining the OECD International Network for Financial Literacy

61. Mongolia should include a dedicated pillar and implementation tools for building MSMEs' financial literacy in the national strategy. A strategy tailored to MSME needs, with appropriate tools and actions, would be more effective than hoping that building citizens' financial literacy will trickle down to entrepreneurs and MSMEs as well. Public and private training programmes for MSMEs would give them the skills required to present their financial statements and formulate reliable financial plans so that they become more "bankable". Online information and tools – either on a comprehensive national strategy website or a dedicated MSME website – could complement other measures. Various OECD countries (like Australia and Portugal) and non-members (like Indonesia) have started to target MSMEs in their national strategies (Box 10).

Box 10. Australia's financial literacy strategy and tools

Australia aims to provide the right environment for SMEs, including financial and education conditions, as pointed out by the OECD Scoreboard on SME and entrepreneurship finance (OECD, 2016). Loans to SMEs represent 32.4% of total business loans in 2014, and interest rates declined to 6.2% in 2014, down from 8.3% in 2010. In addition to providing loan guarantees and support to SMEs, the Australian government pays close attention to consumer protection and financial education through public institutions like the Australian Competition and Consumer Commission (ACCC) and the Australian Securities & Investment Commission (ASIC) (OECD, 2016).

Australia's National Financial Literacy Strategy has a section that specifically focuses on MSMEs, as part of a comprehensive approach that encompasses all Australians. The strategy uses tools designed to reach self-employed people, entrepreneurs and SMEs. An extensive website for financial literacy improvement provides information, tools and training, including:

- MoneySmart website: MoneySmart is the reference website for increasing financial knowledge and includes financial information, videos, online training and calculators.
- Being Money Smart Certificate IV: a competency that companies can obtain online that covers establishing a small business, being a contractor, business planning, and managing business finance and compliance.
- Guidance for self-employed people: MoneySmart also gives guidance on how to manage cash flow, and savings for taxes and retirement
- Online teaching resources for educators addressing students in vocational training.
- The Australian Business Portal: provides information on planning, starting and growing your own business.
- Financial reporting quiz for directors: a free 10-question multiple choice quiz to test knowledge of financial reporting. It provides explanations of answers after the test.

Sources: ASIC (2016a), Australian Securities & Investment Commission website, www.asic.gov.au (accessed May 2016); ASIC (2016b), MoneySmart – Financial Guide You Can Trust, website, <https://www.moneysmart.gov.au> (accessed May 2016).

Sector focus: enhancing access to finance in Mongolia's cashmere and textile sector

62. Better data on SME financing, when available to policy makers, could improve the effectiveness of policies in the cashmere sector. As of today only fragmented statistics are available especially regarding nomadic herders and their financing opportunities and capabilities.

63. Enhancing SMEDF's portfolio for the cashmere sector would ease access to finance by herders and cashmere-producing SMEs and reduce the sector's public investment dependency without setting the private sector aside. The SMEDF's portfolio could be better tailored to the sector, such as through a greater focus on cash flow history and projections, express loans, and loan maturity to match the cycle of herding activities.

64. The MCGF could continue to support the textile sector with customised guarantee products that would also leverage movable assets and past and future cash-flow statements. It should also refine risk assessment criteria in the sector to reduce the rate of payment defaults.

65. Simplifying administrative procedures of both banks and public funds would also increase the sector's access to finance. This should include clearer information and removing the need for herders to provide proof of permanent residence. The government could expand information about government programmes and training in rural regions, and centralise information and procedures in the form of one-stop shops located in both cities and rural areas.

66. Financial education tools for MSMEs in the sector could be tailored to herders and manufacturers respectively. For instance, online training and information on loan and saving decisions and opportunities might better suit herders, while manufacturers might also benefit from workshops on advanced financial reporting and business management. Following Australia's example (Box 9), the creation of an extensive financial literacy website available through smart phones and covering MSME business planning and financial management could help improve financial literacy among herders and manufacturers alike. Considering the relatively high penetration of mobile phone technology in Mongolia, including in rural areas, its use could support the dissemination of financial information, training and calculators.

Notes

¹³ This fee can be calculated as a percentage of the loan or of the guarantee. It can be either paid directly by the MSME to the MCGF, or paid upfront by the lender (OECD, 2012).

¹⁴ These “switching arrangements” can reduce the administrative burden on the customer as the banks perform a considerable part of it. These arrangements typically stem from a self-regulatory code between banks (OECD, 2011).

¹⁵ See also the OECD/INFE Guidelines for Private and Not-for-profit Stakeholders in Financial Education (OECD/INFE, 2014) regarding conflicts of interest of private stakeholders in the provision of financial education.

THE WAY FORWARD

67. This section outlines an indicative roadmap for implementing the policy recommendations. This roadmap takes into account the need to strengthen co-operation among public credit institutions, to increase evidence-based policy on SME financing, to further build capacity at the public credit institutions, and to increase exposure and knowledge sharing with international experience especially by joining the OECD Scoreboard on SME and entrepreneurship finance and the OECD International Network on Financial Education.

Figure 5. Suggested implementation roadmap

Recommendations	Indicative implementation timing		
	Short term < 1 year	Medium term 1-3 years	Long term >3 years
Gather and disseminate coherent data on MSMEs ① <ul style="list-style-type: none"> ▪ A – Develop a co-ordinated approach among public institutions and consider joining the OECD Scoreboard on SME and entrepreneurship finance 	█		
Diversify the products offered by the SME Development Fund ② <ul style="list-style-type: none"> ▪ B - Diversify SMEDF’s products 	█		
Overcome collateral issue by making the Mongolian Credit Guarantee Fund more effective ③ <ul style="list-style-type: none"> ▪ C - Strengthen trust relations between MCGF and banks by including bank representatives on MCGF’s board, by implementing financial agreements and by sharing risk assessments ▪ D - Enhance risk appraisal using risk assessment tools from banks and institutions with international experience 		→	
Streamline administrative procedures for loan applications ④ <ul style="list-style-type: none"> ▪ E - Increase co-ordination between SMEDF and partner banks ▪ F - Reduce the number of documents required by banks ▪ G - Consider implementing one-stop-shops for MSMEs 		→	
Improve financial education by ensuring the national strategy is tailored to MSMEs ⑤ <ul style="list-style-type: none"> ▪ H - Build synergies by mapping and co-ordinating all existing initiatives on financial literacy for MSMEs ▪ I - Include financial education for MSMEs in the national strategy and consider joining the OECD International Network for Financial Literacy 	█		→

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ANNEX A. ADDITIONAL STATISTICS

Table 4. Main MSMEs definitions used in Mongolia and in the EU

 SME definition of Mongolia SME law (2007)				
Company category	Sector	Staff headcount	Turnover	
Medium-sized	Wholesale	≤149	≤ MNT 1.5 bn	
	Retail / Manufacturing	≤199	≤ MNT 1.5 bn	
	Services	≤149	≤ MNT 1 bn	
Small & Micro	All sectors	≤19	≤ MNT 250 mn	
 SME definition of National Statistical Office of Mongolia				
Company category		Staff headcount		
Big		≥50		
Medium-sized		≤49		
Small		≤19		
Micro		≤9		
 SME definition of the European Union				
Company category	Staff headcount	Turnover	or	Balance sheet total
Medium-sized	< 250	≤ € 50 m		≤ € 43 m
Small	< 50	≤ € 10 m		≤ € 10 m
Micro	< 10	≤ € 2 m		≤ € 2 m

Source: Mongolia SME law (2007); Mongolian National Statistical Institute, <http://1212.mn/en/> accessed 8 November 2016; EU Commission http://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition_en accessed 8 November 2016.

Table 5. Business statistics by sector in Mongolia

Sector	Number of establishments	Contribution to employment	Contribution to GDP
Mining and quarrying	1 006	46 700	17%
Agriculture, forestry and hunting	6 627	370 000	14%
Wholesale and retail trade, repair of motor vehicles, household goods	51 941	131 300	12%
Real estate, renting and other business activities	12 089	25 800	10%
Manufacturing	9 547	64 900	8%
Transport, storage and communications	5 346	70 800	7%
Financial services	2 047	17 400	5%
Education	3 893	86 300	5%
Public administration and defence, compulsory social security	1 433	62 900	4%
Construction	9 669	59 200	4%
Electricity, gas and water supply	374	21 200	2%
Health and social work	3 641	37 500	2%
Other community, social and personal services	9 956	27 200	1%
Hotels and restaurants	3 313	30 200	1%

Source: National Statistical Institute of Mongolia official website, www.1212.mn (accessed 25 August 2016)

ANNEX B. METHODOLOGY

Within the framework of the Central Asia Competitiveness III Project, the OECD Eurasia Competitiveness Programme (ECP), the Office of the President of Mongolia and the Government of Mongolia established a public-private working group to develop guidelines and recommendations for enhancing access to finance for MSMEs in Mongolia. The Working Group gathered representatives from government agencies, SMEs, business associations such as the Chamber of Commerce and Industry and the Mongolian Banking Association, banks, and other development partners. Specific questionnaires were drafted by the OECD and distributed to relevant stakeholders to inform the analysis and to validate the relevance of the policy recommendations. The OECD ECP, with contributions from international experts and peer reviewers from selected OECD member countries and Kazakhstan, carried out analysis, data collection and consultations with stakeholders in Mongolia to identify the crucial issues and the most effective policy responses to enhance access to finance for MSMEs.

Several missions took place in preparation for the peer review of Mongolia:

- **20-22 October 2015:** fact-finding mission to Ulaanbaatar (UB) and meeting of the First Steering Group on Enhancing Access to finance for MSMEs
- **26-29 January 2016:** fact-finding mission to UB to gather data and to discuss preliminary analysis
- **14-18 March 2016:** fact-finding mission to UB and meeting of the first Working Group to discuss preliminary recommendations and share insights with local stakeholders
- **7-9 June 2016:** fact-finding mission to UB and meeting of the second Working Group with international expert to present French good practices
- **10-14 October 2016:** fact-finding mission to UB, meeting of the Third Working Group with international experts from Kazakhstan and from the OECD Secretariat, to present the experience of a central Asian country with credit guarantee schemes and to present the OECD International Network for Financial Literacy. Moreover, the second meeting of the Steering Group endorsed the final OECD recommendations, which will be peer reviewed in Paris during Eurasia Week 2016.

This report will be submitted for peer review on 24 November 2016 at the fourth session of the OECD Eurasia Competitiveness Roundtable, a policy network that brings together high-level representatives and technical experts from Eurasia countries, OECD members and partner organisations. The roundtable meets annually and serves as a platform for peer review and knowledge sharing on the implementation of competitiveness reforms in the Eurasia region.

The peer review will help Mongolia define further steps for policy reform implementation. In particular, the roundtable discussion will be facilitated by two experts who will provide an overview of the current situation in Mongolia and insights into the policy experience in OECD and Eurasian countries:

- Mr. Kanysh Tuleushin, Chairman of the Board, DAMU SME Agency, Kazakhstan
- Mr. Vincent di Betta, Head of International Consulting Activities, BPIfrance, France

Progress towards implementing these recommendations will be discussed in three years' time at the 2019 OECD Eurasia Competitiveness Roundtable.



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