Policy Insights

# Monitoring Competitiveness Reforms: Access to Finance for Firms in Mongolia

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Policy Insights

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# *Foreword*

In 2016, as part of the OECD Eurasia Competitiveness Programme, the OECD worked with the Government of Mongolia to enhance access to finance for Micro, Small and Medium-sized Enterprises (MSMEs). Policy recommendations on access to finance were developed in public-private Working Group Meetings throughout 2016. A high-level government delegation, led by the Minister of Food, Agriculture and Light Industry and the Economic Policy Advisor to the President, presented the final results and endorsed the recommendations.

The OECD conducted capacity-building workshops and fact-finding missions to Mongolia in 2017 and 2018 to support the implementation of the recommendations. In 2019, monitoring and capacity-building workshops involving experts from France and Poland were organised to take stock of implementation progress, provide new insights and case studies, and prepare this monitoring note. This note was developed in consultation with the government, private sector companies, business associations, and development partners during the monitoring process. It assesses the implementation progress made in the last three years, and makes recommendations for further progress.

The analysis also addresses the new and specific challenges pertaining to MSMEs' access to finance caused by the Covid-19 outbreak in early 2020 and the economic consequences of the pandemic. The government has taken action to support businesses, in particular SMEs, throughout the pandemic. The experiences of OECD member and non-member countries in supporting business liquidity and the supply of finance to their businesses throughout the crisis provide additional venues that can be explored by the government when designing recovery policies.

The note has been discussed and peer reviewed during an OECD Eurasia Webinar on 18 September 2020.

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# Acronyms and Abbreviations

| | |
|---|---|
| ADB | Asian Development Bank |
| AQR | Asset Quality Review |
| BEEPS | Business Environment and Enterprise Performance Survey |
| BoM | Bank of Mongolia |
| CA | Central Asia |
| CGDP | command GDP |
| EBRD | European Bank for Reconstruction and Development |
| EC | European Commission |
| ECP | Eurasia Competitiveness Programme |
| EU | European Union |
| FDI | foreign direct investment |
| GDP | gross domestic product |
| IFC | International Finance Corporation |
| ICT | information and communications technology |
| IMF | International Monetary Fund |
| INFE | International Network on Financial Education |
| MNCCI | Mongolian National Chamber of Commerce and Industry |
| MCGF | Mongolian Credit Guarantee Fund |
| MNT | Mongolian tugrik (currency) |
| MoFALI | Ministry of Food, Agriculture and Light Industry |
| MSME | micro, small and medium-sized enterprises |
| NDA | National Development Agency |
| NPL | non-performing loan |
| NSO | National Statistics Office |
| OECD | Organisation for Economic Co-operation and Development |
| SMEs | small and medium-sized enterprises |
| SMEDF | SME Development Fund |
| WG | Working Group |

# Key Indicators: Mongolia

| **Mongolia** | |
|---|---|
| Population, 2018 | 3.17 million |
| Surface area, 2018 | 1 564 120 km$^2$ |
| GDP (USD, current prices) 2018 | 13.01 billion |
| GDP per capita (USD, current price), 2018 | 4 104 |
| Real GDP growth (USD, constant prices) 2018 | +6.9% |
| Inflation (average consumer prices, y-o-y change), 2018 | 6.8% |
| Exports of goods and services (% of GDP), 2018 | 60.3% |
| Imports of goods and services (% of GDP), 2018 | 63.5% |
| FDI, net inflows (% of GDP), 2018 | 16.7% |
| General government net lending/borrowing, percentage of GDP, 2017 | -2.7% |
| Unemployment (% of total labour force), 2018 | 6.3% |
| Percentage of GDP in main sectors, 2018: | |
| - Mining | 41.7% |
| - Agriculture | 19.3% |
| - Wholesale trade and retail | 17.0% |
| - Manufacturing | 16.3% |
| - Construction | 5.7% |
| Micro, small and medium-sized enterprises: Statistics | |
| Total number of businesses | 87 725 |
| Businesses with fewer than 50 employees | 85 226 |
| Percentage of MSMEs in selected sectors (out of total MSMEs): | |
| - Mining | 1.0% |
| - Agriculture | 4.3% |
| - Manufacturing | 7.3% |
| - Construction | 7.7% |
| - Wholesale trade and retail | 41.7% |
| Access to finance: Statistics | |
| Outstanding loans (EUR, current prices), 2019 (June) | 6,144 billion |
| Average lending rate for loans in MNT, 2019 (June) | 17.0% |
| Central Bank policy rate, 2019 (July) | 11.0% |
| Deposit rate, 2019 (June) | 10.6% |
| Outstanding loans to MSMEs (% of total loans), 2019 (May) | 14.7% |

*Note*: MSMEs = micro, small and medium-sized enterprises. The National Statistical Office of Mongolia defines MSMEs as companies with no more than 49 staff members. MNT = Mongolian tugrik (currency). USD = United States dollars (currency).
*Source*: National Statistical Institute of Mongolia official website, www.1212.mn (accessed 29 July 2019); Bank of Mongolia official website, www.mongolbank.mn/eng/liststatistic.aspx (accessed 29 July 2019); World Economic Indicators, World Bank, http://data.worldbank.org/indicator (accessed 29 July 2019).

# *Executive summary*

After slowing sharply in 2014-15, Mongolia's economy bounced back strongly in 2017-18, expanding by more than 12.6% over the biennium. However, the economy remains heavily dependent on the mining sector, with minerals and metals accounting for over 90% of total exports. Mongolia thus remains vulnerable to the kind of external shocks that hit the country when the commodity super-cycle ended in the middle of the decade. Diversifying production and exports is thus a critical policy priority. Improving the competitiveness of micro, small and medium-sized enterprises (MSMEs) can help serve this objective, as they represent the vast bulk of firms in non-mining sectors.

Access to finance has long been recognised as one of the main policy barriers hampering MSME development. In 2016, in co-operation with the government, the OECD formulated five policy recommendations to mitigate market failures affecting MSME access to finance. This report assesses the level of reform implementation of each of them and provides guidance on further steps needed.

First, Mongolia needed to improve its **regulatory framework for MSMEs**. In 2019, Mongolia passed a new SME law featuring a harmonised MSME definition. Several institutions have also increased their data collection on MSMEs. This, together with the newly-developed MSME definition, can help improve the evidence base for policy, as well as the design of public financial instruments targeting MSMEs.

Second, the OECD recommended **diversifying the products offered by, and improving the governance of, the SME Development Fund** (SMEDF) in Mongolia. Virtually no action was taken until 2018, contributing to a corruption scandal involving the embezzlement of SMEDF funds. In 2019, the SMEDF embarked on governance reforms and took steps to increase the involvement of private banks. These efforts must be intensified to align the governance and processes with OECD good practices. This could be part of current government plans to transform the SMEDF into an SME agency.

Third, the 2016 report suggested **improving the operations of the Mongolian Credit Guarantee Fund (MCGF) to help address MSMEs' collateral issues**. The management and provision of guarantees have improved during the monitoring period with the support of the ADB. The MCGF has also increased its co-operation with banks and is building partnerships with credit guarantee funds such as France's Bpifrance.

Fourth, Mongolia was advised to **simplify administrative procedures and loan applications** for MSMEs. The government has worked on improving administrative procedures. New one-stop shops (OSSs) are being developed in the country with the support of international organisations, such as the OSS at the National Development Agency (NDA). Procedures have also become more efficient due to increasingly digitalised administrative procedures. **Mongolia should further implement OSSs for MSMEs and consider extending the NDA's OSS to domestic businesses.**

Fifth, public agencies were encouraged to help **enhance the financial literacy of MSMEs** by leveraging the national financial literacy strategy. Efforts have been undertaken under the leadership of the Bank of Mongolia, including training programmes across the country. The Bank has also joined the OECD International Network for Financial Education. However, these efforts were targeted at the general public. The Bank should pursue plans to focus its work on financial literacy for MSMEs.

The **Covid-19 pandemic has further exacerbated the vulnerability of firms, particularly MSMEs, and their financial liquidity.** Recovery prospects will depend crucially on their access to finance to sustain activity and employment. The crisis induced by the pandemic has led to a steady fall in commodity prices and demand, especially from China, reducing growth and making diversification and SME support even more essential. In addition, lockdown measures have put many small private businesses and households under financial strain despite measures to support them. Post-crisis planning will require specific support for businesses to access finance, including through additional guarantees and credit lines as the liquidity crisis will significantly worsen the extent of the slowdown and delay prospects for recovery.

# Summary of Monitoring Assessment

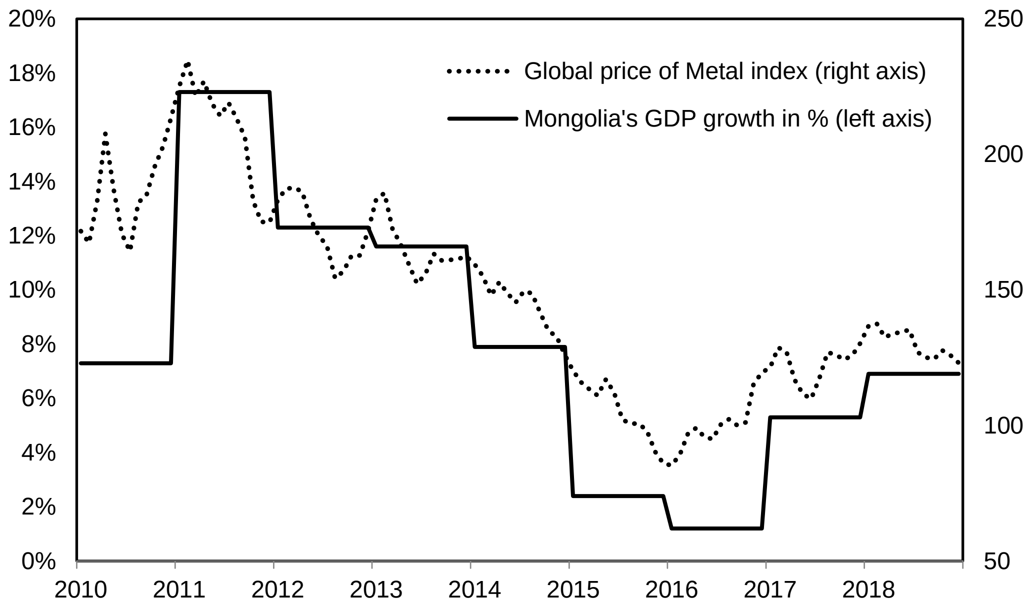
| 2016 recommendation | 2019 monitoring assessment | |
|---|---|---|
| | Progress status | Way forward |
| Develop and disseminate coherent data on MSMEs | ◕ | Implement the SME law<br>Improve data sharing across institutions |
| Diversify the products offered by the SME Development Fund (SMEDF) | ◔ | Improve the governance of the SMEDF |
| Ease collateral demands by making the MCGF more effective | ◕ | Continue to expand guarantee activities and improve risk assessment |
| Streamline administrative procedures for loan applications | ◑ | Consider further implementing one-stop shops for local businesses |
| Improve financial education by ensuring the national strategy is tailored to MSMEs | ◑ | Develop more targeted financial education activities for MSMEs<br>Participate in the OECD/INFE working group on SME finance |

Legend:
Completed ● Close to completion ◕ Being implemented ◑ Initiated ◔ Not started ○

# Introduction

Mongolia was one of the fastest growing countries in the world during 2010-14 before being hit the end of the commodity super cycle. In 2015-16, GDP growth dropped sharply (Figure 1). As commodity prices recovered, growth picked up again, reaching 6.9% in 2018 and 6.7% in 2019. The growth was broad-based, affecting both manufacturing and services, and was driven largely by rising exports (mainly of coal) and strong investment in mining. Private consumption also continued to recover supported by rapid credit growth (ADB, 2019[1]).

**Figure 1. GDP growth and global metal prices are closely correlated**



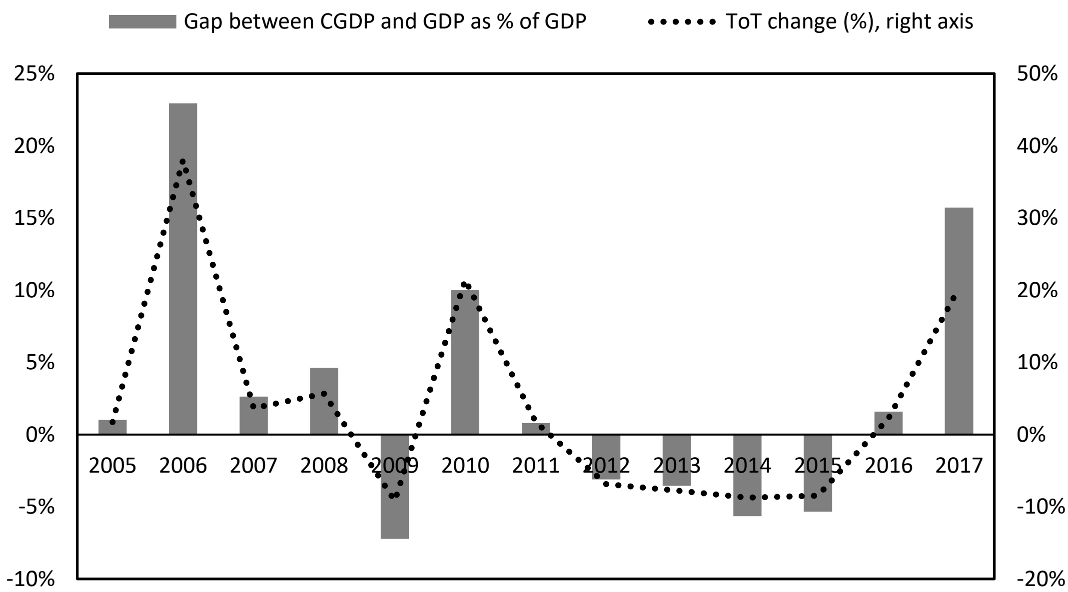

*Note*: The values of the Metal index represent the benchmark prices which are representative of the global market. They are determined by the largest exporter of a given commodity. Index 2016 = 100.
*Sources*: http://datatopics.worldbank.org/world-development-indicators/, https://www.imf.org/en/Research/commodity-prices.

The mining sector – chiefly coal, copper and gold – remains the key driver of Mongolia's growth and exports. The export basket is highly concentrated; in 2017, minerals and metals accounted for over 90% of total exports (Simoes and Hidalgo, 2019[2]). The sector also directly generates almost a quarter of Mongolia's fiscal revenue, and other revenue streams are closely correlated with it (ADB, 2019[1]).

In order to appreciate the sometimes dramatic impact of recent terms-of-trade shifts on real incomes in Mongolia, it is useful to go beyond the conventional measure of real GDP. Volume GDP underestimates the increase in real incomes and purchasing power that may be induced by, for example, a sharp rise in export prices (Kohli, 2003[3]). One way to correct this is provided by the so-called "command GDP" (CGDP) indicator, which adjusts the calculation of GDP to reflect the impact of changes in the terms of trade on the aggregate purchasing power of the economy. In effect, it is a real-income indicator that reflects both the magnitude of terms-of-trade shifts and the economy's exposure to international trade.[1]

The calculation of command GDP provides a stark illustration of just how staggering the terms-of-trade shocks of the last few years have been, with CGDP diverging from conventional GDP by more than 20% of GDP in 2006 and by more than 15% as recently as 2017 (Figure 2).

**Figure 2. Command GDP gap and the terms of trade**




*Note:* ToT = terms of trade.
*Source*: Own analysis based on data from the National Statistical Office and the World Bank.

The dependency on mining makes Mongolia vulnerable to external shocks; this was particularly apparent in 2015-16, when commodity prices dropped sharply. The government's policy of accommodating these shocks with expansionary policies to boost domestic demand left the country with mounting public debt, falling international reserves and declining growth (IMF, 2017[4]).

In order to overcome these fiscal challenges and assure the long-term sustainability of public finances, Mongolia agreed in 2017 to an international financing package amounting to USD 5.5 billion with the IMF and other partners, including the Asian Development Bank

[1] *Command GDP = TDDV + XGSV*(PXGS/PMGS) – MGSV*, where TDDV is total domestic demand; XGSV and MGSV are, respectively, export and import volumes; and PXGS and PMGS are the export and import deflators. Since the terms of trade are defined as the price of a country's exports divided by the price of its imports, deflating both exports and imports by the import price deflator (rather than using different deflators for imports and exports, as is done when computing GDP) yields a summary measure of the impact of terms-of-trade shifts on a country's purchasing power – i.e. on its ability to "command" goods and services. In other words, this indicator reflects an awareness of the fact that exports are important precisely because they enable a country to pay for imports. For further discussion of the command GDP indicator, see OECD (2003, pp. 37-38[46]).

(ADB), the World Bank, and the governments of Japan and Korea. It also included an extended swap line between the Bank of Mongolia and the People's Bank of China (IMF, 2017[4]). The financial assistance, as well as the implementation of reforms agreed as part of the package, have put Mongolia back on a path to debt sustainability. However, the episode also highlighted the urgent need to do more to diversify the economy away from mining and to strengthen the banking sector (IMF, 2019[5]).

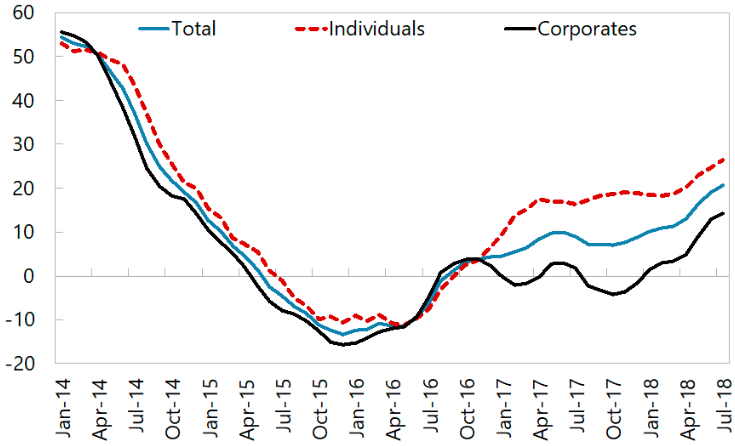
Some 97% of registered businesses in Mongolia are SMEs, which are by far the dominant type of enterprise in non-mining sectors. Improving their competitiveness is hence one of the key policy areas that can help diversify the economy. As of 2018, small and medium-sized enterprises (SMEs) accounted for 72% of total employment and generated 17.8% of GDP, but accounted for only 2.3% of total exports (Government of Mongolia, 2019[6]).

According to surveys by the Bank of Mongolia, the Mongolian National Chamber of Commerce and Industry (MNCCI) and the SME Development Fund (SMEDF), MSMEs face specific difficulties due to their size, including higher transaction costs and more limited access to key business inputs. In a 2018 survey by the Bank of Mongolia, SMEs named the social and political environments as the principal barriers they faced, followed by lack of access to finance. In recent years, surveyed MSMEs have consistently reported lack of access to finance as one of the top barriers for doing business, along with tax and red tape (Bank of Mongolia, 2018[7]; Bank of Mongolia, 2017[8]).

MSMEs' access to finance has improved since 2016, despite the fact that the total volume of domestic credit provided by the financial sector has contracted, from 76% of GDP in 2016 to 65% in 2018 (World Bank, 2019[9]). According to Bank of Mongolia (BoM) data, the volume of outstanding loans to MSMEs has increased by more than a third, from 6.9% of GDP in May 2017 to 9.4% in May 2019. Loans to individuals have been growing since mid-2016 and since 2018, credit to small and medium corporates has also expanded (Figure 3). Most of the outstanding loans are to firms in "wholesale and retail trade, repair of motor vehicles" sector (32%), followed by manufacturing (15%) and construction (12%) (Bank of Mongolia, 2019[10]).

**Figure 3. Credit growth has resumed**

(% change, year on year, three-month moving average)




*Source*: (IMF, 2018[11]).

At the same time, the ratio of non-performing loans (NPLs)[2] to SMEs has declined from a peak of 12.8% in January 2017 to 6.6% in July 2019 – although even the latter figure is high by OECD standards. Concerns were expressed in 2017 and 2018 about the overall strength of the banking sector and possible systemic risks. Bank capitalisation and the low level of provisions considering the high NPL rates were considered insufficient to meet capital adequacy ratio requirements. A reassessment of loans in the scope of the Asset Quality Review (AQR) conducted under the IMF programme revaluated the share of NPLs (see Box 1). This is in line with stable NPL ratios for the banking sector as a whole (IMF, 2018[11]).

**Box 1. Mongolia's Asset Quality Review**

During Mongolia's latest economic downturn in 2015, banking-system vulnerabilities became apparent. This was a legacy of the boom years in 2013 and 2014, when banks' balance sheets doubled in just two years. In addition, foreign currency lending was high at one-quarter of the loans. Underwriting standards were low and credit risks increased significantly. In 2014, NPLs were up by 48% year-on-year. The IMF judged asset quality problems to be understated especially given the inadequate classification of loan restructurings at some banks. In response, and as part of the IMF programme, an Asset Quality Review (AQR) was launched.

Mongolia's AQR, which was not yet concluded at the time of writing, consisted of four main steps. First, a third-party auditor assessed the assets in Mongolia's banks in January 2018 and identified a system-wide shortfall of 1.9 percent of GDP. In May, the BoM informed banks that it had updated this assessment to reflect the projected capital need at end-2018, based on the higher NPLs found by the AQR and banks' business plans. This increased the amount of new capital that the banking system had to raise by end-December 2018 to 3.1 percent of GDP. In June 2018, Parliament passed a Recapitalisation Law to ensure that public capital is available for systemic banks that are unable to raise sufficient capital from private means. In September, banks were required to submit detailed updates regarding capital raised to date and how remaining shortfalls would be met by end December. The reclassification of the NPLs required by the findings of the AQR then resulted in higher NPL shares.

*Source*: IMF (2015[12]; 2018[11]).

Public efforts to improve access to finance for MSMEs were furthermore marred by a corruption scandal concerning the provision of preferential credit through Mongolia's public SME Development Fund (SMEDF). In autumn 2018, it was revealed that many of the companies that had received loans were tied to prominent policy makers. Widespread protests forced the Minister of Food, Agriculture and Light Industry (MoFALI) and the Speaker of the parliament to step down. Criminal prosecution of some of the SMEDF staff ensued, and credit disbursals stopped. Reforms were subsequently undertaken to improve the governance of the fund (Bayartsogt, 201[13]; Dierkes and Jargalsaikhan, 2018[14]).

In addition to addressing the SMEDF's problems, the government has recently undertaken efforts to improve the policy framework for SMEs and ultimately their competitiveness. Among other things, the government has prepared a new SME law including an SME

[2] Loans marked either substandard, doubtful, or as a loss by the BoM.

definition (Box 2) that was recently adopted. Also, a programme for SME development was drafted in spring 2019 and is currently being implemented. The plan has six goals: to improve the legal environment for SMEs; to facilitate access to finance; to develop consulting services; to introduce innovation and eco-friendly technology; to expand market access for SMEs; and to organise a "One Village, One Product" campaign to create brand products locally.

The government has also undertaken steps to improve the legal and regulatory framework related to insolvency and the availability of information on creditors, both of which are crucial for the access to finance of companies. In co-operation with the International Finance Corporation (IFC), a credit bureau has been built and the market for movable-asset financing has been strengthened by the launch of a web-based pledge-notice registry in February 2017. The registry enables creditors to search for existing claims on movable assets that they intend to use as collateral and to file security interest on their approved collateral (World Bank, 2019[15]). Further work is under way to reform the insolvency framework.

However, the Covid-19 crisis in early 2020 has hit the export-oriented economy of Mongolia hard, with a contraction by 9.7% during January-July. The final impact could be even more severe, the balance of risks being weighted towards the downside. Mongolia's growth prospects will largely be determined by global demand of commodities. Lockdown measures have severely challenged the liquidity of firms, in particular the smallest ones. According to the Mongolian Chamber of Commerce and Industry, two thirds of businesses were affected by the pandemic. The government has designed a series of measures to support businesses during the crisis and will need to continue this support for some time yet (Box 2). The impact on public finances, both through falling income and the increased expenditure to support the economy, should not, however, deter the government from pursuing reforms crucial to the recovery.

**Box 2. Mongolia's economic response to the COVID-19 pandemic**

MSMEs in Mongolia have benefitted from a fiscal support package to withstand the loss of revenue induced by the lockdown. Mongolia has designed **a** national package of seven measures totalling MNT 5.1 bn (USD 1.9 bn, roughly 13.9% of 2019 GDP) to protect the health and income of people, preserve employment and stimulate the economy during the Covid-19 crisis. The measures include:

- temporary tax exemptions for six months from 1 April, including the waiver of personal income tax for employees, exemption from social insurance contributions for all private entities, and exemption of corporate tax for entities with annual revenues of less than MNT 1.5 bn (EUR 5 m) (mining, oil, retail and tobacco sectors are excluded from the scheme);
- a monthly payment of MNT 200,000 (EUR 65) for three months to employees of private companies that keep their workers on the job despite declining revenues;
- a planned fuel subsidy to reduce retail fuel prices; and
- sector-specific measures for cashmere producers, including loans and stable prices.

Additional measures aimed at ensuring financial and economic stability, preventing risks and making the digital transition have been announced. This include, among other things, banking sector reforms to foster greater transparency and stability, and the expansion of the activities of the credit guarantee fund.

Most of these measures are in line with OECD countries' responses. Many countries have used deferral of loan repayments, especially for loans disbursed by SME funds, and the development of emergency credit products and guarantees, preferably to be channelled by SME agencies in partnership with banks, as has been done in France. Most of these responses have been designed as short term measures targeted to the most affected players and sectors (OECD, 2020[17]).

However, to recover from the crisis, the easing of lockdown measures alone will not allow financially-constrained businesses to return quickly to previous levels of activity. For recovery to occur, the government will have to further support businesses and the provision of financing could be a core element of recovery planning, prioritising small firms and critical sectors whose disruptions and layoffs would have long-lasting negative impacts, further reducing national productive capacities (OECD, 2020[18]). Further targeted loans and guarantees, based on the mitigation measures implemented during the pandemic could then be used to critically support these businesses and secure employment during the first stages of recovery.

Donors increased their financial support for SMEs before and during the COVID-19 crisis. For example, the European Bank for Reconstruction and Development (EBRD) is providing more than EUR 96 million via two public financial institutions to 20 300 MSMEs, in addition to funding through their Trade Facilitation Programme, risk-sharing and leasing programmes, and microfinance funds. GIZ has also recently developed an Innovation Fund that is benefiting SMEs in Mongolia. This support to business activity has been expanded to fight the COVID-19 effect, including from the ADB, the EU and the World Bank.

This report focuses on more specific areas related to MSME access to finance. The next section recalls the 2016 recommendations while the subsequent section assesses their implementation, taking stock, where relevant, of the new challenges brought by the Covid-19 pandemic and its lasting economic consequences. In the final section, priorities for future reform implementation are identified.

## Overview of 2016 recommendations on access to finance for MSMEs

In 2016, the OECD recommended that the government of Mongolia implement the following five sets of policy measures to mitigate market failures affecting MSMEs' access to finance. The recommendations were developed in public-private working groups that met three times during the year.

### Recommendation 1. Gather and disseminate coherent data on MSMEs

In 2016, the various state institutions were still using different definitions of MSMEs. This led to inconsistencies in both MSME development policies and the provision of targeted support for these companies, including policies to increase access to finance. There was furthermore a lack of co-ordination among the public bodies collecting and working on MSME data. It was therefore recommended that the government develop a consistent SME definition for use by all public institutions. The government also should develop publicly available analysis of SMEs, develop more coherent and widely-shared data for SMEs, and consider joining the OECD Scoreboard on SME and Entrepreneurship Finance.

### Recommendation 2. Diversify the products offered by the SME Development Fund

In 2016, the SMEDF loan offer was limited to a few types of loans and leases. There was limited product offer to address the needs of MSMEs at certain stages in their lifecycles, for instance through loans to start-ups or seed financing. It was therefore recommended that the SMEDF should diversify its loan offer while working closely with the banking sector.

It was also recommended that the SMEDF should involve banks more in the loan application process as well as revise the entire process – first by asking banks to assess loan applications, and then by asking the SMEDF to review the applications selected by banks, to minimise risks of interference.

### Recommendation 3. Overcome collateral issues by making the Mongolian Credit Guarantee Fund more effective

Similarly, the Mongolian Credit Guarantee Fund (MCGF) was urged to engage more closely with banks to help expand its credit guarantee offer. It was recommended that bank representatives should be included in the MCGF's board. This, as well as continuous exchanges with banks, was aimed to help ensure a mutual understanding of the guarantee assessment and provisions. Furthermore, the MCGF was encouraged to enhance its risk appraisal using risk assessment tools from banks and institutions with international partners such as Kazakhstan's DAMU or France's Bpifrance.

### Recommendation 4. Streamline administrative procedures for loan applications

In 2016, bureaucratic barriers to obtaining loans were high and numerous administrative documents were required, a process that involved many interactions with various administrative entities. No one-stop shop was available for businesses. It was therefore recommended to increase co-ordination between the SMEDF and partner banks regarding documentation, to reduce the number of documents required by banks, and to consider implementing one-stop shops for MSMEs to simplify the gathering of administrative documents.

## Recommendation 5. Improve financial education by ensuring the national financial literacy strategy is tailored to MSMEs

MSME access to finance was also limited by supply-related issues, with high rejection rates and poor loan applications according to banks. Low financial literacy remained a major obstacle for MSMEs wanting to access finance. Many were ill-equipped to fill out financial forms and fulfil other documentary requests by banks. Many initiatives were carried out by public institutions, private organisations and donors in a fragmented manner.

It was therefore recommended for Mongolia to map and co-ordinate all existing initiatives on financial literacy for MSMEs. In addition, Mongolia was urged to include financial education for MSMEs in the national strategy and consider joining the OECD International Network on Financial Education (OECD/INFE).

# Findings of the 2019 Monitoring

Mongolia has made strides in improving access to finance, but issues with public instruments such as the SMEDF and delays in passing the SME Law have limited the immediate impact for firms.

On the supply side, Mongolia has been revising its regulatory framework for SMEs including the SME definition, even if these revisions and updates were only recently approved. It has also improved the functioning and funding of the MCGF with the support of the ADB. Overall administrative procedures are being simplified in co-operation with the Mongolian Chamber and Commerce and Industry and international partners. These include the establishment of first concepts of one-stop shops. However, the governance structure and functioning of the SMEDF were not reformed, which may have contributed to aforementioned corruption scandals. Both the MCGF and the SMEDF, if properly reformed, can be essential financial instruments to channel post-crisis funds to businesses, in partnership with banks.

On the demand side, important efforts on financial literacy have been made by the Bank of Mongolia that has joined the OECD International Network for Financial Education (INFE) to gain experience and support initiatives.

## Monitoring of recommendation 1: MSME data

### *The regulatory framework for MSME financing was improved by developing a new SME law and definition*

Effective policy making requires solid evidence-based analysis, which is why the quality of data collected is of high importance. The collection of robust MSME data, including on their access to finance, depends first on having a solid definition of firms by size that is applied consistently throughout the public administration and potentially harmonisable with those applied in other countries (OECD et al., 2016[19]).

Mongolia has made good progress in this regard. In June 2019, a new law on SMEs was adopted that contains an updated definition of SMEs (Box 2). The harmonised SME definition can now help the authorities develop consistent policies and support programmes across ministries and public agencies. It will simplify the visibility and access of MSMEs to government programmes, as some companies were previously excluded from certain programmes due to different MSME definitions. In particular, the definition now also includes micro-enterprises, a fact which will help them access public financial instruments.

The law furthermore contains provisions on governmental activities to strengthen MSMEs and MSME clusters, as well as high-level guidance regarding the SME development programme. It includes provisions on creating a conducive tax regime for MSMEs and on providing information, training, advisory services, and support for exporting SMEs. It defines the rights and obligations of SMEs – such as participation in public SME development programs and projects, and access to training and information – but also includes reporting requirements. The law clarifies which bodies and which different state and local bodies are in charge of the various aspects of SME policy.

**Box 3. Mongolia's new SME definition**

Mongolia's law on SMEs of 6 June 2019 introduced a new and streamlined definition of MSMEs. It defines three types of enterprises – micro, small and medium-sized – with the following characteristics:

- Micro enterprises are defined as businesses with up to ten employees, engaged in production, trade and service sectors and with a sales income of up to MNT 300 million (~ EUR 100 000) annually;
- Small enterprises are defined as businesses with between ten and 50 employees, engaged in production, trade and service sectors and annual income between 300 million to MNT 1 billion (~ EUR 333 000);
- Medium-sized enterprises are businesses with up to 200 employees, engaged in production, trade and service sectors and an annual income of up to MNT 2.2 billion (~ EUR 745 000).

The law further specifies that the number of employees should be used as key indicator in case other data are lacking and/or ambiguous.

*Source*: *Law of Mongolia on SMEs* of 6 June 2019, accessed at https://www.legalinfo.mn/law/details/14525.

In addition to regulatory improvements, several institutions have increased their research on SME issues to support better policy making. This can help provide the evidence base for policy making by the government, as well as the design of financial instruments by the MCGF, the SMEDF and the banks:

- The Bank of Mongolia is producing extensive research on SME issues. One example is its October 2018 survey on SME development and financial access, which consists of a representative sample of 1,922 SMEs from all regions of Mongolia. The survey incorporates questions regarding SMEs' use of support agencies, their perception of the business environment, their external and internal financing, as well as information regarding their sales, costs and revenue (Bank of Mongolia, 2018[20]).
- The MNCCI also carries out surveys together with the Business School of the National University of Mongolia. For example, the nationwide "Mongolian business environment survey", which aims to assess the country's business environment, has identified the lack of sources of financing and seed money as the biggest obstacles for business (JICA, 2018[21]).
- The MCGF has built a database with information on SMEs that are its clients.
- The National Statistics Office gathers data on enterprises (disaggregated by firm size) in general through its annual enterprise survey.
- Promising efforts to establish regular and more granular SME surveys in the context of the Mongolia SME Observatory and 2014 Survey[3] were pursued in 2014, but no follow-up surveys have been undertaken since.

[3] http://sme.gov.mn/observatory-data.

However, there is as yet no evidence of regular exchange of data between the different institutions – particularly as regards the provision of data and evidence to the Ministry of Food, Agriculture and Light Industry (MoFALI), which is the key ministry in charge of SME policies in the country. This may hamper data consistency and limit the effective use of the information gathered.

Since 2016, a number of additional indicators regarding SME access to finance have become available (Table 1) and provide a solid basis for policy making on access to finance. However, several of these indicators stem from surveys that are not conducted on a regularly recurring basis, and there is no single document or institution compiling and reporting on all data available despite the key roles played by the MoFALI and the BoM.

Mongolia has not yet become a member of the OECD SME Financial Scoreboard,[4] an OECD benchmark tool for access-to-finance policies and agencies in OECD member and partner countries, as the approval of an SME law and consistent definition of MSMEs were identified as the most urgent actions. With the law now passed and currently under implementation, the government should consider adhering to the OECD Scoreboard to further systematise its data-gathering efforts on MSMEs and enhance its ability to benchmark performance against peer economies. A dedicated meeting was held between the MCGF and the OECD team in charge of the SME Financial Scoreboard during a study visit to Paris in October 2019. Both parties agreed to continue discussing how Mongolia could join the Scoreboard.

[4] https://www.oecd.org/cfe/smes/financing-smes-and-entrepreneurs-23065265.htm.

**Table 1. Core indicators of the OECD Scoreboard on SME and entrepreneurship finance**

| Core indicators of the OECD Scoreboard | Availability in 2016 | Availability in 2019 | Institution responsible |
|---|---|---|---|
| 1 - Share of SME loans in total business loans | (Y) | (Y)[1] | BoM[2]* |
| 2 - Share of SME short-term loans in total SME loans | N | Y | BoM |
| 3 - SME loan guarantees | (Y) | Y | MCGF |
| 4 - SME guaranteed loans | Y | Y | MCGF |
| 5 - SME direct government loans | Y | Y | BoM |
| 6 - SME rejection rate | (Y) | Y[2] | BoM |
| 7 - SME loans used | (Y) | Y[2] | BoM |
| 8 - SME NPLs / SME loans | N | N | BoM |
| 9 - SME interest rates | (Y) | Y | BoM |
| 10 - Interest rate spread between large and small enterprises | N | (Y) | BoM[3]* |
| 11 - Percent of SMEs required to provide collateral | Y | Y[6] | EBRD, BEEPS |
| 12 - Venture and growth capital | (N) | N | UNDP[4] |
| 13 - Asset-based finance | N | N | |
| 14 - Payment delays | N | Y | NSO[5] |
| 15 - Bankruptcies | N | N | |

* Can be derived from other datasets.
Data in brackets are not readily available but can be computed using different data sources.
*Note*: NSO = National Statistics Office.
*Sources*: [1] National Bank of Mongolia; [2] National Bank of Mongolia; [3] Derived from National Bank of Mongolia; [4] UNDP; [5] Mongolian Statistical Office; [6] World Bank.

## Monitoring of recommendation 2: SME Development Fund loan offers

### *Efforts to expand the loan offer have been undertaken*

The SMEDF has worked to expand its loan offer with preferential interest rates and longer maturities, in line with the 2016 recommendation. In addition, the fund's scope of work has widened, as it is also participating in the organisation of events and expositions. The fund financed 188 projects with a total of EUR 27 million in 2017, up from 154 projects with EUR 16.8 million, respectively, in 2016. The projects cover several SME-dominated sectors, such as food production, light industry, agriculture, animal husbandry, construction, underground storage, eco-friendly/bio activities, wholesale and retail, processing factory and recycling (SMEDF, 2018[22]). In 2019, using a new project selection process, 16 preferential loans, each with a value of more than EUR 100 000, were awarded, for a total value of EUR 4.4 million (ikon.mn, 2019[23]). As of 2019, SMEDF management reports that 10% of the SMEDF's overall loan portfolio consisted of loan amounts below EUR 30 000, 80% corresponded to loans worth between EUR 30 000 and 100 000, and the remaining 10% consists of credits of over EUR 100 000 to a total of around 50 enterprises. Because the SMEDF's budget is based on yearly allocations from the state budget and approved by the Parliament, it is fairly volatile, limiting the predictability of future loan operations while multi-year financing would provide stability and visibility for SMEDF operations.

### *There remains a need to improve loan appraisal transparency and processes at the SMEDF*

Despite the expansion of the SMEDF's loan offer, the fund's governance and loan appraisal processes have not improved. The 2016 recommendations urged the SMEDF to increase banks' involvement in its lending process and, in particular, to have banks make the *first* assessment of loan applications, before the SMEDF reviewed them, to limit interference. Such an approach would improve the loan appraisal process through clearer governance and risk sharing. These recommendations were not implemented.

A corruption scandal erupted in autumn 2018 involving the use of SMEDF funds by its management and by the responsible ministry, the MoFALI. SMEDF’s operations were shaken when it was revealed that high-ranking government officials had benefited illegally from the low-interest loans provided by the SMEDF, as applications were selected by the SMEDF in the first place. The Ministry of Finance, which oversees the financial proceedings of the agency, stopped the operations of some funds and merged the Agricultural Support Fund with the Livestock Protection Fund and SMEDF.

The SMEDF still needs to revise its governance and work processes. As of October 2019, the new structure and governance were still being redefined, although some changes were being implemented – according to the new management of the SMEDF, which was mostly recruited from other public sector entities. The SMEDF has since 2019 begun lending via three commercial banks, thus improving the credit provision process. However, this only applies to credits of EUR 100 000 or more. For credits below that amount, funds are still provided by the SMEDF directly, without the involvement of banks and at a lower interest rate (currently 3%). The SMEDF’s new appraisal process involves four steps: (i) checking the application based on character, financial, collateral and alignment with government plan; (ii) a risk credit assessment; (iii) an onsite visit; and (iv) board approval. The SMEDF’s board takes decisions regarding loans below EUR 100 000 and loan applicants need to present their projects to the board for approval. The board consists of seven members, bringing together representatives of four NGOs/business associations and three public organisations. The fund itself does not have any decision-making power at board meetings regarding loans.

Nevertheless, it would be better if loan decisions and the corresponding risk assessment were taken by banks for all sizes of loans, as it is the banks that have the appropriate expertise, staff, incentives and political independence. Banks should have a financial incentive to participate, but also carry a share of the credit risk. The SMEDF would then confirm its financial support on a case-by-case basis. Co-financing with banks should be the default process of the SMEDF and interest rates should be aligned for all loans to avoid distorting competition. In case of loans co-financed by banks, another feature could also be to expand the co-operation between the SMEDF and the MCGF to provide guarantees to loans selected by the SMEDF.

The SMEDF could further study and aim to replicate the experience of OECD members’ SME funding agencies, such as Bpifrance (Box 3) – in the first instance by involving banks more closely in loan assessment and by delegating the first steps of the loan appraisal process to them, but also by extending its business model to a wider range of support services. Bpifrance and Turkey’s KOSGEB, for example, have progressively moved from a business model where funding was the key activity to become fully-fledged SME agencies providing a wide range of support activities to help SMEs grow and thrive. KOSGEB and Bpifrance have developed incubators, internal universities and support programmes for R&D and for SME internationalisation, among other initiatives (bpifrance, 2019[24]; KOSGEB, 2019[25]). The rationale was to support SMEs during their whole life cycle and not only with respect to financial matters. This could also improve SMEs’ ability to manage their finances and use the disbursed funds.

The Mongolian government is considering the creation of an SME agency by merging the SMEDF with other funds under the aegis of the MoFALI as of 1 January 2020. The

SMEDF, or the new SME agency, could consider expanding its mandate and developing activities on training, information, and expertise targeted at SMEs, partly diverting its resources currently focused on loan provisions to fund these activities.

### *Most governments have channelled financial support through SME agencies to help with post-Covid-19 recovery*

The effects of Covid-19 are most likely to exacerbate the existing vulnerabilities in the financial systems and the access to finance of MSMEs, as banks might be even more reluctant to lend in the current uncertain context. Liquidity provision to businesses might drop, triggering a chain reaction dampening recovery prospects. For MSMEs in Mongolia to play their core economic role, the government has a key role to play in supporting the provision of financing for sustained activity in partnership with banks, without overburdening the banking sector with an unsustainable build-up of liquidity pressures.

Across OECD countries, public institutions devoted to SMEs have been at the core of the crisis package, expanding their loan offer and portfolio. In France for instance, Bpifrance has expanded the scope and amount of its usual SME loan offer (Box 3) to allow even the most vulnerable SMEs to navigate the crisis. Most countries plan to pursue these policies as part of their recovery packages. The SMEDF and the MCGF could play a similar role at the forefront of the support for SMEs during the first stages of economic recovery, through widespread loan provision.

**Box 4. Financial support, governance and work processes of Bpifrance, France's SME agency**

*Governance and work processes*

Bpifrance, the French public bank for SMEs, finances businesses from the seed phase all the way through to stock-exchange listing, through loans, guarantees and equity. It provides access to a vast selection of loans from which SMEs can choose through the website or directly in agencies. Its regional offices include banks on their governing boards so they can participate in decisions on loan risk assessment policies. When making the loans, 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.

Bpifrance uses a dedicated computerised instrument for risk assessment that assigns scores to counterparty risk, project risk and transaction risk. The rating obtained is only a support to decision making, which also takes into account such factors as the qualities and weaknesses of the project, the entrepreneur profile, and market perspectives. The bank 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.

*Bpifrance's response to the crisis*

Bpifrance has been instrumental in France's responses to the COVID-19 in favour of SMEs. Bpifrance is implementing a 300 bn state guarantee scheme (PGE-loans) to support banks in providing loans to businesses, with a 90% cover by the state. It is also providing an unsecured loan of EUR 10,000-5m with maturity of over 3 to 5 years for SMEs, with a significant delay in repayment. Bpifrance has also suspended the payment of its loan instalments.

To support the innovation ecosystem, Bpifrance has maintained its innovation funds of EUR 1.3 bn planned for 2020 and launched 2 calls for proposals on R&D projects and health responses to the COVID-19. Bpifrance is also increasing equity funding for French start-ups and SMEs with the launch of the "Fund for reinforcement of SMEs" (EUR 100 m), and the "French Tech Bridge" (EUR 80m) to support start-ups between two fund raising.

*Source*: Bpifrance (2019[24]).

## Monitoring of recommendation 3: Credit guarantees

### *The management and provision of guarantees by the Mongolian Credit Guarantee Fund have strongly improved*

With the support of the ADB, the MCGF has strongly increased the involvement of banks in the credit guarantee process and increased the number of guarantees provided. While it issued guarantees to 36 SMEs in 2016, this number increased more than fourfold to 160 in 2018. Similarly, the guaranteed loan amount and the guarantee amount increased to support larger loan amounts and longer maturities at lower interest rates.

**Table 2. Amount of loans guaranteed by the MCGF**

| | 2016 | 2017 | 2018 |
|---|---|---|---|
| Number of benefiting SMEs | 36 | 62 | 160 |
| Guaranteed loan amount (MNT mln / EUR mln) | 19 273.1 / 6 508.8 | 23 721.3 / 7 904.2 | 53 200.7 / 19 970.4 |
| Guarantee amount (MNT mln / EUR mln) | 8 008.3 / 1 250.4 | 11 633.6 / 3 888.8 | 29 831.3 / 10 073.3 |

*Source*: MCGF.

This increase is partly due to co-operation with the ADB, which has been supporting the MCGF with a credit line of USD 60 million as well as technical assistance. The fund is thus able to provide two similar guarantee products, one based on internal domestic funding and one based on the ADB loan. As of 2019, the large majority of guarantees given by the MCGF were based on the ADB loan. The ADB has also assisted in the creation of new products (such as specialised guarantees for women entrepreneurs), helped to improve marketing, and supported the reorganisation and governance and transparency reforms in MCGF. The bank also helped improve the outreach to banks and SMEs, and implement financial management reforms in the fund. The technical assistance ended in December 2018 (ADB, 2019[26]).

As of spring 2019, the MCGF had five partner banks (Trade and Development Bank, State Bank, Khaan Bank, Xac Bank, and Capitron Bank), and the number was expected to grow further. The increased trust between banks and the MCGF partly reflects improved processes, as the ADB deposits the guarantee directly with the bank. This procedure covered 150 out of a total of 160 grants in 2018.

Within the scope of the ADB project, the MSME risk assessment tools, which were initially developed by the MCGF and the National University of Mongolia, have been updated based on international experience. The MCGF's assessment is more rigorous than the average of the banking sector's risk assessment tools (ECRC, 2019[27]), and the MCGF is working to further improve its operations by implementing around 30 technical recommendations given by the ADB.

The MCGF has also developed its co-operation with Bpifrance as part of the OECD project; a memorandum of understanding (MoU) between the two institutions was signed during a recent study visit to France. The MCGF has now signed co-operation agreements with 13 commercial banks, the BoM, and the Mongolian stock exchange, building a basis for future growth.

In addition, the fund is collaborating with local academia and research institutions to further professionalise its services and develop a better monitoring and independent assessment of its guarantee provision and impact. To this end, it has signed a co-operation agreement with the National University of Mongolia to work on an impact assessment. To reduce the processing time required by the guarantee service, the MCGF has been working on adopting web-based electronic service and reducing paper use.

### *Credit guarantees can support SMEs during the first stages of post-Covid-19 recovery*

One of governments' policy responses to the COVID-19 crisis aimed to incentivise banks to accommodate the liquidity needs faced by businesses and has largely used new or expanded credit guarantee schemes to support access to finance. In a situation of heightened credit-risk and solvency risk of businesses, the reduction in the expected losses faced by banks provides the right incentive for provision of new credit or rolling over existing ones.

For instance, in countries such as the Germany, France (Box 3), Italy and Spain, guarantees covered at least 80% of the value of credits granted to SMEs which is above the coverage rate (30 to 70%) during normal times.

The MCGF could temporarily expand its credit guarantee schemes, as a complement to easier loan provision by SMEDF, to cover the liquidity needs of MSMEs during the first stages of economic recovery. Such an extension of guarantee schemes would not substitute for conventional lending, but provide temporarily targeted assistance. Supporting the MCGF would allow to expand the financial support to small firms at a smaller cost than soft loans.

## Monitoring of recommendation 4: Administrative procedures and one-stop shops

### *New one-stop shops are being developed*

Since 2016, public institutions, business associations and donors have been working to simplify administrative procedures and loan application processes for MSMEs and banks through digitalisation and the creation of new one-stop shops (OSSs) targeting businesses.

Physical one-stop shops have existed in Mongolia since 2016, supported by the Swiss Agency for Development and Co-operation and catering to all citizens. Even though these one-stop shops are not specialised for MSMEs, business entities and entrepreneurs have been able to get some of the necessary information from them as they provide relevant services and programmes such as social insurance, social welfare, employment promotion, land management, civil registration and bank and notary services (ILO, 2016[28]).

New one-stop shops targeting more businesses are being developed in the country with the support of private, public and international organisations, such as the MNCCI. The MNCCI has developed dedicated space in its offices to support administrative procedures, including loan applications for businesses in Ulaanbaatar and in other cities. The government could partner with the MNCCI to develop these one-stop shops for businesses – involving agencies such as the General Authority for Intellectual Property and State Registration of Mongolia (in particular the Legal Entities Registration Office in charge of business registration), the MoFALI and the General Department of Taxation – with the support of the Communications and Information Technology Authority.

In establishing these new one-stop shops, the government could leverage the precedent of the National Development Agency (NDA) of Mongolia, which has created a one-stop shop with the support of the World Bank and GIZ that targets foreign investors (Montastudio, 2019[29]). In addition, the government could follow the example of Georgia's OSS (Box 5). As a first step, a working group on OSSs could define the needed activities and processes to establish a common front office.

**Box 5. Georgia's one-stop shops**

To improve its provision of public services, the government of Georgia has established public service halls and community centres – all functioning as one-stop shops for public services. These reforms occurred after the Rose Revolution, in line with strong public demand for reducing public sector corruption; the government thus had a popular mandate not only to remove corrupt officials, but also to use large foreign investments to improve both physical and digital public services in the country.

The public service halls bundle the services of the Civil Registry Agency and the National Agency of Public Registry, the National Archives, and the National Bureau of Enforcement as well as the Notary Chamber. The Hall currently offers up to 400 services.

The community centres are similar but are operated and maintained by municipal authorities. Evaluations have characterized this model as being simple and transparent, particularly since the introduction of ICT solutions to the delivery of services.

Between 2012 and 2014, 14 public service halls were opened across the country, serving up to 18 000 individuals per day, with an average waiting period of 5 minutes and a service time of 6-7 minutes. Evaluations and customer satisfaction surveys are conducted daily, allowing for a continuous improvement of the delivery process.

Sources: (Login Asia, n.d.[30]; OECD et al., 2016[19]).

### *Efforts are underway to digitalise administrative procedures*

Mongolia is also working on digital one-stop shops, but development is still at an early stage. The "Khur" system for government information exchange was introduced in 2018 by the Communications and Information Technology Authority of Mongolia and the Mongolian National Data Centre. The system aims to establish direct links between government organisations through digital means, allowing information to be exchanged faster, more flexibly, more safely and more reliably. The system currently allows private organisations to be connected to the system and thus obtain documents and information (National Data Center, n.d.[31]). As a result, banks are now able to receive and download the required public documents for loan applications electronically. Documents include the Identification Card, Birth Certificate, Certificate for Enterprises, Certificate of Ownership of Immovable Property, Certificate of Social Insurance and Vehicle Registration Certificate. Processes have thus become more efficient and the time spent on administrative procedures has decreased.

## Monitoring of recommendation 5: Financial literacy

### *A financial literacy strategy and corresponding tools have been developed*

Financial education is an essential tool for helping MSMEs and entrepreneurs to obtain access to finance and strengthen their business and financial management skills. Better financial education should help MSMEs become more aware of financing opportunities and financial risks and opportunities; make informed business plans and related choices; manage their financial records, planning and risks effectively over the short and long terms; and take other effective actions to maximise the potential of their businesses (Atkinson, 2017[32]).

A few initiatives to improve financial literacy were already in place in 2016, carried out by a variety of organisations. To combine and build on these fragmented initiatives, a working group led by the BoM was established to develop a national financial strategy (Bank of Mongolia, 2015[33]). It brings together the different public, private and donor organisations to improve co-ordination, build synergies among different institutions' activities and align priorities. The BoM has further intensified its co-operation by signing a MoU with the Mongolian Institute of Certified Public Accountants in order to strengthen the financial decision making of MSME owners and increase the quality of their financial documents. It has also created the Economic Training and Research Centre under the Bank of Mongolia to expand its capacity to support improvements in financial education.

During the monitoring period, consumer protection appeared as a priority for the government and the Bank of Mongolia. This was affected by the high level of indebtedness of the general population, which became a major policy concern in 2017-18 and led to the inclusion of the issue of financial consumer protection and the establishment of a legal environment for it in the Monetary Policy Guidelines in 2019. The BoM consequently prioritised financial education for consumers over specific work on MSMEs, but the latter is once again high on the agenda.

Mongolia has nevertheless made substantial progress by including financial literacy in the Monetary Policy Guidelines for 2019 by the State Great Khural (the unicameral parliament of Mongolia), with a focus on MSMEs. The Bank of Mongolia has continued to roll out a significant number of financial literacy initiatives, including training courses, handbooks and manuals for citizens, youth and entrepreneurs. In addition, financial literacy has been included as an elective course of business studies in the curriculum of secondary education; an additional "Personal finance and business entrepreneurship" lesson was been incorporated into the training content of vocational education and training institutions (an effort initiated by the Ministry of Labour and Social Protection); and a compulsory "Personal Finance" course is now part of the programme of Universities. Furthermore, 20 handbooks have been developed to increase the financial literacy of the rural and urban population including MSMEs (GIZ, 2018[34]), and more than 2 300 educators have been trained in order to provide improved financial literacy education.

### *The BoM has joined the OECD International Network for Financial Education*

Specific activities for MSMEs are still being developed in 2019. The BoM has joined the OECD International Network for Financial Education (OECD/INFE) and is using international experience from Malaysia, Portugal and other countries to develop its own pillar on MSME finance in the financial literacy strategy and activities. The BoM is also working on a questionnaire to survey the financial literacy of SMEs and collected guidelines from the OECD/INFE (OECD, 2019[35]). This survey is to be rolled out in spring 2020. The Monetary Policy Guideline for 2020 also instructs the Bank to accelerate the provision of financial literacy of MSMEs using the available resources.

The BoM has also since 2017 participated in the OECD/INFE to gain experience, learn about other countries' practices and share ideas (Box 6). It participated in four technical committee meetings in 2017, 2018 and 2019 and is member of the working groups on digital financial literacy; financial education in the workplace; and standards, implementation and evaluation. However, it is not yet active in the working group on financial education for MSMEs. The OECD/INFE has published a series of guidelines and studies that could be useful to the BoM in further developing its strategy and activities on MSMEs in its report on financial education for MSMEs, which is due to be published in 2020. At the time of writing, a successful first round of meetings with EBRD were conducted for technical assistance to formulate a sub-program for MSMEs. In the scope of this programme, the BoM aims to further co-operate with organisations such as the SME support centre, Mongolia's SMEDF, the Mongolian Bankers Association, MoFALI, the MNCCI, the MCGF, the Microfinance Development Fund, the Sparkasse Fund and other MSME-oriented organisations.

**Box 6. OECD International Network on Financial Education (INFE)**

The financial literacy of MSMEs is a key item in strengthening their access to finance. Therefore, and in co-operation with the G20, the G20/OECD High-Level Principles on SME Financing were developed, with one of the principles urging governments to "enhance SME financial skills and strategic vision" (principle 7).

In this context, the OECD/INFE has undertaken substantial work related to MSME financial literacy. In 2018, the *OECD/INFE core competencies framework on financial literacy for MSMEs* was published. The framework serves as a tool to support the development of learning frameworks for financial education initiatives (including training) targeting MSMEs and potential entrepreneurs, as well as deepening the financial content of programmes covering business skills more broadly. In addition, it can support the development of assessment frameworks for measuring the financial literacy of MSMEs and for use in programme evaluation.

The framework is structured around four main areas of competencies that are organised into three dimensions of financial literacy and across the main development stages of an enterprise. The framework and other INFE work build both on the work of the Working Group on MSME Financial Literacy and on stocktaking exercises of financial literacy in 21 economies.

The OECD/INFE has also developed a questionnaire to assess the level of financial literacy of SMEs and provide instructions for relevant institutions to design their own surveys. The template questionnaire includes detailed questions (which can be adjusted to each country) in different areas, such as: financial products used for the business; managing and planning business finances; financial knowledge; and financial education and protection.

*Source*: (OECD, 2019[36]; Atkinson, 2017[32]; OECD, 2018[37]; OECD, 2015[38]; OECD, 2019[35]).

## Way forward

Mongolia has made significant progress in improving MSME access to finance. However, further efforts, particularly in the area of governance, are required to sustain and build on the successes achieved. The actions needed are detailed in Figure 4 below.

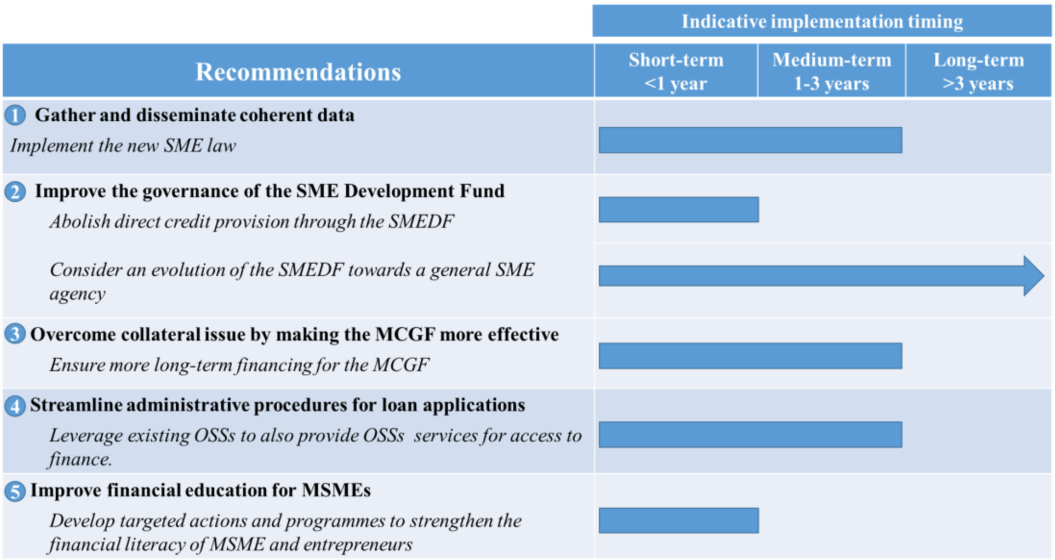
In the near term, agencies and ministries should focus on implementing the new SME law to establish a common definition and policy framework. This will help ensure that future policies are designed based on the targeted needs of Mongolian MSMEs and the long-term development objectives of the country.

At the same time, the governance of the SMEDF requires further improvement. The provision of direct credit through the SMEDF should be scrapped, with all preferential loans – and thus also the credit appraisal process – handled by (ideally private) commercial banks. This should be considered for all loans, independent of the loan amount. In the long term, the SMEDF could be transformed into an SME agency that could also provide training and advisory services for MSMEs and entrepreneurs. In a further step, the existing efforts to establish one-stop shops should be leveraged to also provide OSSs facilitating access to finance.

Progress regarding credit guarantees has been substantial. Mongolia and its partners should now work on ensuring that more long-term financing can be allocated to the MCGF. This would allow the MCGF to extend its offer and further leverage the increased effectiveness it has gained through the reforms already implemented.

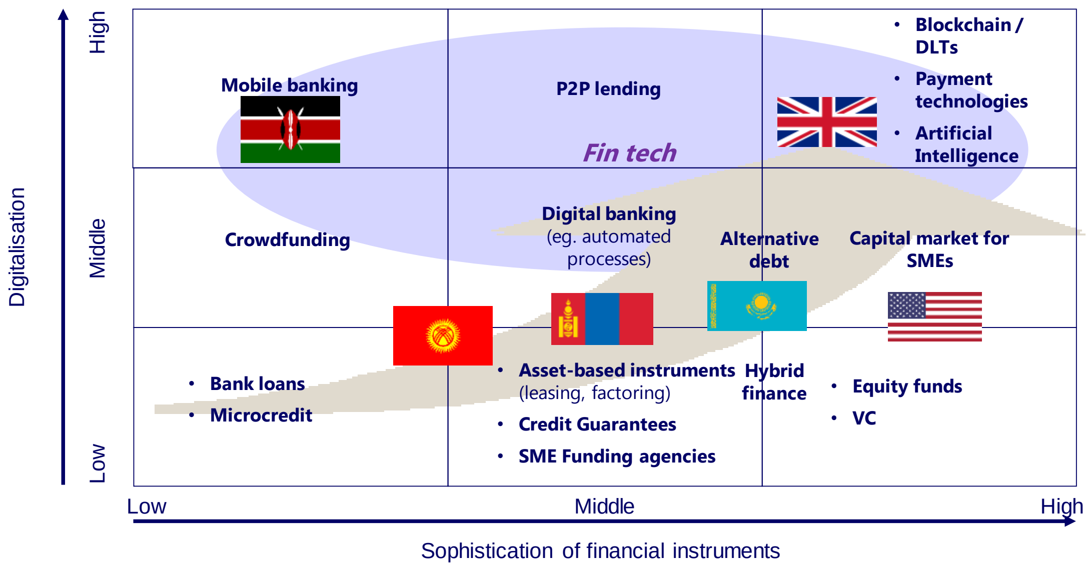
Having developed materials on financial literacy for citizens and established the working group on financial literacy, the government and the BoM should now build on this work and develop targeted actions and programmes to strengthen the financial literacy of MSMEs and entrepreneurs. Training activities dedicated to entrepreneurs on financial management, business case and key financial concepts (inflation, accounting principles) could be developed in partnership with the SMEDF, the Banking and Financing Academy of Mongolia and other institutions. The website of the Bank of Mongolia could also develop web-based tools to help SMEs understand and learn basic financial management concepts through calculators and online courses and videos.

**Figure 4. Implementation roadmap**




Mongolia still needs to improve its digitalisation processes related to access to finance and better respond to businesses' financial needs. Mongolia's financial sector could consider investing in digital and mobile banking to facilitate access to finance (Figure 5). This would help reduce financial transaction costs in the specific context of the widely-dispersed population in Mongolia.

**Figure 5. Financial digitalisation path**




*Source*: OECD analysis.

The overall progress in access to finance for Mongolian MSMEs, while leaving substantial room for improvement, now means that small-firm development and entrepreneurship are better supported. This in turn can contribute to developing non-mining-related sectors in Mongolia and fostering economic diversification, which remains a major economic challenge for Mongolia (OECD, 2018[39]). These reform efforts also need to be accompanied by important structural reforms to improve the overall business climate for both investors and local businesses, enhance the quality of public governance, and better integrate Mongolia into global value chains (World Bank, 2019[40]; OECD, 2018[39]).

Finally, recovery from the current crisis will require the government to restore confidence of businesses and banks, while supporting financially constrained enterprises and individuals. Given the relevance of MSMEs in Mongolia's economy, providing them with liquidity is essential for their activity to resume, sustaining employment, consumption, and ultimately the rebound. In this regard, recovery planning might prove the best opportunity to bring the SMEDF and the MCGF to maturity, taking stock of reform progress since 2016. Increasing loan provision and credit guarantees to MSMEs in the early stages of recovery would pave the way for a sustained relaunch of the economy's most important engines in non-extractive sectors. In addition, Mongolia, like many OECD members and partners, has used the COVID-19 crisis to further promote digitalisation. These efforts could be pursued to deliver more government services online and support businesses in their digitalisation efforts through intermediation with large international IT providers, advisory services and vouchers to transition to e-commerce solutions.

The OECD, together with its international partners, has been helping Mongolia address these challenges, but more needs to be done. A joint OECD-ITF report underlined the importance of boosting connectivity, in particular by investing more in transport infrastructure in Ulaanbaatar and in growing aimags[5] (South Gobi, North), supporting the creation of a modern logistics sector, and improving border crossing points at both ends of the Mongolia's main economic corridor (OECD-ITF, 2019[41]). Current anti-corruption work carried out by the Independent Authority against Corruption (IAAC) needs to be pursued and stepped up (OECD, 2019[42]). Further improvements in Mongolia's competitiveness – in the banking sector, in trade facilitation, and in the legal environment for investment and business regulations, taxation and licensing – could also contribute to boosting private sector development, employment and sustainable economic growth (OECD, 2018[39]; EBRD, 2014[43]).

[5] In Mongolia, an *aimag* is the first-level administrative subdivision. The country currently has 21 aimags. The capital, Ulaanbaatar, is administrated as an independent municipality.

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# MONITORING COMPETITIVENESS REFORMS: ACCESS TO FINANCE FOR FIRMS IN MONGOLIA

The COVID-19 crisis has severely hit Mongolia's economy and SMEs have been hit hardest. Strengthening SMEs is a policy priority that Mongolia has clearly recognised, as their growth can contribute to the diversification of employment and exports, and therefore reduce dependence on extractive sectors. Access to finance in particular hinders firm growth, despite the development of several public financial instruments.

This Policy Insight discusses these challenges, and suggests five sets of policy actions for the Mongolian government to ease access to finance for SMEs: (1) continue to strengthen the regulatory framework and data collection for SMEs, (2) develop the provision of credit guarantees, (3) improve governance and credit processing procedures in public financial instruments, (4) enhance financial literacy of entrepreneurs, and (5) accelerate the digitalisation of procedures.

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