

# Chapter 14

## Development and Access to Finance of Small and Medium-Sized Enterprises in Mongolia

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### ABSTRACT

*This chapter presents a recent survey on the development and accessibility for finance of small and medium-size enterprises (SMEs) in Mongolia. The survey covers a sample of 1922 SMEs from Ulaanbaatar, the capital city, and 21 provinces. We find that banks and local government administrations are the most supportive institutions for SME development. Political instability, corruption, and labour supply, a high lending rate, short maturity loans, and service fees are perceived as the major obstacles that SMEs face in the business environment. Our results also suggest that SMEs in Mongolia are less likely to have access to external finance because of tight credit condition, potentially explaining the lack of SME growth. Implementing country-specific reform strategy for SME development covering key building blocks is needed to promote SME financial inclusion and facilitate SMEs to contribute to the economic growth.*

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## INTRODUCTION

Small and medium-sized enterprises (SMEs) play an important role in most countries, particularly in developing countries. A number of papers find that (i) SMEs are closely linked with economic growth (e.g., Beck et al., 2005, Ayyagari et al., 2007), and (ii) the majority of jobs created by SMEs, specifically in low-income countries (e.g., Beck et al., 2008, Dietrich, 2010, Ayyagari et al., 2011). Therefore, SMEs are the engine of economic development, reduced economic vulnerability for individual households, poverty alleviation, and SME financial inclusion is at the core of the economic diversification and growth challenges. Improving SME financial inclusion can help increase economic growth and job creation. However, SMEs are financially more constrained than large firms and are less likely to have access to formal finance (Beck and Demirgüç-Kunt, 2006). Improving SME financial inclusion can help increase economic growth, job creation and the effectiveness of fiscal and monetary policy and could also contribute to financial stability. Blancher et al. (2019) argue that economic fundamentals and financial sector characteristics (i.e., macroeconomic stability, limited public sector size, financial sector soundness, a competitive banking system) and institutional factors (i.e., strong governance and financial regulatory and supervisory capacity, credit information availability, and supportive business environment and legal systems that allow to adequately enforce property rights and contracts) can help scale up SME bank credit.

This paper presents a recent survey on development and access to finance of small and medium-size enterprises (SMEs) in Mongolia, developing and commodity dependent economy. This survey aims to examine the current development, access to finance and other challenges faced by SMEs. The target group of respondents is business owners and/or management level employees (CEO, general manager and accountant) of the SMEs. According to Doing Business Report 2019 published by World Bank, Mongolia is ranked in 74 out of 190 economies. Though ease of doing business score (67.74) is higher than East Asia and Pacific regional average (63.41), the score is far below from other economies (i.e., China, Japan, Kazakhstan and South Korea). As the economy is heavily dependent on the resource sector accounting for 90% of total exports and 25% of budget revenues, there is essential need of economic diversification. The economy also faces challenges to strengthen its resilience to transform its natural resource wealth into assets that support sustainable growth and prosperity. There is no doubt that SME development can contribute to economic diversification and resilience. Hence, evidence (and lessons) from the Mongolian case would be of high relevance formulating policies in scaling-up SME access to financial services and lowering barriers to SME development for resource-rich developing countries.

The present survey is conducted in October 2018, and the Bank of Mongolia has successfully conducted nationwide SMEs survey for the last 7 consecutive years in order to create the SME database. Without reliable SME data, it is difficult for policy makers to implement policies aimed at expanding and strengthening the SME sector. Highlights of this year's survey are as follows: i) Increased coverage of SMEs operating in slums within 50 km from the province center, ii) The World Bank tablet-based CAPI (Computer Assisted Personal Interview) system was first used nationwide, and iii) SMEs producing value-added products were targeted. The survey creates database for SME development in Mongolia, and the survey questionnaire follows international practices. Sampling takes location, number of employees into account in terms of representation. Total sample is determined with 95% confidence and with 5% significance level. Population for the survey is determined by the overall number of businesses (83,086) registered at the National Statistics Office's database as of 2018. According to the statistical calculations, optimal sample size is 850-1000 for Ulaanbaatar and 30-50 for each province, respectively.

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