



THE BANK OF MONGOLIA

**SMALL AND MEDIUM
ENTERPRISES' DEVELOPMENT
AND FINANCIAL ACCESS**



2017

**SURVEY
REPORT**

Research and Statistics Department

The views and results expressed in this report are those of the respondents in the survey and do not necessarily reflect the official policy or position of the Bank of Mongolia.



2017/08

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INTRODUCTION

Small and medium enterprises (SMEs) development remain a top policy priority for all countries, and new challenges are constantly emerging that demand an in-depth analysis. The development of SMEs has played an important role in reducing poverty, creating jobs for the growing population and in supporting inclusive growth. Developing SMEs is critical for reducing income inequality, enhancing social stability and strengthening private sector. Therefore, it is necessary to formulate an effective strategy to create an enabling environment for SMEs and identify mechanisms that help to promote its development.

With the aim of fostering SMEs growth, the Government of Mongolia has set a policy framework for SMEs development and, in this regard, the “Law on Small and Medium Enterprises” was passed in 2007. Furthermore, the Government has established SMEs agency, in charge of implementation to SMEs policies and a Fund for SMEs development in 2008 and 2009, respectively. To promote SMEs development and improve business climate, the Government announced 2009 as the year of supporting industrial production; 2010 as the year of improving business environment; 2011 as a year of supporting employment; and 2012 as a year of supporting households’ development. In 2014, the SMEs Development Program (2014-2016) was commenced by the Government. In accordance with implementation of the program, 2016 was announced as a year of “Promoting domestic production, and sales” and policy actions have been taken to enhance SMEs competitiveness and create employment.

The Bank of Mongolia annually conducts a nationwide (Ulaanbaatar and 21 provinces) SMEs survey in order to have a better understanding of the business characteristics, current development, financial access and the challenges faced by SMEs.

The survey has been conducted six times, and the current survey covers 1,950 SMEs operating in Mongolia. The SMEs categorization follows the definition stipulated by the “Law on Small and Medium Enterprises” and sampled randomly based on location, number of employees and sectors in which they operate.

The objective of the current survey is to identify business characteristics of the SMEs, current situation, level of development and support, factors influencing their operation, financing condition and cost structure of SMEs.

The report consists of four chapters and structured as follows. Chapter I begins with the general characteristics of SMEs, including types and length of business operation, number of employee and ownership structure. Chapter II will enable us to comment on the fact that whether, and to what extent, organizations support SMEs development. In addition, this chapter analyzes the need for further policy measures and actions to foster SMEs growth. Consequently, constraints and problems faced by the SMEs on their access to finance, additional financing need and loan terms and preferred conditions will be outlined. Chapter III will evaluate the business environment factors with respect to macroeconomic, social, political, financial, market and infrastructure conditions. Lastly, Chapter IV will give a more in-depth information on SMEs operational aspects such as revenues and expenses.

OBJECTIVE, METHODOLOGY AND SAMPLING

Objective of the survey

The aim of this survey is to assess the development, current operations, financing condition and challenges faced by SMEs operating in Mongolia and hence assist in policy formulation.

The target group of respondents were business owners and/or management level employees (CEO, general manager, accountant etc.) of the firms.

Methodology

The survey is conducted with World bank's CAPI (Computer assisted personal interviewing) system. The survey questionnaires follow international practices.

Sampling

The interview respondents were sampled randomly based on location and number of employees. The sample size is carefully determined to represent the population parameters with 95% confidence level.

Population for the survey is determined by an overall number of businesses (75,796) registered at the National Statistics Office's database at the end of 2017. According to the statistical calculations, optimal sample size was between 1000 and 850 (roughly 30-50 for each) for Ulaanbaatar and provinces, respectively. However, there were a decent possibility of different number of responses due to quality of the survey responses. In consequence, 1950 samples, which is 5% more than required, was covered in this survey. By looking at geographical location, it is shown that the 57% of the SMEs are from Ulaanbaatar and 43% of those are from provinces.

Table 1.1 Small and medium enterprises surveyed

	Total enterprises		Enterprises surveyed		
	Total number	Weight	Sample size	Weight	Percentage of total
Arkhangai	1054	1.4%	35	1.8%	3.3%
Bayan-Ulgii	1489	2.0%	44	2.3%	3.0%
Bayankhongor	1025	1.4%	33	1.7%	3.2%
Bulgan	1132	1.5%	33	1.7%	2.9%
Gobi-Altai	811	1.1%	25	1.3%	3.1%
Gobisumber	318	0.4%	22	1.1%	6.9%
Darkhan-Uul	2062	2.7%	71	3.6%	3.4%
Dornogobi	1050	1.4%	42	2.2%	4.0%
Dornod	1416	1.9%	51	2.6%	3.6%
Dundgobi	622	0.8%	31	1.6%	5.0%
Zavkhan	1259	1.7%	37	1.9%	2.9%
Orkhon	2226	2.9%	60	3.1%	2.7%
Uvurkhngai	1283	1.7%	46	2.4%	3.6%
Umnugobi	1385	1.8%	3	0.2%	0.2%
Sukhbaatar	762	1.0%	24	1.2%	3.1%
Selenge	2143	2.8%	62	3.2%	2.9%
Tuv	1254	1.7%	51	2.6%	4.1%
Uvs	1481	2.0%	8	0.4%	0.5%
Ulaanbaatar	48519	64.0%	1116	57.2%	2.3%
Khovd	1854	2.4%	65	3.3%	3.5%
Khuvsgul	1621	2.1%	55	2.8%	3.4%
Khentii	1030	1.4%	36	1.8%	3.5%
Total	75796	100%	1950	100%	2.6%

Source: The Bank of Mongolia, SME survey (2017)

GENERAL CHARACTERISTICS

Number of business operation

It is found that the majority (79%) of firms operate in one sector, whereas remaining operate in multiple sectors.

Corporate structure

Out of total SMEs surveyed, 54% of them are private business owners, 38% are limited liabilities companies, 2% are partnership and 1% are listed on the stock exchange.

Ownership structure

Based on the ownership type, a clear majority of firms (97%) have domestic investment whereas remaining are foreign invested enterprises. In recent years, the number of foreign invested companies decreased due to the contraction in foreign direct investment.

Main activity

Majority (74%) of firms are engaged in retail trade and services sector, whereas 13% operates in the manufacturing sector and only 5% and 4% focus on agricultural and construction sectors, respectively.

Length of operation

Business representatives were asked how long their firm had been operating. It is shown that 14% of firms have been operating for less than 1 year, 19% for 1-3 years, another 19% for 3-5 years, 23% for 5-10 years and 25% for more than 10 years.

Number of employees

Micro enterprises (1-9 employees) constitute the clear majority (84%), followed by small enterprises with 10-49 employees (13%). Only 4% can be regarded as medium-sized enterprises with more than 50 employees.

Figure 1.1: Number of business operation

Responses by percentage

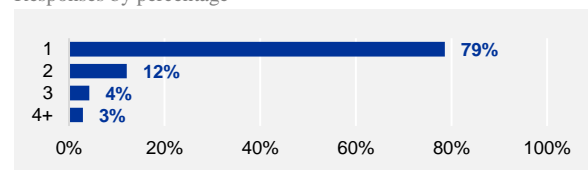


Figure 1.2: Corporate structure

Responses by percentage

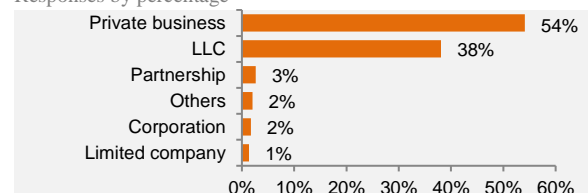


Figure 1.3: Ownership structure

Responses by percentage



Figure 1.4: Business main activity (by sectors)

Responses by percentage

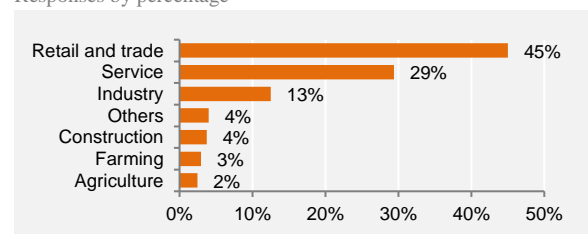


Figure 1.5: Age of businesses

Responses by percentage

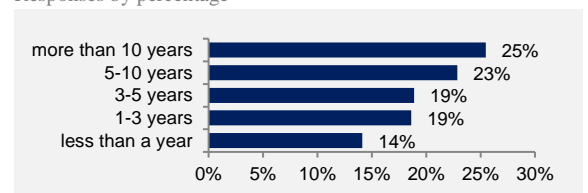
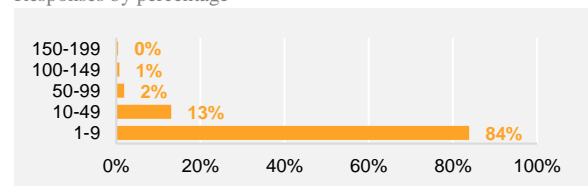


Figure 1.6: Number of employees

Responses by percentage



Source: The Bank of Mongolia, SME survey (2017)

Licenses

Of all the SMEs surveyed, 60% stated that they have obtained a business license, while 36% have not and 4% are in application procedure.

Initial investment

With regard to the firms surveyed, 57% reported that they employed own capital to finance their businesses. While 18% took out loans from banks, 16% used informal loan sources like borrowing from family.

Financial statements

It is stated that 63% of the firms surveyed produce financial statements, whereas 32% do not. Only 5% reported that they are incapable of doing it. |

Figure 1.7: Business licenses

Responses by percentage

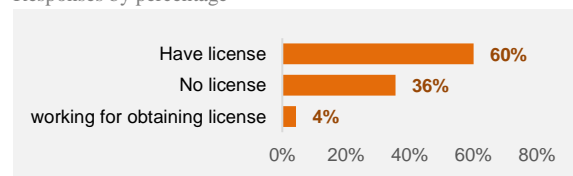


Figure 1.8: Sources of initial investment

Responses by percentage

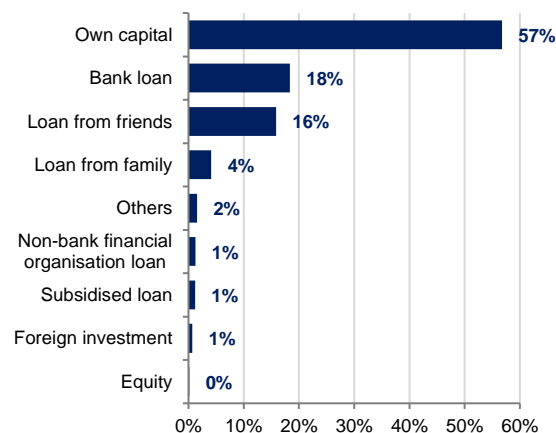
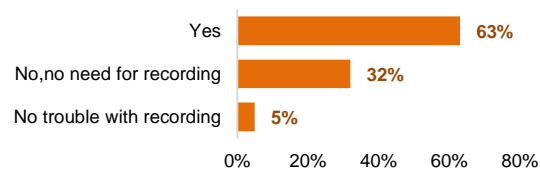


Figure 1.9: Financial statements

Responses by percentage



Source: The Bank of Mongolia, SME survey (2017)



SUPPORTS FOR SMALL AND MEDIUM ENTERPRISES DEVELOPMENT

Supporting organizations

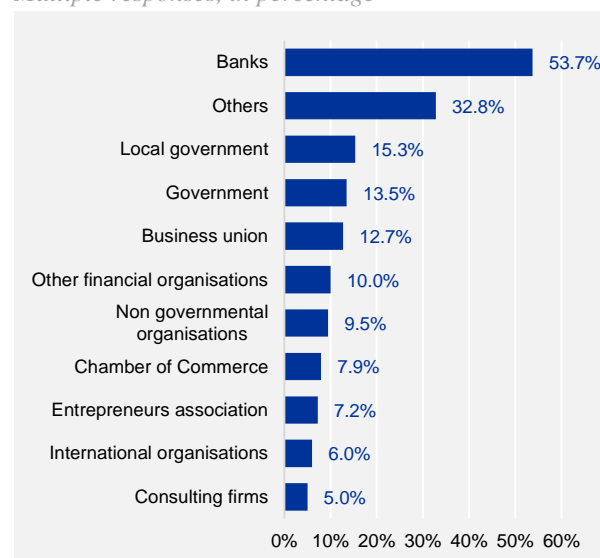
It is reported that much support is provided by commercial banks to SMEs followed by local authority, the government, producer association and other financial institutions. The finding is in line with the previous survey results. However, businesses stated that the support by consulting firms and international organizations are not satisfactory /Figure 2.1/.

The Government has been implementing numerous policy actions specific to SMEs development reflected in the Millennium Development Goals, Sustainable Development Program, Regional Development Policy Guidelines, and Economic Growth Support and Poverty Reduction Strategy. Over 10% of the SMEs surveyed stated that the government and local authorities support their businesses.

However, it should be noted that 53% of the SMEs operating in agricultural and construction sectors highlighted support of the government and local authorities. Furthermore, a majority (67%) of firms operating in manufacturing sector reported that banks are supportive for their businesses /Figure 2.2/

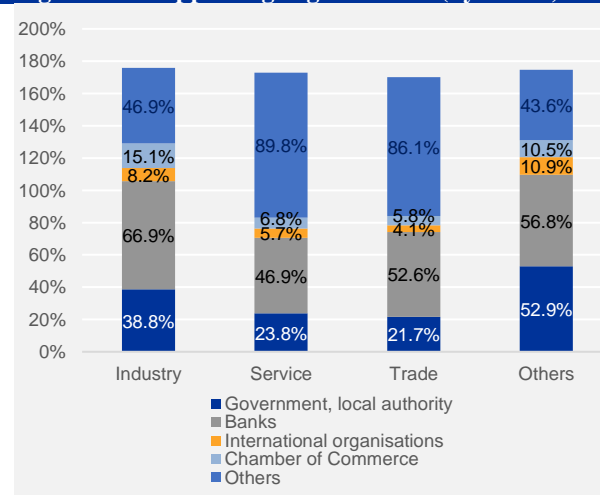
Figure 2.1: Supporting organisations

Multiple responses, in percentage



Source: The Bank of Mongolia, SME survey (2017)

Figure 2.2: Supporting organisations (by sector)



Source: The Bank of Mongolia, SME survey (2017)

Types of supports for SMEs

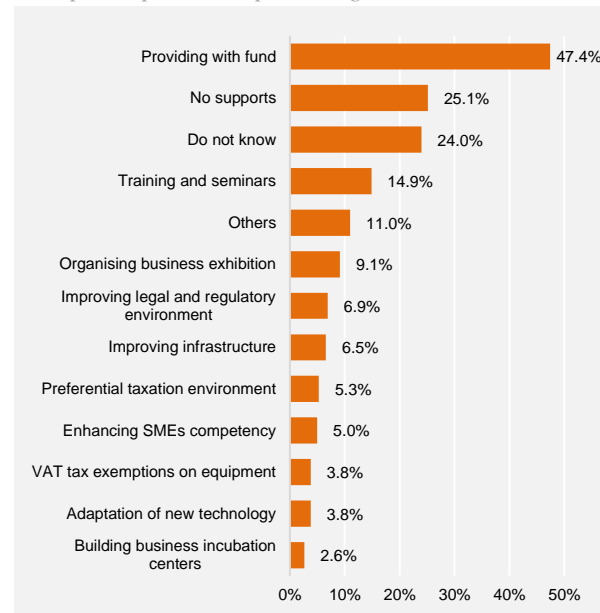
The findings of the survey suggest that SMEs receive support in the form of financing, training, consultancy, organizing business exhibition and through improvement of legal and regulatory environment. On the other hand, SMEs indicated less support in areas like establishment of business incubators, introduction of technological advances and exemption from VAT/Figure 2.3/.

Further measures to support SMEs

The survey result suggests that SMEs place a higher priority on maintaining a favorable tax regime, extending coverage of preferential lending and cutting of red tape and bureaucracy. Only 10% of businesses reported that measures need to be implemented include setting up business incubators, providing marketing advice, supporting firms, which promotes new technology, improving infrastructure and reducing license fees /Figure 2.4/.

Figure 2.3: Types of supports for SMEs

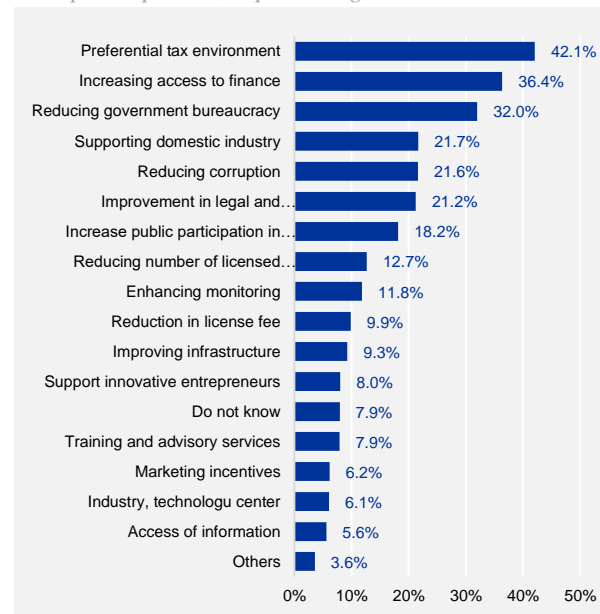
Multiple responses, in percentage



Source: The Bank of Mongolia, SME survey (2017)

Figure 2.4: Further measures to support SMEs

Multiple responses, in percentage



Source: The Bank of Mongolia, SME survey (2017)

FINANCING FOR SMALL AND MEDIUM ENTERPRISES

2.1. FINANCING IN THE PAST

Financing Condition

Access to financing is important for SMEs' development as loans enable businesses to expand and invest when their own resources are at deficit. Of all firms surveyed, 56% of them obtained financing whereas 44% did not. The majority (72%) of the local SMEs stated that they have obtained financing from external sources while only 43% of the SMEs operating in Ulaanbaatar had access to loans and other sources of financing /Figure 2.5/

This is quite surprising as the finding may suggest that local SMEs gained more access to external financial resources compared with SMEs operating in Ulaanbaatar.

Sources of Financing

It is found that 56% of SMEs used external financing instrument for their business expansion. Of those enterprises, a great share (81%) of them stated that they had obtained their loans from a commercial bank.

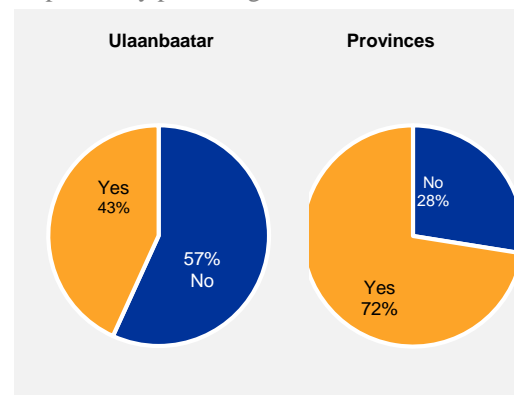
Non-bank financial organization loans and subsidized loans, on the other hand, were among the less frequently used financial sources for 7% and 6%, respectively. Also, it is reported that only 4% of SMEs use informal financial sources like borrowing from family or friends /Figure 2.6/.

Purpose of the financing

Clearly, the purpose of the loan varies. However, about 64% of SMEs reported using financing for current assets, while 12% mentioned equipment. To a lesser extent, SMEs used funds to expand the business (9%), invest in buildings (8%), purchase new buildings (4%), train employees (2%) and for other purposes (2%) /Figure 2.7/.

Figure 2.5: Financing condition

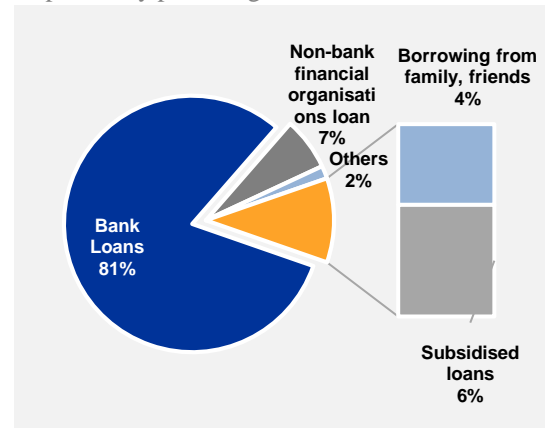
responses by percentage



Source: The Bank of Mongolia, SME survey (2017)

Figure 2.6: Sources of financing

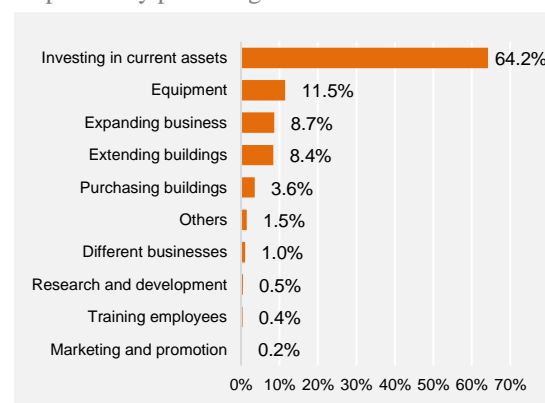
responses by percentage



Source: The Bank of Mongolia, SME survey (2017)

Figure 2.7: Purpose of financing

responses by percentage



Source: The Bank of Mongolia, SME survey (2017)

Reasons for not obtaining external finance

As mentioned in the previous section, 44% of the SMEs stated that they did not obtain any external financing. When asked for the reasons why an external financing was not used, firms stated sufficient internal fund (64%), unwillingness to be financed through bank loans due to its strict terms and conditions (28%) and rejection of loan application as a result of tough requirements (8%) /Figure 2.8/.

Reasons why bank loan terms are not favorable

In this regard, 55% of total SMEs whose application for bank loans were rejected reported that interest rates were high. Also, short maturity (13%), inadequate collateral valuations (18%) and too much paperwork being involved (9%) were indicated as reasons for unfavorable loan terms /Figure 2.9/.

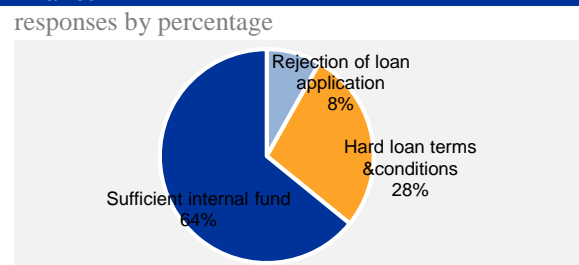
Reasons why loan applications were rejected

There are about 8% of total SMEs whose loan application was rejected. They were asked to indicate the reasons. Approximately 40% of firms reported insufficient collateral while 15% stated that they were lacking fixed income to guarantee the payments. Other reasons include incomplete document (10%), lack of creditor's guarantee(8%), higher business risk (5%) and unsatisfactory credit score (3.6%). Remaining 11% indicated other reasons why their loan applications were rejected /Figure 2.10/.

Changes in the number of employees

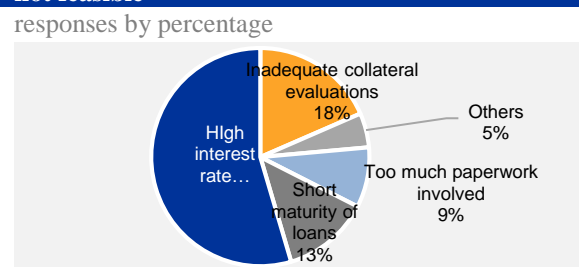
Of all of SMEs surveyed, a majority (76%) of firms have not changed number of employees. However, 12% of firms increased number of employees, whereas 10% decreased the number /Figure 2.11/.

Figure 2.8: Reasons for not obtaining external finance



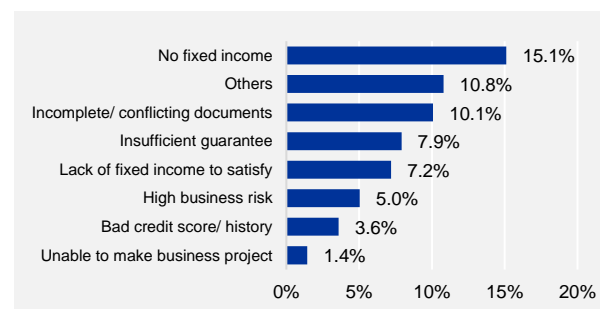
Source: The Bank of Mongolia, SME survey (2017)

Figure 2.9: Reasons why bank loan conditions are not feasible



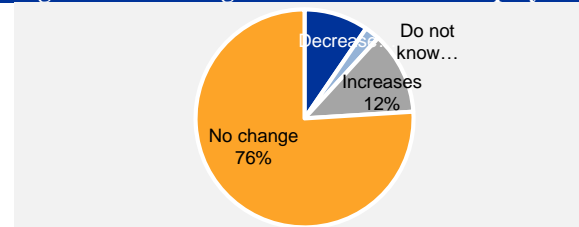
Source: The Bank of Mongolia, SME survey (2017)

Figure 2.10: Reasons why loan applications were rejected



Source: The Bank of Mongolia, SME survey (2017)

Figure 2.11: Changes in the number of employees



Source: The Bank of Mongolia, SME survey (2017)

2.2. FINANCIAL ACCESS

Need for further funding

While the previous section focused on current and past funding, following section deals with future financial needs. Around two third of SMEs surveyed (65%) have declared that they have considerable further funding needs and plan to apply for funding, whereas 27% have no interest/*Figure 2.12/*.

Sources of Additional Funding

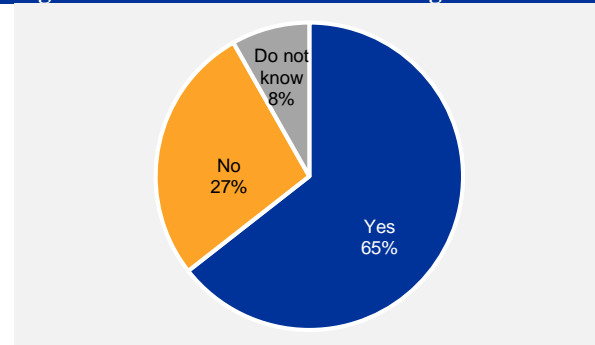
Of the fairly big number of surveyed enterprises which has financing needs, 61% reported that they are willing to apply for bank loans. While about one third SMEs (30%) are eager to obtain subsidized loans, only 2% intend to use informal loan sources like borrowing from family, relatives and/or friends /*Figure 2.13/*.

Moreover, it is found out that SMEs prefer subsidized loans over bank loans, but access to the latter found to be quite limited.

The Amount of Funding Needs

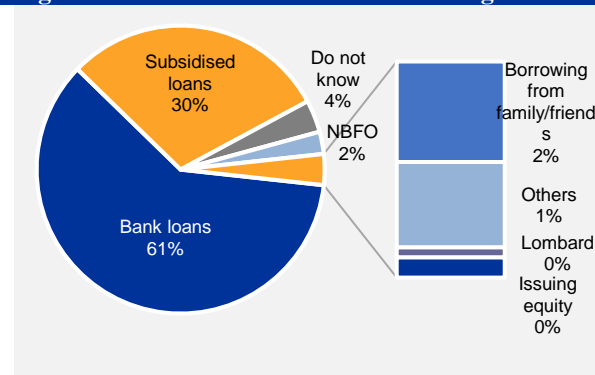
According to this survey, about one third SMEs (32.7%) stated that they need additional funding of 10-50 million MNT, mostly to expand the business. Also, SMEs reported that they had considerable financing need of more than 100 million MNT (18.4%) followed by 50-100 million MNT (17.6%). Another one third (28.7%) SMEs indicated that they need only less than 5 million MNT for further business operation /*Figure 2.14/*.

Figure 2.12: Need for further funding



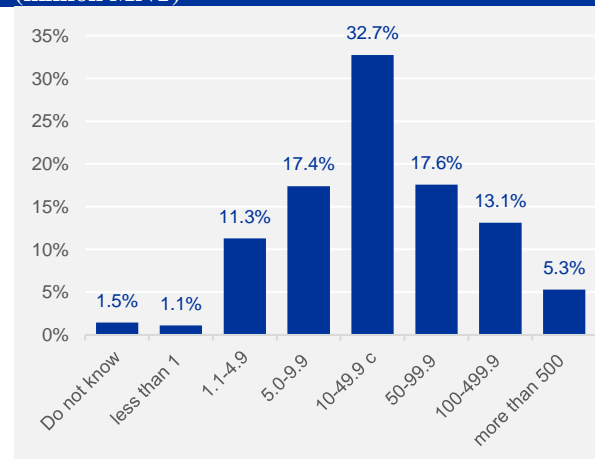
Source: The Bank of Mongolia, SME survey (2017)

Figure 2.13: Sources of additional funding



Source: The Bank of Mongolia, SME survey (2017)

Figure 2.14: The amount of funding needs (million MNT)



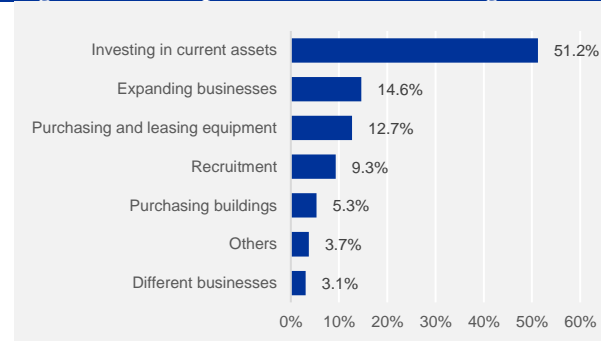
Source: The Bank of Mongolia, SME survey (2017)

Purpose of additional funding need

Of the fairly significant number of surveyed enterprises which are in need of additional financing, half of the firms would prefer to use it for investing in current assets. About 20% of SMEs reported using funds for investments in buildings. To a lesser extent, SMEs mentioned investments in equipment (13%), for job creation (9%), and other business activities (3%) /Figure 2.15/.

The same pattern may be applied to both purpose of outstanding loan in the past and purpose of additional funding in the future. In other words, enterprises mainly want to obtain funding for investing in current assets and purchasing equipment.

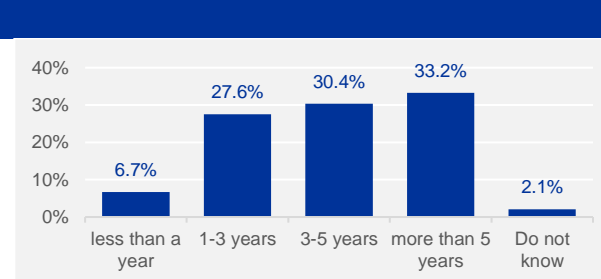
Figure 2.15: Purpose of additional funding need



Preferred maturity

Of the surveyed enterprises which are in need of additional financing, one third of the firms (33.2%) would like to obtain funding with a maturity of more than 5 years. Another one third (30.4%) mentioned 3 to 5 years. While 27.6% would like to get loan with 1 to 3 years, and only 6.7% reported a maturity of less than a year. Overall, it is found that, on average, preferred maturity of additional funding for SMEs is 3.6 years.

Figure 2.16: Preferred maturity

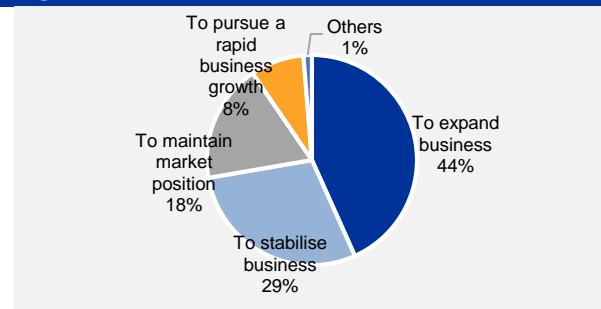


Source: The Bank of Mongolia, SME survey (2017)

Future outlook

According to the survey, 43% of SMEs are seeking to expand the businesses, whereas 29% are considering for stabilizing the businesses. Furthermore, a relatively small percentage (8.3%) of SMEs are pursuing a rapid business growth. By contrast, 18% of SMEs are operating only to maintain their market position and/or cover running costs /Figure 2.17/

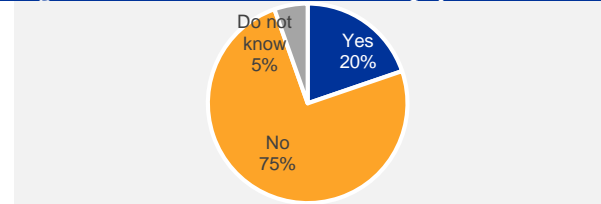
Figure 2.17: Business future outlook



Existence of over-due payments

Majority (75%) SMEs covered in this survey never defaulted on their loans, while 20% of them had missed the loan repayment dates /Figure 2.18/.

Figure 2.18: Existence of over-due payments



Source: The Bank of Mongolia, SME survey (2017)

Sector categorization

Financing

According to the survey, business representatives operating in manufacturing, retail trade and service sectors (70.2%, 53.3% and 47.4%, respectively) took out financing in the past. The result may indicate that SMEs focusing on manufacturing sector have more need for financing compared to others /Figure 2.19/

Sources of financing

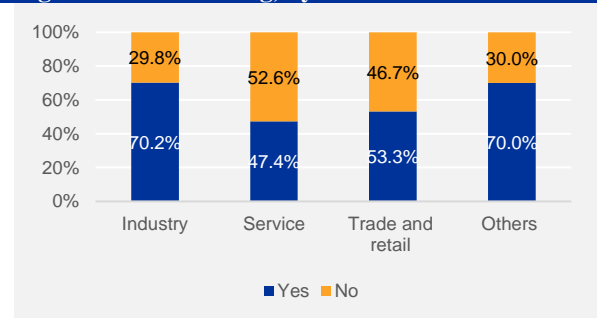
Overall, when looking at financing sources by sectors, no significant difference can be observed. In order words, SMEs took out the loans from banks regardless of sectors in which they operate.

The share of businesses which got loans from commercial banks in the manufacturing, service, retail trade and other sector is significant, approaching nearly 80%. Subsidized loans were the preferred choice for 15% of SMEs operating in manufacturing, agriculture and construction sector. Furthermore, the share of SMEs in retail trade sector which take loan from non-bank financial organizations (10%) is higher than those operating in other sectors (6%) /Figure 2.20/.

Reasons for not obtaining external finance

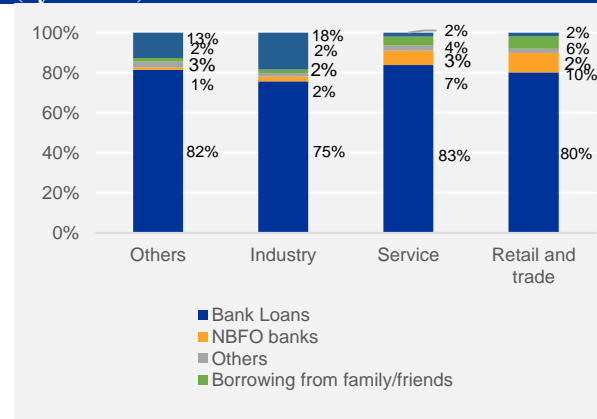
Business representatives were asked to state the reason for not taking financing. Most of SMEs operating in service and retail trade sector (67%) reported that they have sufficient internal funds. Also, SMEs did not get any financing due to stricter lending requirements, in the manufacturing sector is higher (10%) than the share of those who operates in service and retail trade sector.

Figure 2.19: Financing, by sector



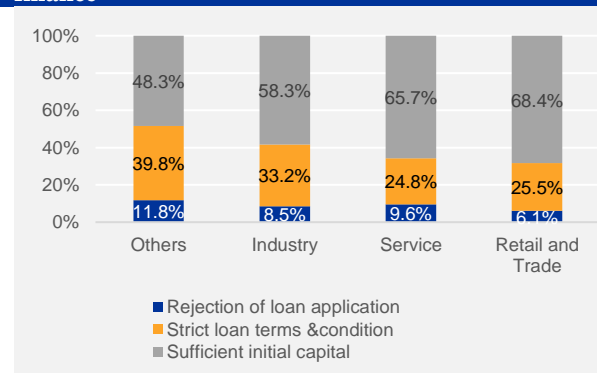
Source: The Bank of Mongolia, SME survey (2017)

Figure 2.20: Sources of financing (by sectors)



Source: The Bank of Mongolia, SME survey (2017)

Figure 2.21: Reasons for not obtaining external finance



Source: The Bank of Mongolia, SME survey (2017)



Sources of additional funding

As mentioned earlier, most SMEs obtained bank loans for additional funding need. By comparing sectors, firms operating in service and retail trade would like to use bank loans, whereas manufacturing firms tend to prefer subsidized loans /Figure 2.22/

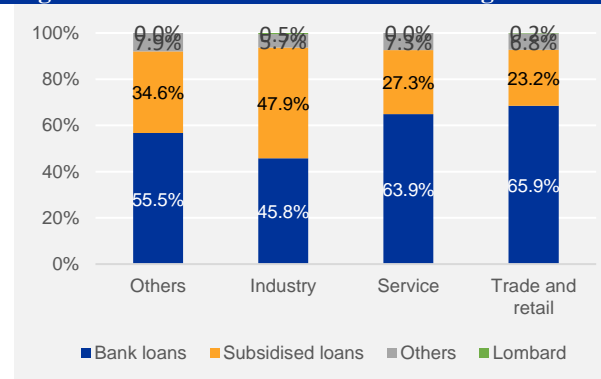
The amount of funding feeds

According to the survey, it can be drawn that manufacturing firms need relatively large amount of financing compared to others. SMEs operating in manufacturing sector who reported that they need less than 101 million MNT is much lower (18%) than share (38%) of those in service and retail trade. Furthermore, one third of manufacturing firms reported that they need more than 100million MNT for additional funding.

Purpose of additional funding need

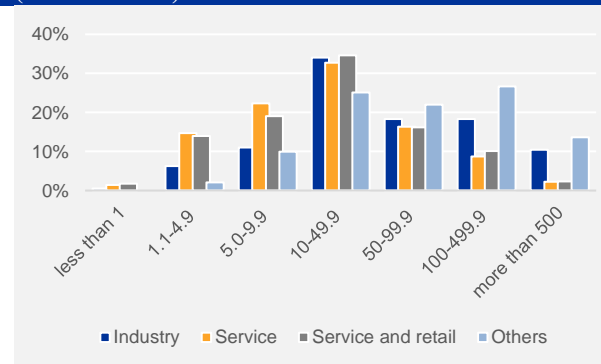
As previously reported, firms in all sector are more likely to use financing for investing in current assets. About 60% of SMEs operating in retail trade reported using funds for investing in current assets and the result is higher than those operating in other sectors. On the other hand, 18% of manufacturing firms stated that they will use additional funding for purchasing equipment /Figure 2.24/

Figure 2.22: Sources of additional funding



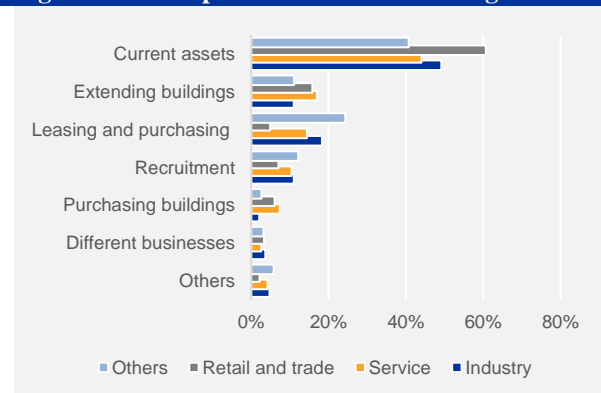
Source: The Bank of Mongolia, SME survey (2017)

Figure 2.23: The amount of funding needs (million MNT)



Source: The Bank of Mongolia, SME survey (2017)

Figure 2.24: Purpose of additional funding

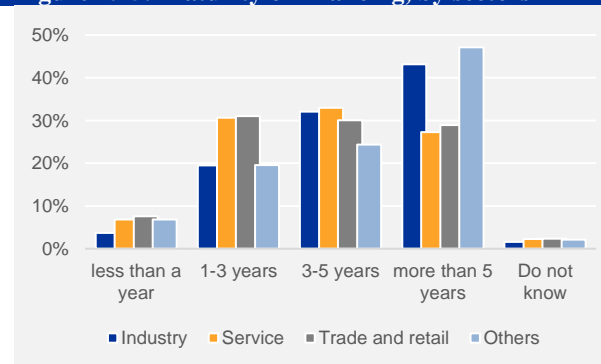


Source: The Bank of Mongolia, SME survey (2017)

Preferred maturity

It seems that, in contrast to SMEs operating in trade and service sectors, those operating in manufacturing, agriculture and construction sectors need more long-term funding. While about 45% of manufacturing firm would like to obtain additional financing with a maturity of more than 5 years, 38% of service sector firms mentioned that they need a financing with a maturity of less than 3 years.

Figure 2.25: Maturity of financing, by sectors



Source: The Bank of Mongolia, SME survey (2017)

BUSINESS ENVIRONMENT

3.1. GENERAL INDEX

The factors potentially influencing SME operation are classified into the following six groups:

- Macroeconomic environment
- Social, political environment
- Legal and institutional environment
- Market condition
- Financing condition
- Infrastructure condition

In total, 33 factors are allocated amongst these groups.

Indexed results from the survey is evaluated as social, political condition (-0.99), macroeconomy (-0.80), financing (-0.64), legal and institutional condition (-0.56), market condition (-0.27), infrastructure (0.01) /Figure 3.1/.

Above results suggest that social and political condition, macroeconomy, financing, legal and institutional condition are the most challenging factors in business environment, where infrastructure and market condition are less challenging.

When all individual factors are ranked, poverty, unemployment, political condition, corruption, exchange rate and inflation are evaluated as the worst /Figure 3.2/. Following these, loan rate, crime, foreign debt, current economic growth and loan fee are cited as having negative impact on SME operations.

On the other hand, SMEs agreed that electricity supply, communication technology are at satisfactory level. Moreover, market competition, technological advancement, transportation, water supply and road access are amongst the least challenging factors.

Figure 3.1: SME business environment

/-2 = very bad, -1 = bad, 0 = neutral, 1 = good, 2 = very good/

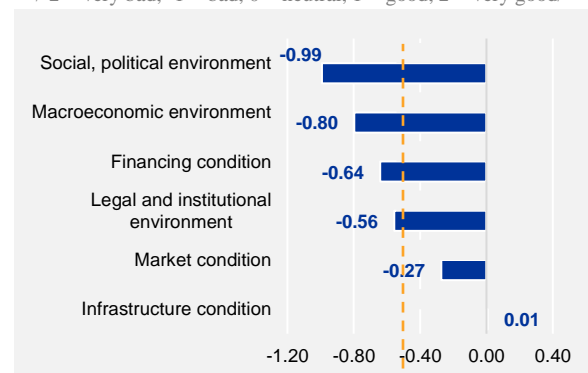
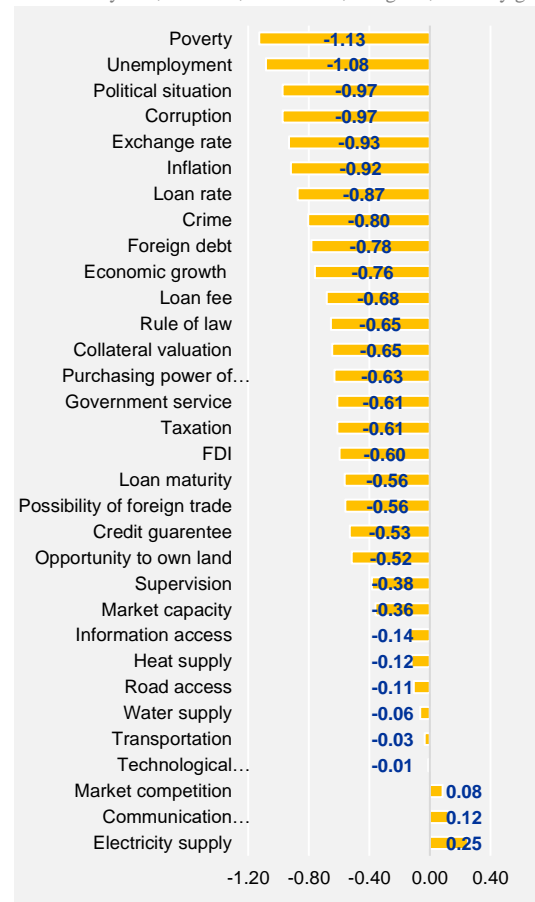


Figure 3.2: SME business environment/by factors/

/-2 = very bad, -1 = bad, 0 = neutral, 1 = good, 2 = very good/



Source: The Bank of Mongolia, SME survey (2017)

3.2. MACROECONOMIC ENVIRONMENT

Overall results

In the macroeconomics framework, like other groups, corresponding business environment factors are evaluated by qualitative questions ranging from very bad /-2/ to very good /+2/ with matching numeric value and averaged to an index number.

Macroeconomic environment is represented by economic growth, inflation, exchange rate, foreign direct investment (FDI) and foreign debt. Overall evaluation is bad (-0.71).

Results of this year's survey suggests that exchange rate, inflation are the most challenging factors. For SMEs, foreign debt is also challenging but less challenging than current stance of economic growth and FDI /Figure 3.4/.

Provinces and cities

Overall macroeconomic environment indicator is ranked among regions. Amongst them Umnugobi and Gobi-Altai provinces are evaluated at worst where Khentii and Arkhangai provinces are evaluated below average.

On the other hand, SMEs in Uvs, Selenge, Zavkhan and Sukhbaatar provinces find macroeconomic environment least troubling compared with others.

Figure 3.3: Macroeconomic environment index

/-2 = very bad, -1 = bad, 0 = neutral, 1 = good, 2 = very good/

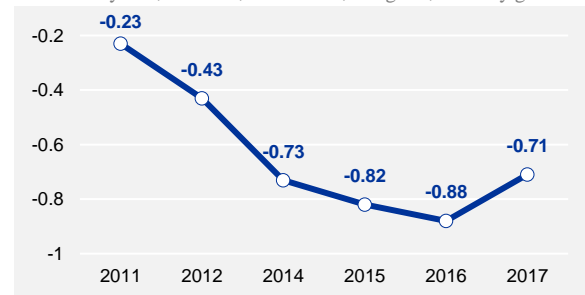


Figure 3.4: Macroeconomic environment /by factors/

/-2 = very bad, -1 = bad, 0 = neutral, 1 = good, 2 = very good/

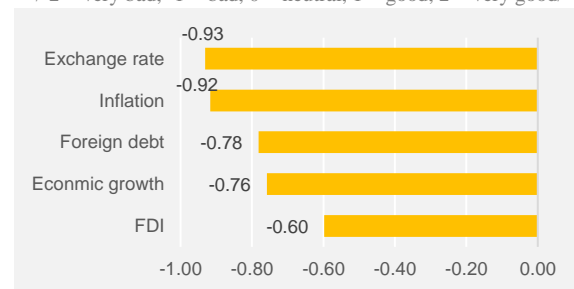
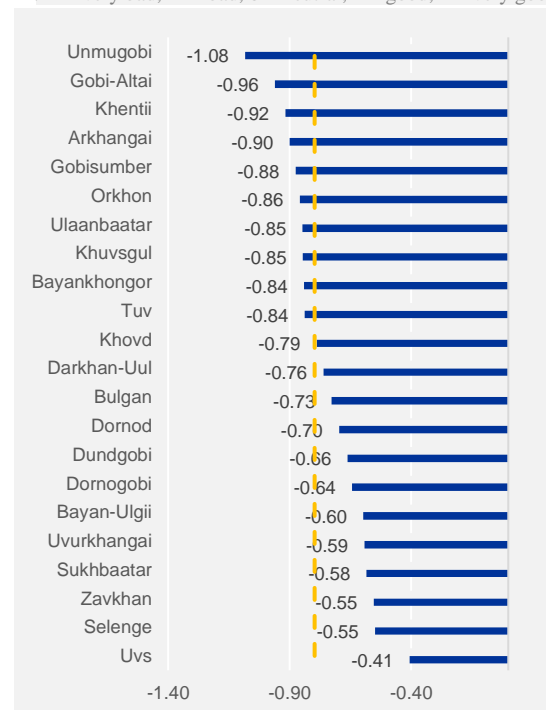


Figure 3.5: Macroeconomic environment /provinces and cities/

/-2 = very bad, -1 = bad, 0 = neutral, 1 = good, 2 = very good/



Source: The Bank of Mongolia, SME survey (2017)

3.3 SOCIAL AND POLITICAL ENVIRONMENT

GDP growth in Mongolian economy was at 1.0% by the end of 2016 and per capita GDP was \$3,857¹, unemployment at 9.1%. According to “Transparency International” report in 2014 corruption index² is at 3.8.

Overall results

In the social and political framework business environment factors are evaluated by qualitative questions ranging from very bad /-2/ to very good /+2/ with matching numeric value and averaged to an index number.

Social and political environment consists of five factors namely poverty, unemployment, corruption, crime and political situation. The overall evaluation of social and political environment is bad (-0.99), but with little improvement compared to last year /Figure 3.6/.

Poverty and unemployment stands out as the most challenging factors in the social and political environment this year. Unemployment is perceived as the significant obstacle for SME after poverty, both undermining sales, thus playing significant factor in their sales income /Figure 3.7/.

Provinces and cities

When ranked among cities and provinces with social and political environment index, SMEs in Khentii, Gobi-Altai and Bayankhongor provinces are placed at worst. Where Khuvsgul and Ulaanbaatar stands out below average.

Uvs and Zavkhan provinces are, on the other hand, situated at better place compared to other provinces and cities in terms of social and political environment /Figure 3.8/.

Figure 3.6: Social and political environment index

/-2 = very bad, -1 = bad, 0 = neutral, 1 = good, 2 = very good/



Figure 3.7: Social and political environment index /by factors/

/-2 = very bad, -1 = bad, 0 = neutral, 1 = good, 2 = very good/

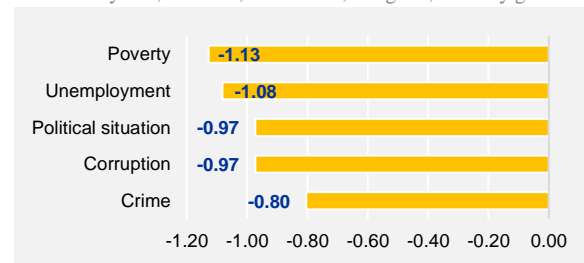
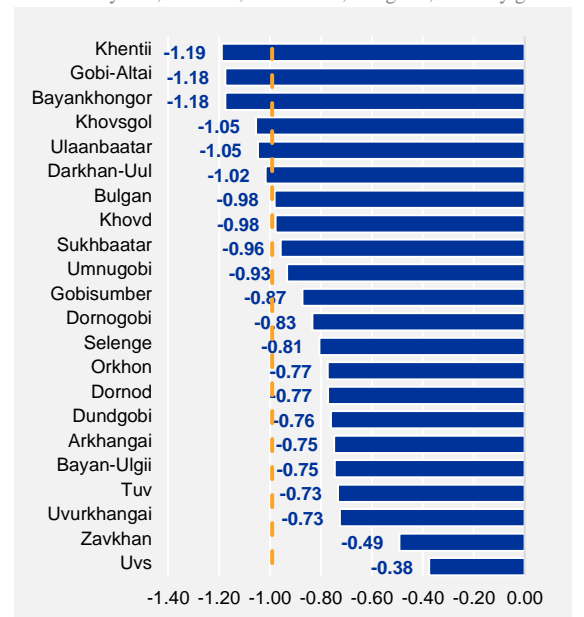


Figure 3.8: Social and political environment index /provinces and cities/

/-2 = very bad, -1 = bad, 0 = neutral, 1 = good, 2 = very good/



Source: The Bank of Mongolia, SME survey (2017)

¹ Atlas method of World Bank

³ Numeric values range from 0 to 10, 0 being the worst and 10 being with little or no corruption

3.4. LEGAL AND INSTITUTIONAL ENVIRONMENT

Despite numerous efforts targeting to strengthen SMEs legal and institutional environment over the past years, the business entities did not find it enough.

Overall results

This year's legal and institutional environment index was indicating to a bad score again (-0.56) despite gain of 0.07 point from last year /Figure 3.9/

A deeper look into the legal and institutional environment suggests a weak rule of law is the biggest concern ranking the first amongst the difficulties. Likewise, government service and taxation frameworks are similarly discouraging /Figure 3.10/.

The reason why weak rule of law stands out as the biggest obstacle in legal environment is maybe due to unsatisfactory outcome of numerous legislations such as the "Law on SME", "Law on Legal Status of Industrial and Technology Park", "Law on Employment Promotion", "Law on Credit Fund".

Provinces and cities

Bayankhongor's SMEs are apparently more disturbed by legal environment than other cities and provinces followed by Gobi-Altai and Khovsgol provinces. Unlikely, SMEs in Uvs and Bayan-Ulgii find it plausible and Dundgobi and Dornogobi provinces are amongst least of distressed provinces in terms of legal environment /Figure 3.11/.

Figure 3.9: Legal and institutional environment index

/-2 = very bad, -1 = bad, 0 = neutral, 1 = good, 2 = very good/

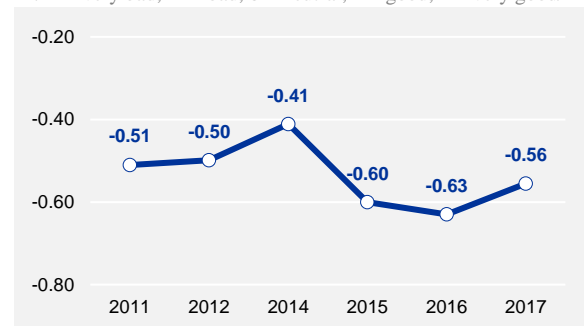


Figure 3.10: Legal and institutional environment index /by factors/

/-2 = very bad, -1 = bad, 0 = neutral, 1 = good, 2 = very good/

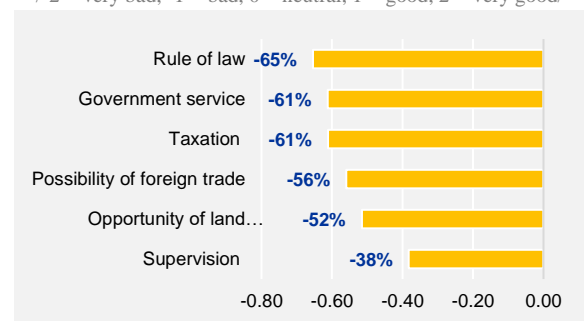
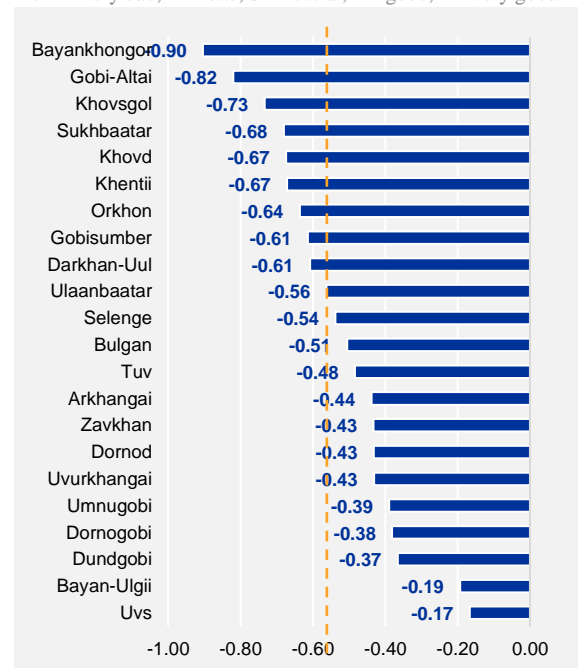


Figure 3.11: Legal and institutional environment index /provinces and cities/

/-2 = very bad, -1 = bad, 0 = neutral, 1 = good, 2 = very good/



Source: The Bank of Mongolia, SME survey (2017)

3.5. MARKET CONDITION

Overall results

The market condition index has improved to (-0.27) from all time low (-0.43) in last year, gaining a significant (0.16) point /Figure 3.12/.

This year's results points out to low purchasing power of consumers (-0.63), as it is a potential candidate to blame for the decline in business activity /Figure 3.13/. However, business entities rated market competition and technological advancements to be at satisfactory level.

Provinces and cities

Market condition index in Khovd, Bayankhongor and Bulgan provinces are ranked worst at (-0.58), (-0.55) and (-0.51) points. Followers are Gobisumber, Gobi-Altai, Dundgobi and Khuvsgul departing well from the average /Figure 3.14/.

In Bayan-Ulgii and Uvs provinces SMEs see almost no difficulty in market condition. Dornogobi and Sukhbaatar provinces also find least of difficulties in market condition.

Figure 3.12: Market condition index

/-2 = very bad, -1 = bad, 0 = neutral, 1 = good, 2 = very good/

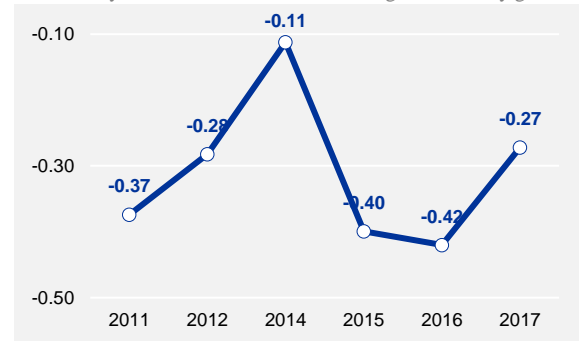


Figure 3.13: Market condition index /by factors/

/-2 = very bad, -1 = bad, 0 = neutral, 1 = good, 2 = very good/

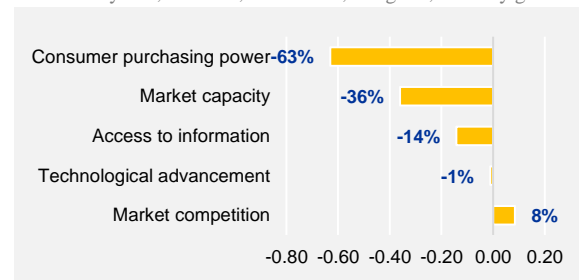
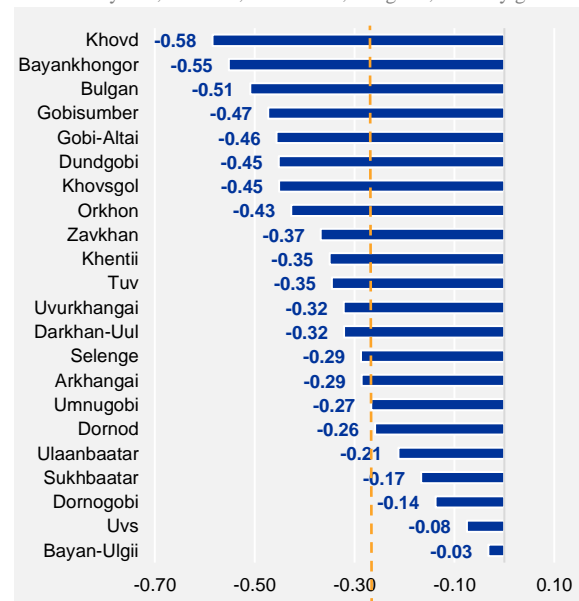


Figure 3.14: Market condition index /provinces and cities/

/-2 = very bad, -1 = bad, 0 = neutral, 1 = good, 2 = very good/



Source: The Bank of Mongolia, SME survey (2017)

3.6. FINANCING CONDITION

Overall results

The financing condition index has been declining for second consecutive year cancelling out gains between 2014 and 2015 and settling to (-0.64) point low of 2012 /Figure 3.15/.

A closer look suggests higher loan rate to be the worst factor in this category. And not so far apart, other indicators namely loan fee, collateral valuation, maturity, amount and credit guarantees are also upsetting /Figure 3.16/.

The lowest point in the category (-0.87) of loan rate has changed little to the worsen side than last year, and still remains the key obstacle for SMEs.

Provinces and cities

SMEs in Bayankhongor, Gobi-Altai, Gobisumber and Khuvsgul provinces gave financing conditions a bad review. This is contrary to SMEs in Uvs and Dornogobi provinces /Figure 3.17/ where financing conditions seems reasonable.

Figure 3.15: Financing condition index

/-2 = very bad, -1 = bad, 0 = neutral, 1 = good, 2 = very good/

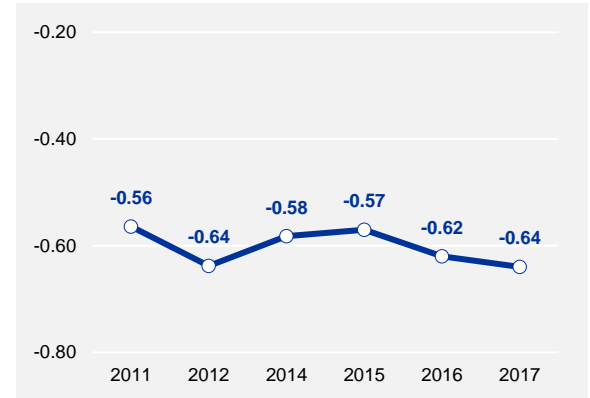


Figure 3.16: Financing condition index /by factors/

/-2 = very bad, -1 = bad, 0 = neutral, 1 = good, 2 = very good/

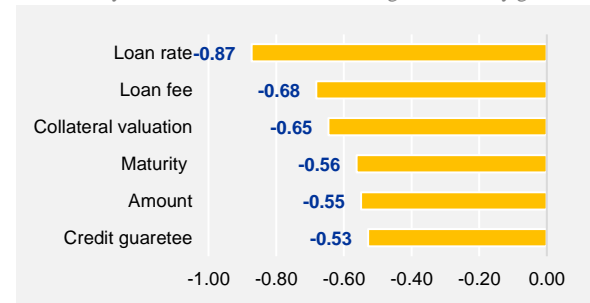
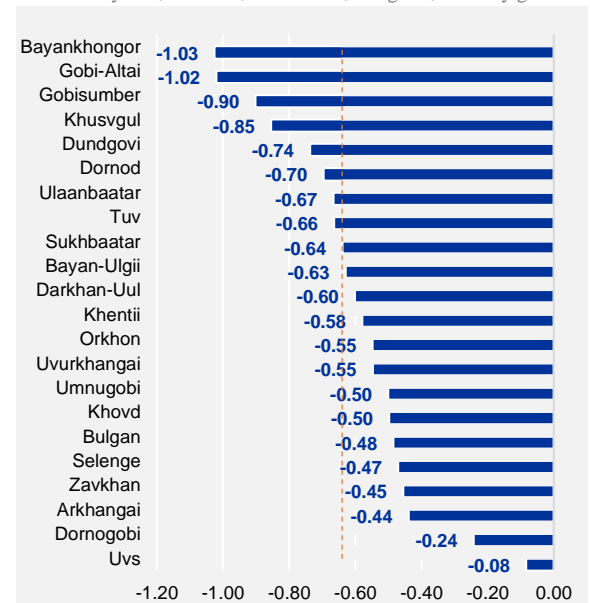


Figure 3.17: Financing condition index /provinces and cities/

/-2 = very bad, -1 = bad, 0 = neutral, 1 = good, 2 = very good/



Source: The Bank of Mongolia, SME survey (2017)

3.7. INFRASTRUCTURE CONDITION

Infrastructure is no doubt a key component for business activity to sustain. Thus, it is considered as one of twelve defining elements in Global Competitiveness Index report.

In this survey infrastructure condition is represented by road access, heat supply, transportation, water supply, electricity supply and communication technology.

Overall results

Amongst other group of factors infrastructure is the least troublesome (0.01) with only positive score. Infrastructure has gained 0.1 points from last year and reached to the all time high.

Weakest point of infrastructure seems to be heat supply and road access, where electricity supply and communication technology are placed on the positive side /Figure 3.19/.

Provinces and cities

Among provinces and cities Bayankhongor, Khentii and Darkhan-Uul provinces demand more attention with the lowest scores. On the contrary Arkhangai, Dornogobi and Dundgobi are at satisfactory level of infrastructure in overall.

Figure 3.18: Infrastructure condition index

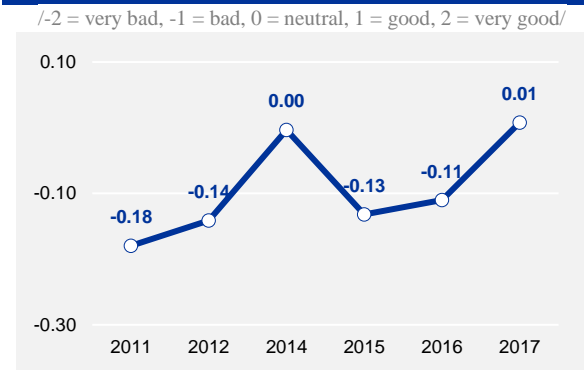


Figure 3.19: Infrastructure condition index /by factors/

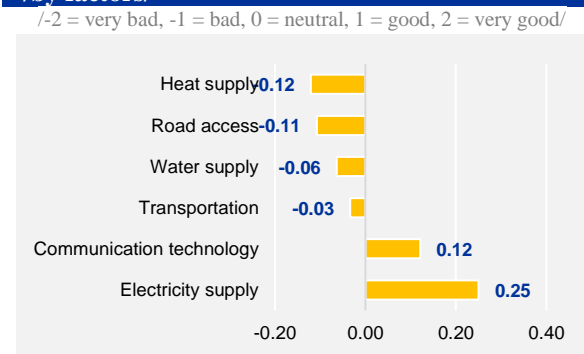
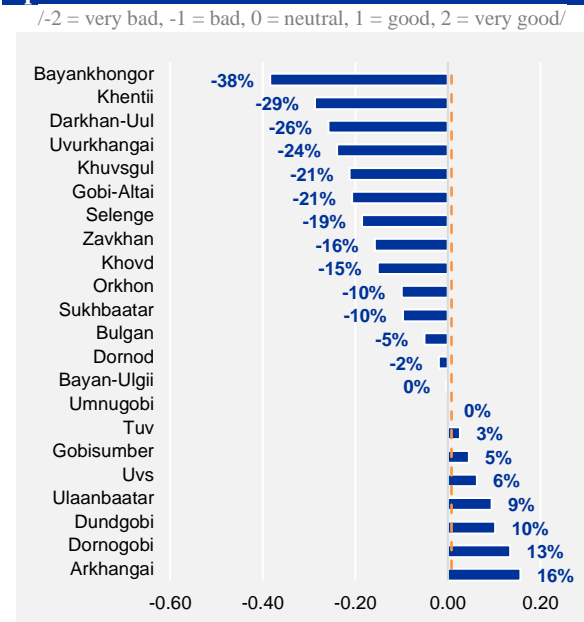


Figure 3.20: Infrastructure condition index /provinces and cities/



Source: The Bank of Mongolia, SME survey (2017)

SME OPERATIONAL ASPECTS

4.1. OPERATIONAL ASPECTS

Sales, labour supply, labour skills, possibility of introducing new products, supply of buildings, supply of raw material, quality of machinery and competitiveness are the factors considered within operational aspects.

Operational aspects got a score of (-0.14) from the range of (-2.0) to be the worst and (+2.0) to be the best. Sales and labor supply stands out as the biggest obstacle in this category followed by supply of buildings. Quality of machinery, supply of raw material and competitiveness are the positive sides in this category /Figure 4.1/.

When taken by provinces Bayankhongor, Khovd and Khuvsgul provinces stand out as worst and Bayan-Ulgii, Arkhangai provinces and Ulaanbaatar is at positive score /Figure 4.2/.

Labour supply is considered at worst condition in Umnugobi and Bulgan provinces while in Bayan-Ulgii, Ulaanbaatar, Arkhangai it has a positive score. In terms of capabilities, labour forces are evaluated at worst in Umnugobi and Bayankhongor, while SMEs in Ulaanbaatar tend to evaluate it positively.

Survey evaluates that the possibility of introducing new products is the most restricted in Khovd, Bayankhongor and Umnugobi. In Dornogobi, Arkhangai, Dornod and Darkhan-Uul possibilities are found better than other regions.

Supply of building is comparatively restricted in Umnugobi, Khovd, Khuvsgul and acceptable in Uvs, Dornod and Tuv provinces.

Figure 4.1: Operational aspects /by factors/

/-2 = very bad, -1 = bad, 0 = neutral, 1 = good, 2 = very good/

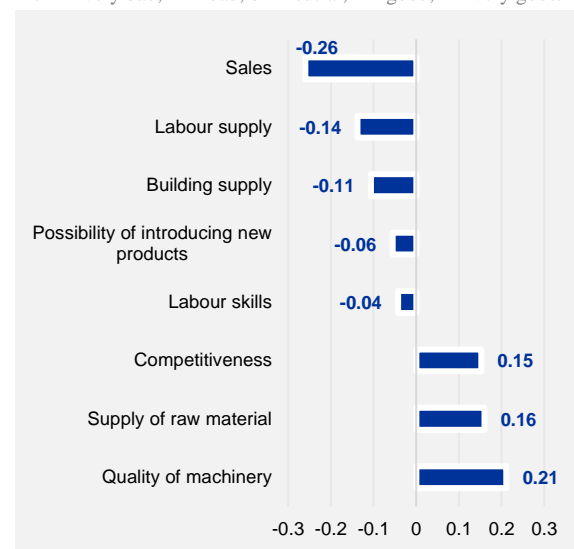
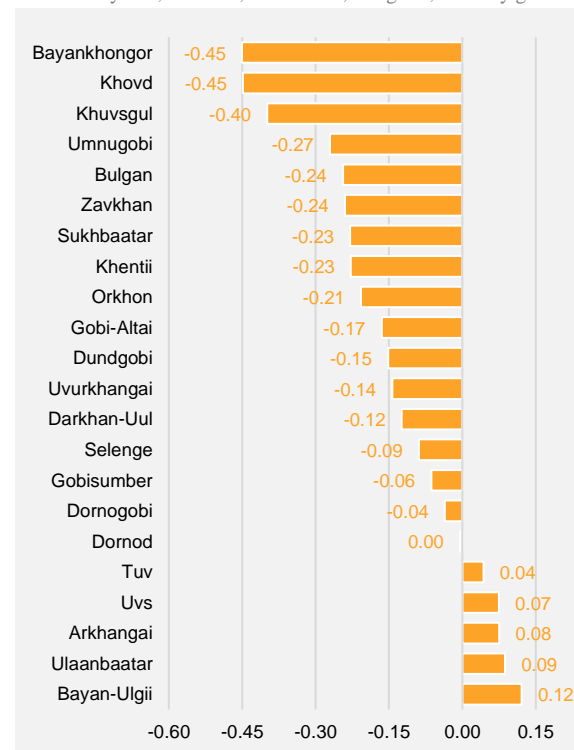


Figure 4.2: Operational aspects /provinces and cities/

/-2 = very bad, -1 = bad, 0 = neutral, 1 = good, 2 = very good/



Source: The Bank of Mongolia, SME survey (2017)

Supply of raw materials is comparatively restricted in Bayankhongor, Khovd, Khuvsgul, Bulgan provinces.

Quality of machinery in Bulgan, Khovd, Khuvsgul, Bayankhongor, Gobisumber, Zavkhan and Darkhan-Uul is found to be comparatively worse than others.

Competitiveness is mostly found positive /Table 4.1/.

4.2. SALES INCOME

Around 40% of the SMEs has sales income of ₮10-49 million, 29% of SMEs has sales income of ₮1.1-9.9 million and 6% has sales income below ₮1.0 million, in total, making around 75% of SMEs surveyed has sales income more than ₮50 million. Rest of them consists of ₮50-499 million sales income only making 5% and ₮500-1,500 million makes 20%.

Compared to last year's survey share of SMEs with sales of ₮10-49 million and ₮500-1,500 million is bigger and others less. Decline in shares of lower income ranges and increases in higher income ranges could suggest that there has been an improvement in sales compared with last year. /Figure 4.3/.

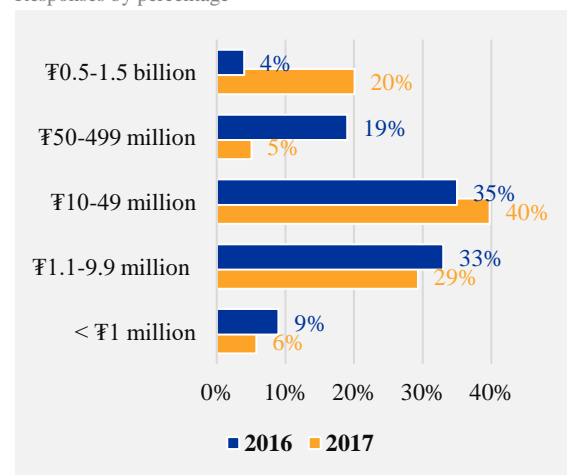
Table 4.1: Operational aspects /by factors/

/-2 = very bad, -1 = bad, 0 = neutral, 1 = good, 2 = very good/

	Labour supply	Labour skills	Supply of raw materials	Quality of machinery	Competitiveness	Possibility of introducing new products	Supply of buildings	Sales
Улсын дүн	-0.14	-0.04	0.16	0.15	0.21	-0.06	-0.11	-0.26
Arkhangai	-0.14	0.06	0.40	0.40	0.23	0.03	-0.20	-0.17
Bayan-Ulgii	-0.14	0.03	0.22	0.40	0.25	0.11	0.03	0.08
Bayankhongor	-0.48	-0.55	-0.34	-0.16	-0.44	-0.56	-0.29	-0.78
Bulgan	-0.72	-0.34	-0.22	0.04	0.00	-0.21	-0.21	-0.28
Gobi-Altai	-0.40	-0.48	0.28	0.04	0.24	-0.12	-0.20	-0.68
Gobisumber	-0.35	-0.12	-0.11	-0.06	0.29	0.24	-0.29	-0.11
Darkhan-Uul	-0.27	-0.27	-0.05	-0.02	0.02	-0.08	-0.15	-0.17
Dornogobi	0.00	-0.12	0.00	0.02	0.05	-0.02	-0.12	-0.10
Dornod	-0.36	-0.32	0.10	0.23	0.28	0.02	0.17	-0.16
Dundgobi	-0.47	-0.43	0.27	0.13	0.00	-0.13	-0.19	-0.39
Zavkhan	-0.54	-0.52	-0.11	-0.04	0.04	-0.17	-0.26	-0.32
Orkhon	-0.45	-0.28	0.07	0.02	-0.21	-0.17	-0.25	-0.38
Uvurkhangai	-0.45	-0.32	-0.09	0.05	0.07	-0.05	-0.19	-0.16
Umnugobi	-0.67	-0.67	-0.33	0.00	0.50	-0.50	-0.50	0.00
Sukhbaatar	-0.50	-0.50	-0.08	0.04	-0.08	-0.25	-0.21	-0.25
Selenge	-0.39	-0.15	-0.04	0.00	0.18	-0.11	-0.11	-0.11
Tuv	-0.32	-0.02	0.04	0.20	0.27	0.19	0.09	-0.10
Uvs	0.00	0.29	0.00	0.00	-0.14	-0.40	0.67	0.40
Ulaanbaatar	0.03	0.12	0.29	0.23	0.34	0.00	-0.06	-0.25
Khovd	-0.40	-0.43	-0.43	-0.38	-0.37	-0.52	-0.47	-0.58
Khuvsgul	-0.56	-0.48	-0.27	-0.18	-0.25	-0.47	-0.37	-0.62
Khentii	-0.40	-0.49	-0.09	0.00	-0.09	-0.24	-0.24	0.00

Figure 4.3: Annual sales income

Responses by percentage



Source: The Bank of Mongolia, SME survey (2017)

Growth in sales income

Sales income has grown on average 26.9% in construction and agriculture sectors, while sales growth in services and retail trade industry is 12 pp. lower than of previous /Figure 4.4/.

Change in sales income

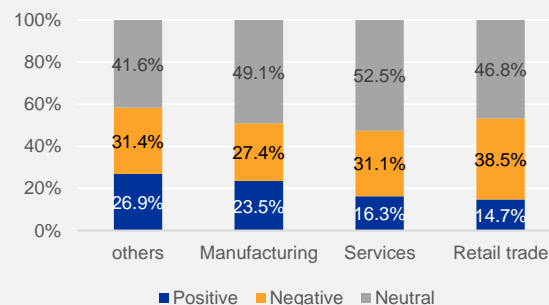
Amongst SMEs surveyed 18% has positive sales growth and 34% has negative growth, while 48% has stated that sales stayed the same. SMEs with positive growth has grown 18.7% on average, where those with negative growth has shirked 26.2% in sales. In overall, all SMEs sampled have declined 5.6% on average. /Figure 4.5/

Profitability

Among all the SMEs covered in this year's survey 40% of them had a positive net income, while 16% had a loss and another 40% has no or little profit over last year /Figure 4.6/

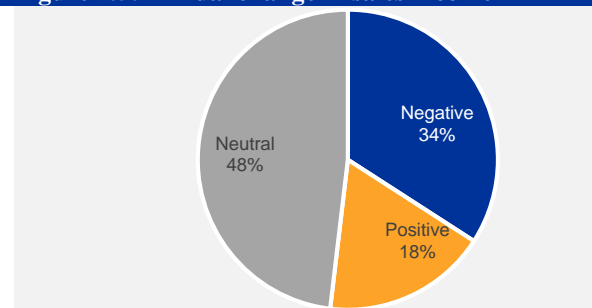
When sales income responses are considered by regions, Gobisumber, Dundgobi, Sukhbaatar provinces and Ulaanbaatar has the most, reaching 77%, of SMEs with sales income of up to ₮50 million. Darkhan-Uul and Selenge provinces has the least of shares with less income than ₮50 million making 48% and highest share reaching to 10% of top earners group of ₮500-1,500 million.

Figure 4.4: Growth in sales income



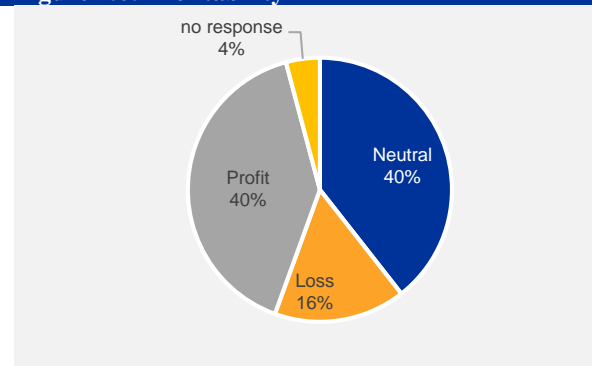
Source: The Bank of Mongolia, SME survey (2017)

Figure 4.5: Annual change in sales income



Source: The Bank of Mongolia, SME survey (2017)

Figure 4.6: Profitability



Source: The Bank of Mongolia, SME survey (2017)

4.3. COSTS

This section of the report will deal with the issues of costs related to business operations for SMEs and their pressing issues in this matter.

Only 63% of the SMEs covered in this survey has responded “yes” to whether they produce financial statements.

This years costs are evaluated at (-0.98) point, gaining 0.19 points from last year but still remaining in troubling zone /Figure 4.8/.

A deeper look suggests that interest rate costs are the most troubling one followed by government service fees, loan fees, raw material costs, heating costs, labour costs, operational costs and transportation costs. Communication costs and water supply costs seem to be the least troubling costs within this category /Figure 4.9/.

Main production costs like labour costs and raw material costs are taking the largest portion, 46.8% of all costs for SMEs.

On the other hand, rent and electric bills are accounting for 12.9% and 6.2% respectfully in other additional operational costs which is in total 36.6%. While non-operational costs like interest payment and service fees takes also considereably high 10.5% and 6.1% share in the total costs. In the meantime, daily operations take 9.8%.

Figure 4.7: Annual sales income /provinces and cities/

responses by percentage

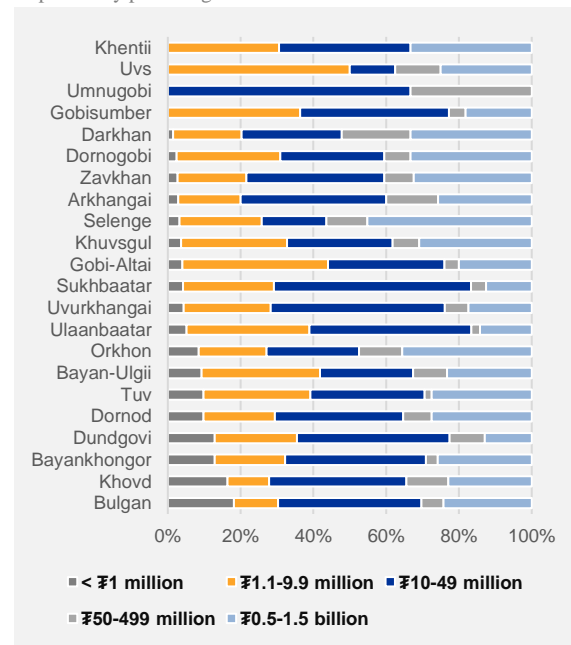


Figure 4.8: Cost index

/-2= Very troublesome, -1= Troublesome, 0= No trouble/

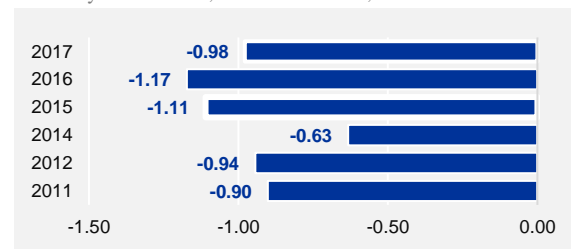
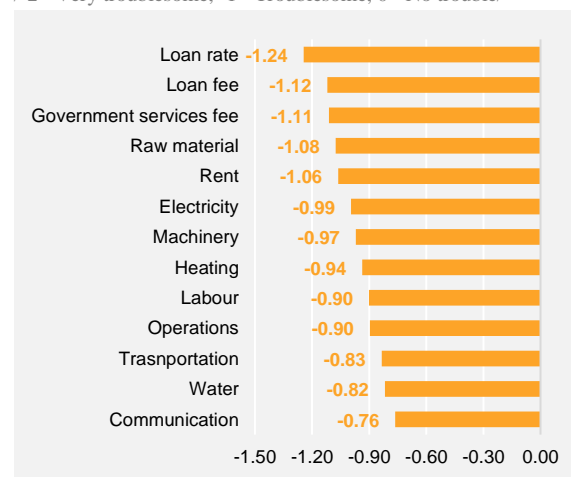


Figure 4.9: Cost index /by factors/

/-2= Very troublesome, -1= Troublesome, 0= No trouble/



Source: The Bank of Mongolia, SME survey (2017)

Survey results suggest that SMEs on average have 6.4% profit rate and tax payment takes 11.6% in all costs.

Compared with last year's results raw material, renting costs have risen the most where communication and labor costs have declined the most /Figure 4.10/.

Cost index in Byaankhongor has the lowest point followed by Khovd, Darkhan-Uul, Selenge and Uvurkhantai. The most pressing issues in these provinces are interest rate payments and fee related expenses.

Figure 4.10: Costs

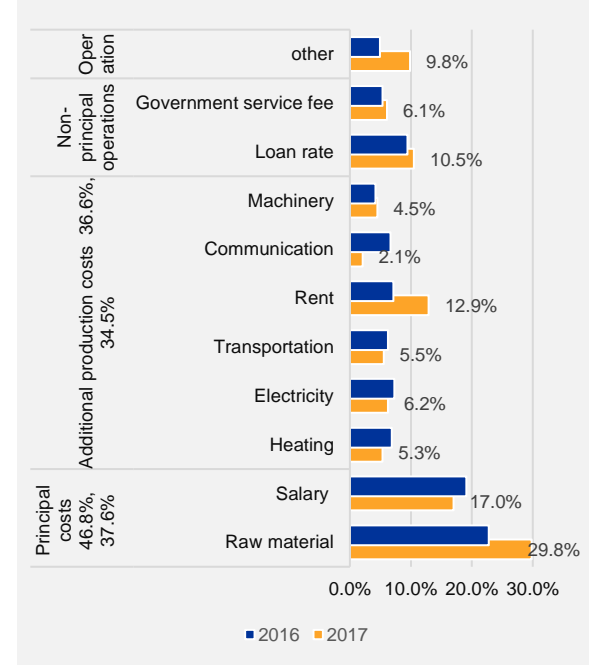
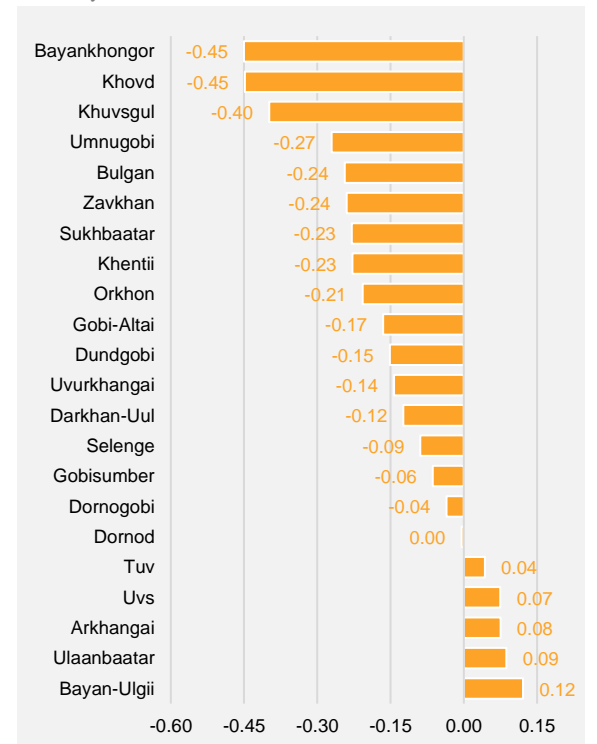


Figure 4.11: Cost index /provinces and cities/

/-2= Very troublesome, -1= Troublesome, 0= No trouble/



Source: The Bank of Mongolia, SME survey (2017)

CONCLUSION

Decline in economic activity has led to deficiency in working capital, difficulty in maintaining and expanding business operations. Financial support from international organizations and government subsidy seems not to be at the sufficient level and inclusion, hence most of the SMEs apply for financing to commercial banks. The amount requested by SMEs tend to be between ₦10 to ₦50 million for a period of 1-5 years. Exchange rate and inflation as macroeconomic factor, poverty and unemployment as a social factor, weak rule of law and government services tend to be the biggest obstacle needed to be addressed in business environment of SMEs.

This survey finds that, there are series of actions needs to be taken in order to improve SME business environment:

- Reinforcing rule of law, and stronger action against corruption
- Providing equal access, greater inclusion and transparency to government subsidized financing
- Promote employment and diversification of economy
- Tax subsidy for baby industries and startups until its maturity
- Targeting tax and other subsidies to non-export tradable industry
- Reducing exchange volatility

APPENDIX

PROVINCES AND CITIES

Financing in the past

SMEs in Gobisumber, Dundgobi, Khuvsgul and Selenge provinces stand out as the highest percentage (above 80%) of access to financial resources compared with the lowest of 37.5% in Uvs and 43% in Ulaanbaatar. SMEs in Khentii, Bayan-Ulgii, Arkhangai and Umnugobi provinces follows the lowest of the ranking /Appendix 1.1/.

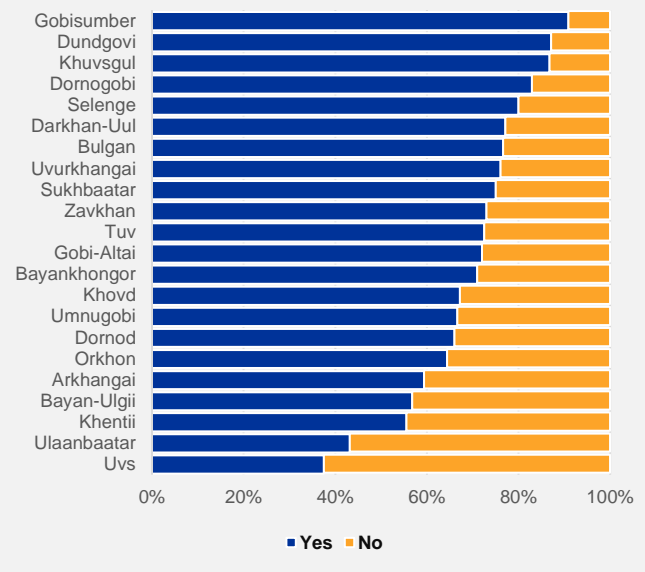
Sources of financing

While banks dominate in terms of financial sources for SMEs, Ulaanbaatar is placed at 86% which is 12 pp. above provinces' averages of 74% /Appendix 1.2/. Similar observation can be drawn on non-bank financial institutions with Ulaanbaatar (13%) is around 11 pp. higher than of provinces (1.5%). This difference is covered in provinces (9.6%) by access to subsidized loans 8 pp. higher than that of Ulaanbaatar.

Usage of financing

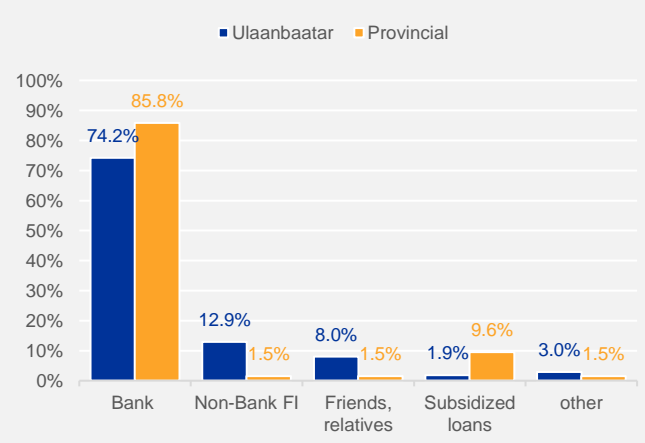
SMEs in Ulaanbaatar had used their external financing sources mostly (71%) on working capital which was 13 pp. higher than that of provinces. While other usages stay the around the same percentage SMEs operating in the provincial area tend use their financial resources more (8 pp higher) on business expansion /Appendix 1.3/.

Appendix 1.1: Financing history



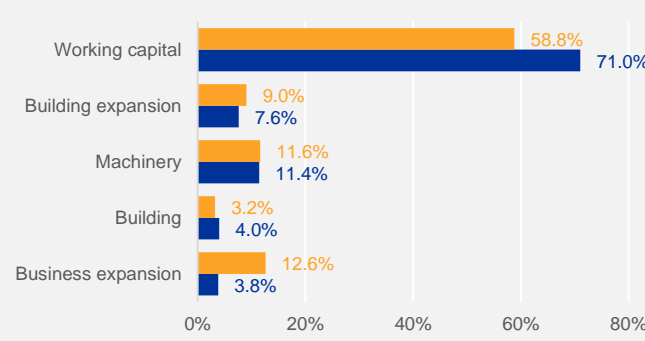
Source: The Bank of Mongolia, SME survey (2017)

Appendix 1. 2: Sources of financing



Source: The Bank of Mongolia, SME survey (2017)

Appendix 1.3: Purpose of financing



Source: The Bank of Mongolia, SME survey (2017)

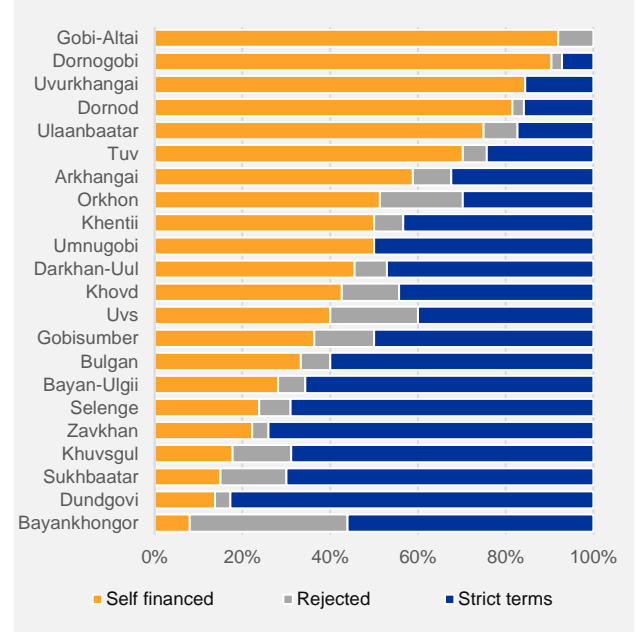
Reasons for not obtaining external finance

Of all SMEs covered in this survey, 44% has responded that they did not have any external financing /Figure 2.5/. The percentage of self-financing as the reason for not obtaining external finance in Gobi-Altai, Dornogobi, Uvurkhangai, Dornod and Ulaanbaatar is the highest (above 75%). On the other hand, terms and conditions of loans stand out as the main reason (above 65%) in Dundgobi, Zavkhan, Khuvsgul, Bayan-Ulgii and Selenge. SMEs operating in Orkhon, Khovd, Gobisumber and Khuvsgul provinces tend to get more rejection from external financing (above 13%) than in other provinces /Appendix 1.4/.

Change in sales income

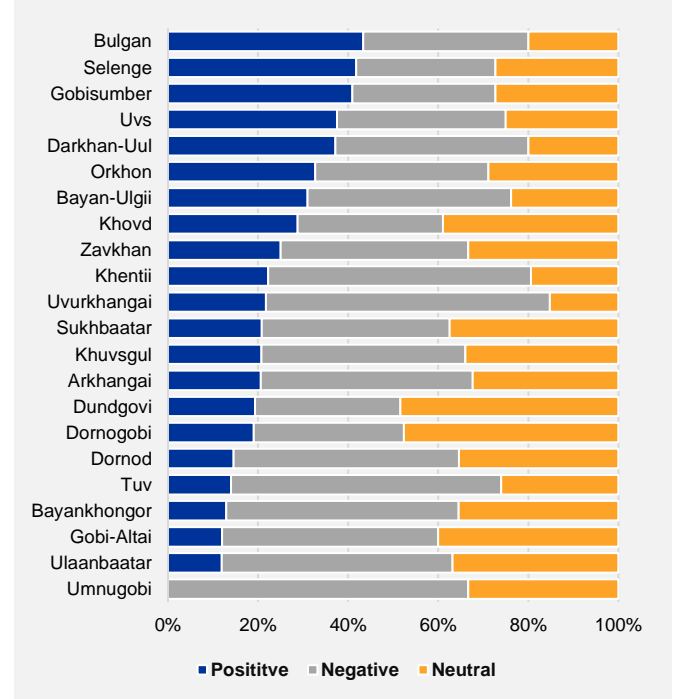
Percentage of SMEs with growing sales income is the most Bulgan, Selenge, Gobisumber, Darkhan-Uul and Uvs provinces with more than 35%. This is contrary to the position of Umnugobi, Ulaanbaatar, Gobi-Altai, Bayankhongor, Tuv and Dornod where the share of SMEs with positive sales change is only up to 15%.

Appendix 1.4: Reasons for not obtaining external finance



Source: The Bank of Mongolia, SME survey (2017)

Appendix 1.5: Change in sales income



Source: The Bank of Mongolia, SME survey (2017)

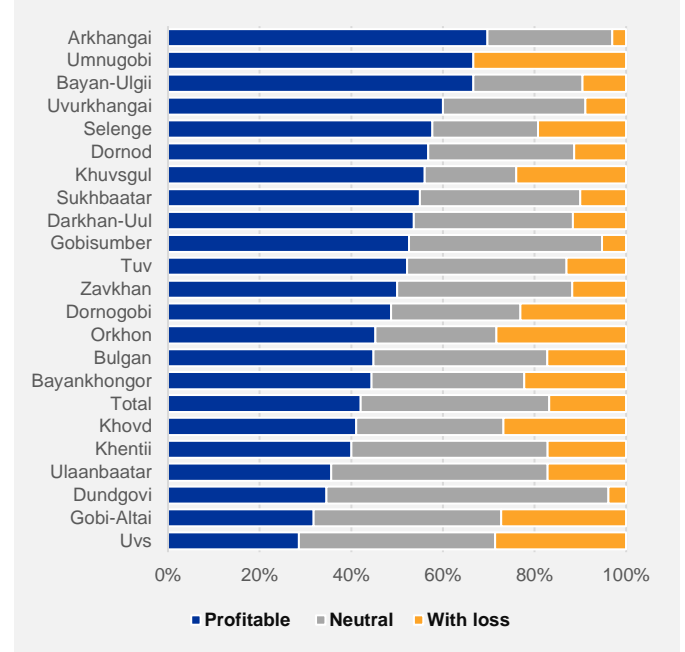
Profitability

More than 60% of SMEs in Arkhangai, Umnugobi, Bayan-Ulgii and Uvurkhangai provinces has operated with profit whereas more than 25% has operated with loss in Uvs, Gobi-Altai, Khovd, Orkhon and Umnugobi provinces

Need for further funding

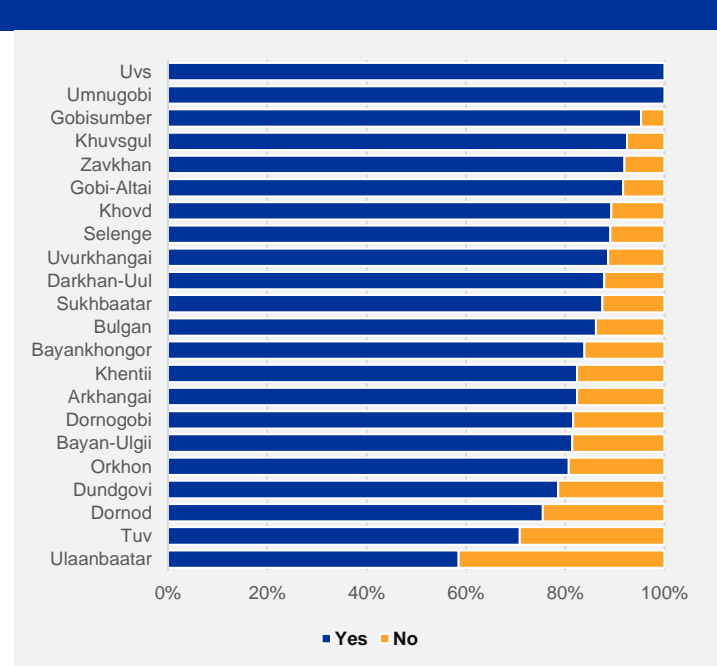
The highest share of SMEs in need of further financing are in Uvs, Umnugobi, Gobisumber, Khuvsgul, Zavkhan, Gobi-Altai and Khovd with more than 90%, whereas those without need of further funding has highest share in Ulaanbaatar, Tuv, Dundgobi, Dornod and Orkhon with more than 20%.

Appendix 1.6: Profitability



Source: The Bank of Mongolia, SME survey (2017)

Appendix 1.7: Need for further funding



Source: The Bank of Mongolia, SME survey (2017)



Profitability and financing needs

Regardless of profitability in last year's operation SMEs in need of financing is around 65%.

Financing in the past and future needs

Share of SMEs with needs of external financing is 22 pp. higher in SMEs with former history of external financing (74.7%) than of no history.

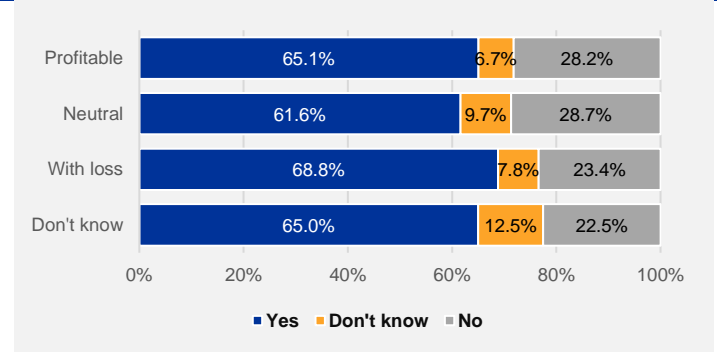
Profitability by sector

Despite increase in sales income, construction, agriculture sectors did not manage to operate with profit. Manufacturing sector had the most share of profitable firms (46%) which is 8 pp. higher than of service sector, and 30 pp. higher than of agriculture sector /Appendix 1.10/.

Financing needs by sector

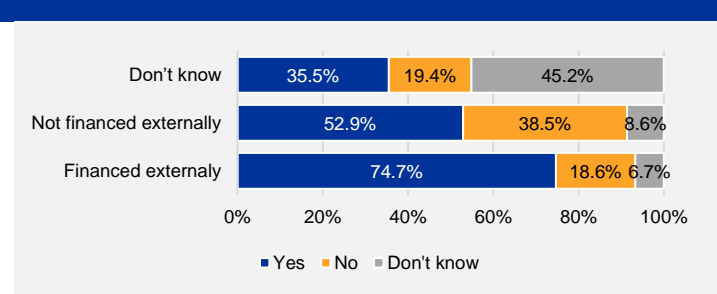
Regardless of sectors, more than half of SMEs needs further funding. However, retail trade and service sector have less share of firms needing further fund / Appendix 1.11/.

Appendix 1.8: Profitability and financing needs



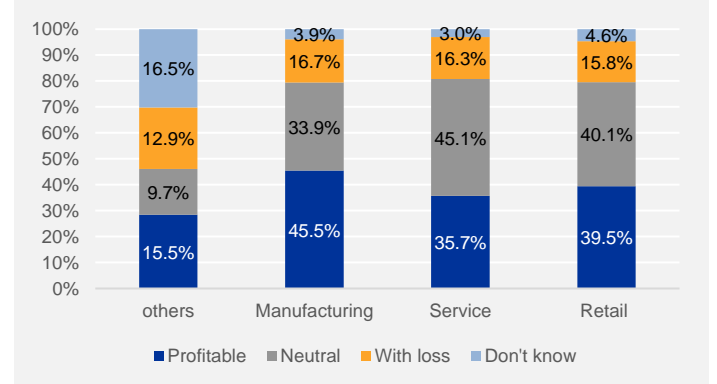
Source: The Bank of Mongolia, SME survey (2017)

Appendix 1.9: Financing in the past and future needs



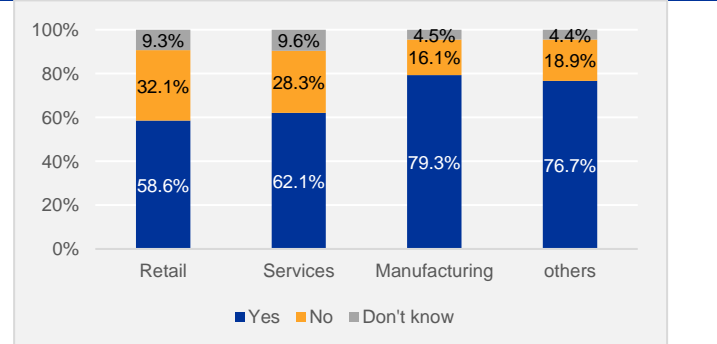
Source: The Bank of Mongolia, SME survey (2017)

Appendix 1.10: Profitability /by sector/



Source: The Bank of Mongolia, SME survey (2017)

Appendix 1.11: Financing needs /by sector/



Source: The Bank of Mongolia, SME survey (2017)