European Investment Bank
The EU bank

# Moldova

## Private Sector Financing And The Role Of Risk-bearing Instruments

November 2013

# Private Sector Financing In The Eastern Partnership Countries And The Role Of Risk-bearing Instruments

## Country report: Moldova

November 2013


Business & Finance Consulting

**BFC**
Max-Högger-Strasse 6
CH-8048 Zurich, Switzerland
Phone: +41 44 784 22 22
Fax: +41 44 784 23 23
info@bfconsulting.com
www.bfconsulting.com

# EPTATF VISIBILITY

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# DISCLAIMER

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# List of acronyms

| | |
|---|---|
| BSTDB | Black Sea Trade and Development Bank |
| CAR | Capital Adequacy Ratio |
| DCA | USAID's Development Credit Authority |
| DEG | German Investment and Development Corporation |
| EC | European Commission |
| EBRD | European Bank for Reconstruction and Development |
| EFSE | European Fund for Southeast Europe |
| EIB | European Investment Bank |
| EU | European Union |
| EUR | Euro (currency) |
| EURIBOR | Euro Interbank Offered Rate |
| FDI | Foreign Direct Investment |
| FMO | Dutch Development Finance Company |
| FX | Foreign Exchange |
| CAGR | Compounded Annual Growth Rate |
| CPI | Consumer Price Index |
| GDP | Gross Domestic Product |
| GoM | Government of Moldova |
| GVA | Gross Value Added |
| IAS | International Accounting Standards |
| IDA | International Development Agency |
| IFAD | International Fund for Agricultural Development |
| IFC | International Finance Corporation |
| IFRS | International Financial Reporting Standards |
| KfW | German Development Bank |
| LIBOR | London Interbank Offered Rate |
| MDL | Moldovan Leu (currency) |
| MFO/MFI | Micro-finance Organization/Institution |
| NBM | National Bank of Moldova |
| NBS | National Bureau of Statistics |
| NCFM | National Commission for Financial Markets |
| NPL | Non-Performing Loans |
| ODIMM | Organization for SME Development in Moldova |
| OPIC | Overseas Private Investment Corporation |
| R&D | Research and Development |
| RFC | Rural Finance Corporation |
| ROAA | Return on Average Assets |
| ROAE | Return on Average Equity |
| SCA | Savings and Credit Association |
| SMEs | Small and Medium Enterprises |
| USAID | United States Agency for International Development |
| USD | United States Dollar (currency) |
| VAT | Value Added Tax |
| WNISEF | Western NIS Enterprise Fund |

**End of period exchange rates used in this report**

| | June 30, 2013 | 2012 | 2011 | 2010 | 2009 | 2008 |
|---|---|---|---|---|---|---|
| USD/MDL | 12.5268 | 12.0634 | 11.7154 | 12.1539 | 12.3017 | 10.4002 |
| EUR/MDL | 16.3118 | 15.9967 | 15.0737 | 16.1045 | 17.6252 | 14.7408 |

## About this report

This report is one of a series of reports produced by Business & Finance Consulting GmbH (BFC) for European Investment Bank (EIB) as part of the project "Private Sector Financing In The Eastern Partnership Countries And The Role Of Risk-bearing Instruments." The series of reports includes individual country reports on Armenia, Azerbaijan, Georgia, Moldova, and Ukraine, as well as a synthesis report which considers the results from all five countries. The purpose of the project is to assess the financing needs of SMEs in the Eastern Partnership countries and identify market failures that prevent the development of the SME sector.

The project was carried out from June 3, 2013 to November 1, 2013 by a team of four experts from BFC. Onsite visits were conducted for each country in order to meet with representatives from financial institutions, development institutions, the government, and other relevant actors who can comment on the SME sector and its access to finance. The visit to Moldova took place from July 29 to August 2, 2013, during which time meetings were held with representatives from 19 organizations, including 16 local financial institutions, 1 credit bureau and 2 government bodies.

The authors take full responsibility for the contents of this report. The opinions expressed do not necessarily reflect the view of the European Investment Bank.

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# 1. EXECUTIVE SUMMARY

**Macroeconomic environment:** Moldova's landlocked economy is primarily driven by trade in agricultural products and basic manufacturing and by rising domestic consumption financed by the flow of remittances from emigrants. Migration and aging contribute to the reduction of the economically active population. At the same time, the unemployment rate is still higher than the pre-crisis level. The informal sector represents an important part of the economy, accounting for 30% of total employment. The economic reform process has stalled due to the lack of political stability since 2009. The country's vulnerability to political instability and external economic shocks creates an unfavorable climate for investments and future development of MSMEs.

**Financial sector:** The financial crisis had a significant impact on Moldova's economy in general and on the financial sector in particular. Although lending activity has since recovered, credit quality remains a serious problem. Commercial banks dominate the financial sector, accounting for 95% of total assets. Microfinance lenders and leasing companies represent an alternative but their share is still very small. Capital markets are underdeveloped.

**Demand:** MSMEs in Moldova play an important role in terms of output and employment. In a consumption-oriented economy, trade still dominates and drives MSME sector. The agriculture and IT sectors have strong potential for growth. Demand for finance is generally high but is hindered by a rather low level of innovation, slow integration of modern technology developed abroad, and the generally poor level of entrepreneurial and financial literacy among MSMEs. The re-introduction of the corporate income tax in 2012 has placed an additional burden on small businesses.

**Supply:** Bank loans are the main source of MSME funding (more than 90% of total supply) with other elements of the financial sector being poorly developed (capital markets) or having a low share of total finance (microfinance, leasing, and risk capital). The predominance of customer deposits as funding source significantly limits long-term lending. Trade finance products such as letters of credit and guarantees are used and made up a meaningful proportion of SME funding among the banks surveyed, although guarantees (rather than LCs) account for nearly all the volume.

**Gaps in MSME financing:** The main gaps in funding are a lack of long-term credit and very scarce non-loan alternatives. IFIs play an important role in funding intermediaries in Moldova. However, there are significant opportunities to further address MSME financing gaps, which include long-term loans, subordinated loans, and equity investments in intermediaries that facilitate MSME finance. In addition to financial support, IFIs could be more active in providing proper technical assistance, especially with the transfer of technology for MSME lending.

# 2. MACROECONOMIC ENVIRONMENT[1]

***Conclusion:***
The macroeconomic environment represents a major constraint for SME development in Moldova. The country's vulnerability to political instability and external economic shocks creates an unfavorable climate for investments and future development of the SME sector.

***Key findings:***

- *Slowdown in external demand and severe drought in 2012 interrupted Moldova's recovery from the global economic and financial crisis.*
- *A significant inflow of remittances plays an important role in increasing household incomes, driving consumption demand, and thus stimulating consumption-oriented SME development.*
- *Trade continues to be one of the main drivers for economic growth but agriculture is seen as having the biggest potential for expansion.*
- *Reintroduction of corporate income tax in 2012 helped further fiscal consolidation but constrained SME performance.*
- *Signing of an Association Agreement with the EU could significantly improve the political and macroeconomic environment and boost SME growth.*

A landlocked economy with limited access to natural resources besides arable land, Moldova has experienced a relatively modest economic performance. The economy is primarily driven by trade in agricultural products and basic manufacturing and by rising domestic consumption financed by the flow of remittances from emigrants. Moldova's SMEs remain vulnerable to political uncertainty and external shocks. The signing of an Association Agreement with the EU could significantly deepen Moldova's political association and economic integration with the EU, adding stability, improving investment climate, and increasing export opportunities for the SME sector.

Key macroeconomic indicators for the country are presented in Annex 1. Unless otherwise noted, data in this section is taken from the National Bureau of Statistics, State Registration Chamber, Ministry of Finance, and National Bank of Moldova.

## 2.1 Economic development and growth

**GDP growth:** After a prolonged recession in the 1990s, Moldova's GDP grew for eight straight years between 2001 and 2008, with an average growth in real GDP of 6.4%, primarily driven by soaring remittances from migrant workers abroad that fueled economic growth. During this period, turnover of SMEs increased by 54.1%. The economic expansion was interrupted by the global economic and financial crisis, with GDP and SMEs' turnover decreasing in 2009 by 6.0% in 16.3%, respectively. Economic growth rebounded in 2010. In the second half of 2012, however, Moldova entered into another recession. The economy was hit by two shocks: slowdown in external demand (lower demand for exports and remittances from Europe) and severe drought (agricultural value added declined by 23%, with the grain harvest halved).

**Employment:** Moldova's economically active population is shrinking due to migration and aging. The official unemployment rate has been decreasing over the last three years (from 7.4% in 2010 to 5.6% in 2012) but is still higher than the pre-crisis level of 4.0% in 2008. Registered MSMEs traditionally account for 55-60% of formal employment. However, about 30% of employment is informal.

[1] Based on data taken from the National Bureau of Statistics, State Registration Chamber, Ministry of Finance , and National Bank of Moldova.

**Income:** Despite more than doubling its GDP per capita in PPP (purchasing power parity) terms from USD 1,916 in 2003 to USD 4,182 in 2012, Moldova remains the poorest country in Europe.[2] Nominal GDP per capita in 2012 was just EUR 1,586. Remittances play an important role in increasing household incomes. The share of remittances in disposable household incomes increased steadily and reached its maximum of 21.3% in mid-2008 and declined afterwards. The contribution of remittances to the welfare of the population is important especially in rural areas. The Pilot Project for Attracting Remittances into the Economy (PARE 1+1) is an important component of the state support to the SME sector development. Increased disposable income contributed to the increased purchasing power of the population. A consumption-oriented economy has been the main stimulus for development of SMEs in trade and services.

## 2.2 The structure of the economy

**Agriculture:** As a landlocked country with limited access to natural resources besides arable land, Moldova relies on the production, processing, and trade in agricultural products. Agriculture and the processing industry contributed 13.1% and 13.6%, respectively, to gross value added (GVA) in 2012. Agriculture plays an important role for MSMEs. Besides registered MSMEs, which account for 97.6% of total registered agricultural enterprises, there are some 380,000 unregistered farms of various sizes, more than 98% of which are farms with less than 5 hectares.

**Other sectors:** Trade is another important economic sector (16.7% contribution to GVA in 2012). 40.5% of all MSMEs are in engaged in trade, and they account for almost half of the total MSME turnover. Trade is still one of the main drivers of economic growth in Moldova in general and SME development in particular. Other large economic sectors include transport (12.9%) and real estate operations (10.4%), both of which are well represented by SMEs.

**State-owned enterprises:** Moldovan legislation does not formally discriminate between state-owned enterprises and private-run businesses[3]. However, there are reports[4] of state-owned enterprises having an advantage over privately-run businesses in Moldova. Either from government representatives sitting on their boards or from their dominant position in their industry, state-owned companies are generally seen as being better positioned to influence decision-makers than the private sector, and they use this perceived competitive advantage to prevent open competition in their particular sector.

**Informal sector:** The informal sector represents an important part of the economy in Moldova. The vast majority of informal sector activities provides goods and services whose production and distribution are perfectly legal. They are not necessarily formed with the deliberate intention of evading the payment of taxes or social security contributions, or infringing the labor legislation or other regulations. Informal employment accounts for about 30% of total employment and is generated primarily by the agricultural sector, which accounts for two thirds of informal employment. To a lesser extent, the informal sector includes enterprises from the construction, trade, and industry sectors.

[2] The World Banks's World Development Indicators (http://data.worldbank.org/indicator/NY.GDP.PCAP.PP.CD)
[3] The Law on Entrepreneurship and Enterprises has a list of activities restricted solely to state enterprises, which includes, among others, human and medical research, manufacture of orders and medals, postal services (except express mail), sale and production of combat equipment and weapons, minting and real estate registration.
[4] 2013 Investment Climate Statement – Moldova, U.S. Department of State

## 2.3 Inflation and asset prices

**Consumer price index:** Moldova has experienced moderate inflation rates since the financial crisis (7.4%, 7.7%, and 4.7% in 2010, 2011, and 2012, respectively). Since 2012, the NBM keeps the inflation rate within the range of 5.0%±1.5 percentage points, in the context of its inflation targeting strategy. The dry weather conditions in the region, which have caused the increase in food prices, were the main factors that have exerted inflationary pressures during 2012. In addition, the CPI change was favored by the side effects caused by increases in gas tariffs in 2011 and the increase in electricity tariffs in May 2012. The main factor that restrained the price increase during 2012 was a lower aggregate demand than previous years due to the slowdown in the growth of household disposable income. Lower inflation rates helped reduce interest rates by the financial institutions, which is expected to stimulate demand for new credit and further expansion of the SMEs.

**Asset prices:** The real estate market has been in a continuous decline since the financial crisis. Both primary and secondary markets experience decreased demand, resulting in fewer transactions. Real estate developers, in search for clients, engaged in a price competition. However, it has created an impression of continuous devaluation of real estate and potential buyers wait for still better prices. Companies in the construction sector have continued to perform poorly. Reduced prices for commercial real estate encourage small retailers and food service operators to purchase new shopping areas and old houses in downtown Chisinau, which are used for fast food restaurants and cafes[5].

## 2.4 Balance of payments

**Current account:** Traditionally, Moldova has a large current account deficit driven by imports of consumer goods and energy resources. The current account deficit declined from 11.3% of GDP in 2011 to 9.4% of GDP in 2012. With the balance of goods and services largely unchanged in annual terms, the lower current account deficit came from growth in remittances from CIS countries. Trade growth has stagnated, reflecting the decreased demand for Moldovan goods and services in importing countries. This is an indication of missed opportunities for both exporting and importing SMEs.

**Capital account:** Moldova profited from increased inflows of foreign direct investment (FDI) with the eastward expansion of the EU, which became the country's immediate neighbor following Romania's accession to the EU on January 1, 2007. However, the global crisis significantly decreased FDI in Moldova, which fell more than 60% in 2009 and has yet to return to pre-crisis levels. Net FDI halved from 4% of GDP in 2011 to 2.2% in 2012. The amount of FDI is far below what Moldova needs to create jobs and promote economic growth. Limited foreign investment reduces financing opportunities for SMEs in Moldova. Portfolio investment represents an insignificant amount of the capital account.

**Exchange rate:** Generally, there are no difficulties associated with the exchange of foreign or local currency in Moldova[6]. After the tumultuous period of inflation and devaluation of the 1990s, MDL has been generally stable. It regained its pre-crisis position in the aftermath of the first wave of the global crisis and somewhat weakened in 2012 as the country suffered from a worsening economic situation in the Eurozone and a bad agricultural year. The NBM implements a managed floating

[5] Analysis of the Real Estate Market in the First Half of 2013 (http://lara.md/en/analytics/?lang=en).
[6] Moldova accepted Article VIII of the IMF Charter in 1995, which required liberalization of foreign exchange operations.

exchange rate regime without having a pre-established target for MDL exchange rate[7]. Overall, low volatility of the exchange rates has been favorable to SMEs.

## 2.5 The fiscal and political situation

**Fiscal consolidation:** Despite poor economic performance, fiscal consolidation continued in 2012. The general government deficit improved from 2.4% in 2011 to 2.1% in 2012, mainly due to strong growth in budget revenues (+11.2%) stemming from a re-introduction of corporate income tax. However, following the 'no-confidence' vote on March 5, the Parliament adopted increases in pensions and wages of top civil servants that risk reversing recent gains in fiscal consolidation. An increased budget deficit could lead to inflationary pressures, which may be unfavorable to SMEs.

**Taxation:** After a four-year period with no corporate income tax, the GoM reintroduced a 12% corporate income tax beginning in January 1, 2012. Small businesses that meet requirements set out in the Fiscal Code can opt for a flat 3% of revenues instead of corporate income tax. Starting in 2012, the Tax Code has fewer corporate income tax breaks available for businesses.

**Public debt:** In 2012, the public debt represented 33% of GDP, up 2.8% on a year before. Government debt accounted for 72.5% of total public debt, with the remainder accounted for by SOEs and the National Bank of Moldova. As Moldova is taking out new loans, the utilization of the borrowed foreign resources remains a serious concern. A number of tranches from foreign loans were reportedly[8] cancelled because the loan recipients did not meet certain contractual conditions. These included cancelled parts of the World Bank's loans within the Energy Project II and Rural Investment and Services Project II. Both loans have SMEs as target beneficiaries.

**Reserves:** A combination of lower current account deficit and higher external borrowing allowed the NBM to accumulate foreign exchange reserves of USD 2.5 billion, exceeding 4 months of imports, as of end 2012. The reserves reached their historical maximum of USD 2.578 billion in August 2013. The current level of currency reserve represents a healthy "safety cushion" for the national economy, in case of external shocks and unexpected challenges.

**Political uncertainty:** The economic reform process has stalled due to the lack of political stability since 2009. In mid-2009, following the opposition's gain of a narrow majority in parliamentary elections, four opposition parties formed the Alliance for European Integration (AEI), which has acted as Moldova's governing coalition since. Moldova held three general elections and numerous presidential ballots in parliament, all of which failed to secure a president. Following November 2010 parliamentary elections, a reconstituted AEI-coalition formed a government, and in March 2012 was finally able to elect an independent as president. The ongoing political uncertainty contributes to important structural reforms being delayed and populist measures undermining macroeconomic stability, which, in turn, leads to a larger adjustment and delay in IFI financing once the new government is in place.

**EU Association Agreement:** The EU and Moldova are currently negotiating an Association Agreement to succeed the Partnership & Cooperation Agreement. The EU has recently concluded negotiations for a Deep and Comprehensive Free Trade Area (DCFTA) with Moldova, Armenia and Georgia. The DCFTAs are part of the Association Agreements with these three countries. The official

[7] The inflation target of 5.0% is the nominal anchor for the NBM's monetary policy in recent years. The inflation target is being achieved using the main monetary policy instrument - open market operations. At the same time, NBM also uses complementary monetary policy instruments, such as standing facilities, required reserves ratio, and interventions on the foreign exchange market.

[8] Moldova's foreign debt goes up, 19 July 2013 (http://www.allmoldova.com/en/moldova-news/economics/1249056584.html).

initialing of the Association Agreements is planned for the Eastern Partnership Summit on 29 November 2013 in Vilnius. This Association Agreement will significantly deepen Moldova's political and economic integration with the EU.

# 3. FINANCIAL SECTOR OVERVIEW

***Conclusion:***
The financial sector in Moldova is dominated by commercial banks, which account for about 95% of total assets. Microfinance lenders and leasing companies represent an alternative but their market share is still insignificant. Capital markets are underdeveloped.

***Key findings:***
- *The financial crisis had a significant impact on Moldova's economy in general and financial sector in particular. Although lending activity resumed, credit quality remains a serious problem.*
- *The microfinance sector is small but plays an important role for low income borrowers, especially in rural areas.*
- *Private equity and venture capital activity is low, with no domestic funds established so far.*
- *The securities market is underdeveloped, with a limited number of IPOs.*

## 3.1 Financial sector overview

The financial crisis had a significant impact on Moldova's economy in general and financial sector in particular. Impressive growth in loan portfolio and profitability vanished in 2009. Although lending activity resumed shortly thereafter and loan portfolios easily surpassed the pre-crisis level, credit quality remains a serious problem. Traditionally, the main source of funding is customer deposits. Growth in customer deposits in recent years is driven by individuals, with their share steadily increasing compared to corporate clients.

The banking system is the basic component of the financial sector in Moldova, accounting for about 95% of total assets. Non-bank financing (microfinance lenders, leasing companies, and insurers) is growing but still plays a minor role. There are several regional private equity funds that have invested in Moldova. Venture capital is virtually non-existent.

**Number of financial institutions by type**

| Type of institution | 2012 | 2011 | 2010 | 2009 | 2008 |
|---|---|---|---|---|---|
| Banks | 14 | 15 | 15 | 15 | 16 |
| Microfinance institutions† | 60/73 | 48/59 | 37/43 | 29/35 | 23/24 |
| Leasing companies* | 25 | 20 | 23 | 24 | 27 |
| Savings & Credit Associations | 359 | 376 | 398 | 394 | 424 |
| Insurance companies | 18 | 20 | 24 | 24 | 33 |

*Notes:* *† Number of companies that reported to the NCFM / number of registered companies*
** Number of active companies, i.e. companies that reported to the NBS*
*Source:* *NBM, NCFM, NBS*

The current interest rates are at their historical low, and the market is characterized by a run for larger market shares.

## 3.2 Banking sector

### 3.2.1 Structure

**Size and growth:** The banking system in Moldova has two tiers: the National Bank of Moldova (NBM) and 14 commercial banks, down from 16 in 2008 (the licenses of two commercial banks were withdrawn by NBM in 2009 and 2012). Total assets, loan portfolio, customer deposits, and total equity have all grown at an average annual rate[9] in the range of 12-14% over the last five years. The banking system is the basic component of the financial sector in Moldova. Total bank assets account for 95% of the entire financial sector.

**Number, total assets and outreach of the banking sector**

| | 2012 | 2011 | 2010 | 2009 | 2008 |
|---|---|---|---|---|---|
| Number of banks | 14 | 15 | 15 | 15 | 16 |
| Number of bank branches | 1,263 | 1,248 | 1,160 | 1,146 | 1,164 |
| Bank assets (EUR millions) | 3,644.8 | 3,165.0 | 2,624.7 | 2,265.9 | 2,650.3 |

*Source: NBM*

**Ownership:** The GoM used to hold 56% in one bank, Banca de Economii, but lost its controlling position in August 2013[10]. Foreign investors' share in Moldovan banks' capital is around 75%. Due to the limited transparency of Moldovan bank capital, it is rather difficult to evaluate the real situation with respect to foreign investment. Except for several “genuine” majority foreign investors, the rest of majority equity foreign investors, and, in many cases, minority equity foreign investors, are in fact companies registered abroad by Moldovan residents in order to avoid regulations on disclosure of information about shareholders[11].

**Concentration:** The sector is highly concentrated, with the largest five banks accounting for about 70% of total assets. The five-bank concentration has steadily grown in recent years, from 63.3% in 2008. Moldova's five largest commercial banks and their respective share of total assets at mid-2013 are: Moldova Agroindbank (19.2%), Victoriabank (17.8%), Moldindconbank (15.7%), Banca de Economii (9.0%), and Eximbank (7.4%).

### 3.2.2 Performance

**Summary:** The financial crisis had a significant impact on Moldova’s economy in general and financial sector in particular. Impressive growth in loan portfolio and profitability of the banking system vanished in 2009. Although lending activity resumed shortly thereafter and loan portfolio easily surpassed the pre-crisis level, credit quality remains a serious problem. Due to increased loan loss provisions, profitability is lower after the crisis. At the same time, banks remain well capitalized and soundly liquid.

**Capital adequacy:** The total capital adequacy ratio has steadily decreased over the last five years, from 32.1% in 2008 to 23.3% in mid-2013. This is, however, still well above the required minimum of 16% set on 30 June 2012, up from 12% previously. NBM regulations are in line with the provisions of Basel I.

**Profitability:** The profitability of the banking system reached its maximum levels in years prior to the financial crisis. Net profit grew by 58.3% in 2007 and by another 16.0% in 2008 and exceeded EUR 83 million. ROAA was in the range of 3.4%-3.9%, while ROAE was above 20%. In 2009, however, due to reduced lending activity and deteriorated quality of the loan portfolio, banks registered a net loss. Although this was the only unprofitable year, the profitability after the crisis has been much lower compared to pre-crisis years. ROAA and ROAE have ranged from 0.5% to 1.8% and from 2.6% to

[9] Calculated as compounded annual growth rate (CAGR) on amounts expressed in EUR.
[10] There was a new emission of shares on 29 August 2013 to raise additional MDL 80 million (EUR 4.7 million). The state share reduced to 33.3% +1, which represents a blocking ownership and allows the state to participate in, but not control, the bank’s activity. In addition, the bank raised MDL 1 billion (EUR 58.5 million) from private debt investors.
[11] Federal Ministry of Finance (Germany), KfW Bank (Germany), and Institute for Development and Social Initiatives “Viitorul” (Moldova). *Financing Small and Medium-scale Enterprises in the Republic of Moldova: Challenges, Trends, and Future (a study performed based on discussions within the 3rd Moldovan-German Forum, May 24, 2012)*.

10.6%, respectively. A relatively high net interest margin has been offset by increased loan loss provisions.

**Liquidity:** The banking sector has been rather liquid in recent periods. Both long-term and current liquidity ratios of the banking sector are well above the required standards. The current liquidity ratio, defined as the share of liquid assets in total assets, has been over 30% for years, while the NBM requires it to be at least 20%. Deposits experienced healthy growth before the financial crisis. During 2009, however, deposits in the banking sector shrunk by almost 3% due to withdrawals by individuals. The continuous stability of the sector coupled with a lack of more attractive alternatives for investment contributed to the return of savers and a quick replenishment and further growth of the bank deposit base. The loan-to-deposit ratio returned to its pre-crisis level of 85-87%, once again demonstrating the high reliance on deposits and rather modest wholesale funding of Moldova's banks.

**Credit risk:** As a result of the financial crisis and economic recession, gross loan portfolios decreased by 9.5% in 2009. At the same time, portfolio quality deteriorated significantly with NPLs[12] soaring from 5.9% in 2008 to 16.4% in 2009. Despite the subsequent growth of the loan portfolio, increasing 62% from 2009 to 2012, non-performing loans remain a serious problem, consistently accounting for more than 10% of the loan portfolio. The overall perception is that banks are guided by the wish to seize market shares as large as possible and thus take on more credit risk.

**Market and other risk:** Loans in foreign currency (EUR and USD) represent 40-45% of banks' total loan portfolio. Sensitivity to currency risk is largely offset by the similarly high portion of foreign-currency deposits, at 45-50% of total deposits. This is due to massive flow of remittances from Moldovans working abroad, part of which end up as deposits in banks.

### 3.2.3 Regulation and state support

The National Bank of Moldova is responsible for the regulation of the banking system. The rules of NBM for regulating the banking system are based on and correspond to the Basic Principles of the Basel Committee for Bank Supervision (Basel I). Overall, the NBM is perceived by the banks as a strong regulator. The regulatory environment and state support are generally conductive to banking sector development. Several key issues and constraints are described below.

**Capital adequacy:** The risk-weighted capital adequacy ratio was increased in mid-2012 from 12% to 16%. Currently, the compliance is based on provisions of Basel I. A Twinning project is drafted aimed at strengthening the NBM's capacity in the field of banking regulation and supervision in the context of the Basel II Accord.

**Minimum capital requirements:** The minimum required capital for banks has been gradually increased: MDL 100 million (EUR 6.2 million) starting from 2011, MDL 150 million (EUR 10 million) starting from 2012, and MDL 200 million (EUR 12.5 million) starting from 2013. Smaller banks believe that such a policy is intended to further consolidate the banking sector.

**Provisioning and write-off policy:** Having switched to IAS in 2012, risk assessment for impairment is now performed in accordance with IAS 39 (recognition and measurement of financial instruments), while the previously used prudential requirement for writing off compromised loans was lifted. In addition to accounting for the assessment of credit risk (impairment test), banks are required under the Regulation on Assets and Contingent Liabilities to set up loan loss provisions for prudential

[12] The main quantitative criteria for NPLs is 91+ days past due.

purposes, which influences the total regulatory capital. The difference between accounting impairment and calculated prudential provisions for losses diminishes the tier I capital of banks.

The list of prudential ratios for banks applied by the central bank is presented in Annex 3. A short description of key regulations is presented in Annex 4.

### 3.2.4 Funding

**Main sources:** Traditionally, Moldovan banks' main source of funding is customer deposits, which are 5-6 times higher than borrowings from other sources. Growth in customer deposits in recent years is driven by individuals, with their share steadily increasing compared to corporate clients. As of mid-2013, individuals accounted for 67.1% of total customer deposits. Term deposits of individuals represent the bulk of all customer deposits. Deposits are guaranteed regardless of the deposit's currency and depositor's residency, but the deposit guarantee is limited to MDL 6,000 (about EUR 350) per depositor per institution, a rather small amount.[13] A key reason for bank deposit growth seems to be lack of attractive alternatives.

Loans from IFIs represent the second source of funding. Banks can negotiate a loan directly with an IFI (e.g. OPIC, WNISEF, IFC, EFSE, and BSTDB are active), or sign subsidiary loan agreements with the Credit Line Directorate under the Ministry of Finance that manages loans to the Republic of Moldova for implementation of various development and support projects (e.g. IFAD, IDA, EIB, and KfW). Subordinated debt is only being used by one bank, ProCredit.

**Parent bank funding**: Out of 14 commercial banks in Moldova, five banks have a parent shareholder, i.e. a shareholder with more than 50% ownership. Four banks belong to international groups. Parent finance is significant for three banks (ProCredit Bank, Eximbank, and BCR Chisinau) and is absent for two banks (Mobiasbanca and Comertbank). Normally, parent company funding takes form of borrowed funds (loans or credit lines) but one bank has also subordinated debt from its parent.

**Table 1. Parent finance, as of 31 December 2012, EUR million**

| Bank | Parent | Group | Parent finance | | |
|---|---|---|---|---|---|
| | | | Share capital | Subordinated debt | Borrowings |
| ProCredit Bank | ProCredit Holding (GE) – 84.91% | ProCredit (GE) | 19.4 | 6.3 | 21.6 |
| Mobiasbanca | Société Générale (FR) – 67.85%, BRD (RO)[1] – 20.00% | Société Générale (FR) | 5.49 | - | - |
| Eximbank | Veneto Banca (IT) – 100% | Veneto Banca (IT) | 39.7 | - | 46.6 |
| BCR Chisinau | Banca Comerciala Romana (RO) – 100% | Erste (AU) | 39.2 | - | 22.8 |
| Comertbank | ACF Corporate Finance Consulting (AU) – 80.19% | n/a | 7.4 | - | - |

*Notes:* [1] *BRD (RO) is a subsidiary of Société Générale (FR)*
[2] *93.5732 % of Banca Comerciala Romana (RO) belong to EGB Ceps Holding, a 100% subsidiary of Erste Group Bank (AU) through EGB Ceps Beteiligungen*
*Source: Annual Reports*

[13] Moldova has the lowest deposit coverage among the CIS countries. Source: Comparative Analysis of Deposit Insurance Systems in CIS Countries, International Association of Deposit Insurers (IADI) – July 2012.

**Conditions of funding:** Deposit interest rates decreased significantly after the financial crisis and are currently at their historical low. The average deposit interest rate went down from 17.9% in 2008 to 7.6% in 2012[14]. Deposits in MDL bear higher interest rates, the premium being about 4-6 percentage points in 2012. Term deposits of up to one year dominate customer deposits, with a share of more than 95%. Virtually all deposits are with floating interest rate.

Loans are typically provided for a long term (5 to 10 years). The cost of borrowing from IFIs is variable and is calculated based on a market benchmark plus a margin (e.g. 6-month LIBOR + 3.5% or 10-year US Treasury note + 3%). Funds received within development and support projects are generally less expensive (e.g. 6-month LIBOR or the base rate of NBM for long-term loans) but have specific eligibility requirements for their use. Potential borrowers may be limited by their location (e.g. rural versus urban, or specific region), business size (e.g. SME versus large companies), age (e.g. youth support projects), legal form (e.g. individuals versus legal entities), economic sector (e.g. agriculture versus other sectors), and/or ownership (e.g. private versus public).

## 3.3 Microfinance sector

### 3.3.1 Structure

**Size and growth:** The microfinance sector in Moldova is made up of two types of institutions: savings and credit associations (SCAs) and microfinance organizations (MFOs). Information on SCAs is provided in Section 3.5.2 below. The number of MFOs has been increasing dramatically due to liberal regulations. There were 73 registered MFOs by the end of 2012, three times more than in 2008 and 5.6 times more than in 2007. Not all of them, however, are active, with only 60 MFOs having provided financial reports in 2012. MFO assets are still below the pre-crisis level[15] and represent only 3% of total financial sector assets.

**Number, total assets and outreach of the microfinance sector**

| | 2012 | 2011 | 2010 | 2009 | 2008 |
|---|---|---|---|---|---|
| Number of MFOs† | 60/73 | 48/59 | 37/43 | 29/35 | 23/24 |
| MFO assets (EUR millions) | 118.3 | 122.4 | 110.8 | 109.7 | 166.5 |

*Notes:* † *Number of companies that reported to the NCFM / number of registered companies*
*Source:* *NCFM*

**Ownership:** Most MFOs have domestic shareholders. A few exceptions include Microinvest (foreign shareholders account for more than 80%), Prime Capital (100% ownership by the US-based NCH Funds), and Iute Credit (100% Estonian capital). The Rural Finance Corporation (RFC) is owned by SCAs (85%) and the organization's staff (15%), as it was originally intended to serve solely as an APEX organization providing lending services to SCAs.

**Concentration:** The microfinance sector is highly concentrated, with the largest five MFOs accounting for about 75% of total assets. Moldova's largest MFO's and their respective share of total assets as of 2012 are: Prime Capital[16] (20.4%), Microinvest (18.8%), RFC (13.2%), Credit Rapid (11.6%), and Elat Profit (10.5%).

[14] The World Banks's World Development Indicators (http://data.worldbank.org/indicator/FR.INR.DPST)
[15] To be noted is that ProCredit started its operations in Moldova as an MFO in 1999. It soon became the market leader, not only by portfolio size but also by product range and service standards. In December 2007, ProCredit Bank obtained a commercial banking license. ProCredit thereafter worked as a bank in Chisinau but continued to operate as MFO in the countryside. The plan was to transfer the whole business to the bank and liquidate the MFO. As of 31 December 2011, the MFO's loan portfolio was nil.
[16] Includes assets of Prime Capital 2, a smaller joint-venture.

### 3.3.2 Performance

**Summary:** Despite the deteriorating loan quality, timely changes in risk management policy allowed MFOs to continue posting profits and even grow their ROAA. With continuous capitalization of earnings and reduction in external funding, their debt-to-equity ratio fell below 1. Loan portfolio growth resumed in recent years and there are good signs of further development.

**Capital adequacy:** MFOs in Moldova are highly capitalized. The equity-to-assets ratio has been growing from 16.5% in 2008 to over 50% in recent years. Equity growth was primarily fueled by retained earnings.

**Profitability:** The entire MFO sector saw a massive rise (181.7%) in its total profit in 2008. An exceptionally impressive increase (821.6%) was registered by Microinvest. During and after the financial crisis, despite the deteriorated asset quality, the microfinance sector continued reporting growing net profits. ROAA grew from 1.4% in 2007 to 6.2% in 2011 and declined to 4.8% in 2012[17]. ROAE, on the other hand, has been steadily declining from its peak value of 18.2% in 2008 to 9.4% in 2012. As explained above, this is due to a rapidly increasing equity base.

**Liquidity:**[18] The two large MFOs that have been interviewed for this report maintain sufficient liquid resources to meet their obligations as they fall due. Until 2010-2011, liquid assets of both institutions accounted for 45-60% of total assets. In recent years, with the increasing loan disbursement, the share of liquid assets dropped significantly, which is still acceptable given that a large amount of borrowed funds are long term, which largely corresponds to the long-term profile of the loan portfolio.

**Credit risk:** The loan portfolio quality of MFOs deteriorated significantly in 2009. In response, some MFOs introduced a number of prudential norms that their clients had to comply with, while others suspended the disbursement of loans to new clients for some period of time. PAR 30 dropped from more than 10-15% in 2009 to only 3-5% in mid-2013.

**Market and other risk:** MFOs have interest-bearing loans and borrowings denominated in currencies other than MDL. Since FX-denominated loans represent only a small portion of the total loan portfolio, currency risk sensitivity comes from the liability side, especially for those MFOs that have easier access to foreign funds. In order to mitigate currency risk, they may place deposits in foreign currency and obtain loans in MDL, collateralized by currency deposits.

### 3.3.3 Regulation

**Supervision:** MFOs operate outside of the banking system and are regulated by the NCFM. The regulation is however loose. The sector is governed by the only normative act, the Law on MFOs (No. 280-XV as of 22 July 2004), which does not stipulate any prudential norms or minimum capital requirements. Some players argue that there is no need for more stringent supervision because MFOs do not take deposits and thus do not pose any public risk. Instead of the state, creditors impose risk measurement and management systems. Arguably, the introduction of a minimum capital requirement would lead to market concentration, which some MFOs believe to be necessary. Currently, NCFM is developing a new legal framework[19] to strengthen the regulation and supervision of the entire non-bank financial sector.

[17] Interpretation of this performance has to be done with caution due to MFOs' heterogeneous approach to loan loss provisioning.
[18] Comprehensive data is not available on the liquidity of the MFO sector
[19] Including draft laws on NCFM, Pension Funds, and NBFIs, modifications to the laws on Credit Bureaus, Leasing, and Joint-Stock Companies, as well as normative acts subordinated to the new Law on Capital Market.

**Loan loss provisioning:** In the absence of mandatory prudential requirements, each MFO has internal policies regarding the calculation of loan loss provisions, which significantly impacts the calculation of net profits. In order to standardize the practice, in 2012 NCFM developed a regulation on loan classification and loan loss provisioning. A common standard governing loan loss provision policies and the treatment of restructured loans will make it possible to compare MFOs on a more consistent basis.

#### 3.3.4 Funding

**Main sources:** Since they cannot take deposits and there is no capital market in Moldova, MFOs borrow funds from larger local and international financial institutions. Given that a number of local commercial banks have serious plans to develop their own MSME portfolios, the opportunities for borrowing funds from the local banking system are limited. At the same time, the small size of MFOs makes it difficult to access foreign funding as well (with the exception of several larger MFOs that have ties with foreign investors). As a result, external funding has been decreasing in both absolute amounts and as share of total assets. Limited access to funding is thus constraining growth of MFOs.

**Conditions of funding:** The cost of borrowing from IFIs is variable and is typically calculated based on a market benchmark plus a margin (e.g. 3-month EURIBOR + 5% or 6-month LIBOR + 5.8%). Microfinance lenders would prefer to have more access to funds denominated in MDL to reduce their exposure to the foreign currency risk.

### 3.4 Private equity and venture capital

#### 3.4.1 Sector overview

There is little private equity and venture capital investment activity in Moldova. There is no domestic fund and no evidence of investor interest in creation of a domestic fund. Several regional private equity funds are present in the country. Examples include funds of NCH Capital, Horizon Capital, Dragon Capital, Agribusiness Management Company, and Fribourg Capital. Details on the size, strategy and selected investments in Moldova of these funds are presented in Annex 5.

#### 3.4.2 Ecosystem

**Techno-parks and incubators:** There have been created several science and technology parks and innovation incubators, which offer a series of strategic and logistics services. Currently, there are three science and technology parks, three innovation incubators, and five business incubators (see Annex 6 for details). The business incubator in Soroca is the only one to offer, besides office space, production facilities.  Half of the residents are start-ups.

**Business angels:** There are no private or publicly-supported business angel networks (BANs) in Moldova. There are several BANs in the CIS countries, out of which four are members of the European Business Angel Network (EBAN): the Association of Private Investors of Ukraine, Business Angels and Venture Investors Network of Belarus, National Association of Business Angels and National Union of Business Angels of Russian Federation. Some of them welcome investment projects (typically from USD 20,000 to several millions) from all CIS countries, including Moldova.

**State support:** The Agency for Innovation and Technology Transfer (AITT) was founded in October 2004 under the Academy of Sciences with the objective to coordinate, stimulate and implement the mechanisms of innovation and technology transfer in Moldova. Therefore, the Agency is created to serve as an intermediary between scientists and entrepreneurs and enable fast implementation of innovations and transfer of advanced technologies into the production process. Companies can call its Innovation Brokerage Center to identify opportunities and seek financing. This agency aims to enhance the visibility and accessibility of innovations and acquaint the scientists about the real innovation needs and demand of the business environment. Collaboration between scientists and the business sector, however, is at a very early stage.

**Training:** In the framework of the National Program for Economic Empowerment of Youth (PNAET), a component is dedicated to entrepreneurial training and consultancy, which is implemented by ODIMM. Effective Business Management is another state program for entrepreneurs of any age that provides free courses on eight business topics. Training and consultancy is given within numerous other projects and programs financed by the international development organizations (e.g. Rural Investments and Services Project, Farmer to Farmer Program, the Dutch PUM program, and others).

### 3.4.3 Regulation

**Regulatory framework:** The existing Law on Investment Funds (No. 1204-XIII from 05 June 1997 with subsequent amendments) provides only a general framework regarding investment funds. A draft Law on Venture Capital Funds has been prepared by the Academy of Sciences of Moldova in 2006, adoption of which was included in the Action Plan for the Implementation of the SME Development Support Strategy for 2006-2008. The law did not pass, however, and its adoption has been postponed indefinitely.

**Supervision:** Investment funds are hypothetically supervised by the NCFM but there are no private equity or venture capital funds in Moldova. At the moment, NCFM supervises activity of three private pension funds and the process of liquidation of 26 remaining investments funds that facilitated the privatization process in 1990s.

**Foreign investor rights:** The Law on Investment in Entrepreneurship (No. 81-XV from 18 March 2004) prohibits discrimination against investments based on citizenship, domicile, residence, place of registration, place of activity, state of origin or any other grounds. The law provides for equitable conditions for all investors. The only exception is purchase of agricultural and forest land, which is restricted to the state, Moldovan citizens, and legal entities without foreign capital. All incentives are applied uniformly to both domestic and foreign investors. There are no restrictions on repatriation of net profits.

## 3.5 Other financial sector institutions

### 3.5.1 Leasing companies

**Structure:** In 2012, there were 25 active leasing companies, whose total leased assets stood at MDL 816 million (EUR 51.0 million) in 2012. The top 5 companies accounted for 67% of the total assets leased. The top-five concentration has decreased in recent years, from 73% in 2010. Moldova's five largest leasing companies and their respective share of total assets leased in 2012 are: MAIB Leasing (25%), Capital Leasing (15%), Total Leasing (12%), Raiffeisen Leasing (8%), and BT Leasing (6%). All leasing companies are privately owned[20]. With the exception of the two largest players, all other significant leasing companies are foreign-owned (Total Leasing, Raiffeisen Leasing, BT Leasing, TOP Leasing, Express Leasing, and Euroleasing).

**Number, size and concentration of the leasing sector**

| | 2012 | 2011 | 2010 | 2009 | 2008 |
|---|---|---|---|---|---|
| Number of active leasing companies | 25 | 20 | 23 | 24 | 27 |
| Share of top 5 companies in | 67% | 72% | 73% | 60% | 67% |

[20] The formerly state-controlled Banca de Economii provides leasing as one of its financial products. Its market share is insignificant though.

| | | | | | |
|---|---|---|---|---|---|
| total assets leased | | | | | |
| Total assets leased (EUR million), including | 51.0 | 55.5 | 33.2 | 23.4 | 84.6 |
| - transport | 87.3% | 79.0% | 83.9% | 89.9% | 88.7% |
| - equipment | 8.0% | 11.3% | 8.7% | 7.4% | 8.3% |
| - buildings | 2.5% | 6.9% | 7.4% | 2.3% | 2.3% |
| - other | 2.2% | 2.8% | 0.1% | 0.4% | 0.7% |

*Source: NBS*

**Performance:** The leasing market in Moldova has seen its peak in 2008 with total assets leased exceeding MDL 1.2 billion (EUR 84.6 million). In 2009, the market shrank to less than one third of its previous size and has been generally growing since then, with the exception of 2012. Motor vehicles, and specifically passenger cars, have traditionally been the key driver of the sector, accounting for 80-90% of the total assets leased (60-80% passenger cars).

**Regulation:** The legal framework is provided by the Law on Leasing (No. 59-XVI from 28 April 2005) that allows any legal entity or individual to both offer leasing services (currently without license) and lease any type of assets (moveable and immoveable) with some exceptions (including agricultural land). At the same time, there is no regulator to supervise and monitor the sector. There are no requirements towards the minimal capital, internal control and risk management procedures, or reporting. Inadequate transparency creates coordination problems for the players and, in some cases, encourages false publicity which can mislead consumers.

**Funding:** Leasing companies that are subsidiaries of commercial banks (e.g. MAIB Leasing and Victoria Leasing) are financed by their parent companies. Companies that are established by foreign financial institutions (e.g. Raiffeisen Leasing, BT Leasing, and Express Leasing) also enjoy the financial support of their foreign parent. Other leasing companies fund their growth from sources other than shareholders. Total Leasing is one example, where current lenders include DEG, BSTDB, FMO, EBRD, Oikocredit, as well as Moldindconbank and Mobiasbanca. Cost of funds from IFIs is variable, while Moldovan banks prefer to lend at fixed interest rates.

### 3.5.2 Savings and credit associations

**Structure:** There are 361 licensed SCAs in Moldova. Of these, 320 submitted their financial statements to NCFM in 2012. SCAs are relatively small, with their total assets of EUR 20.9 million accounting for only 0.5% of total financial assets in Moldova. Due to the SCAs' rural presence, more than two thirds of loans are extended to the agriculture and agribusiness sectors, the share of which in SCAs' total loan portfolio has been quite stable over the last years.

**Number, total assets and outreach of the SCA sector**

| | 2012 | 2011 | 2010 | 2009 | 2008 |
|---|---|---|---|---|---|
| Number of SCAs† | 320/361 | 351/377 | 352/399 | 379/395 | 422/ |
| Number of members | 126,746 | 137,342 | 131,675 | 124,139 | 123,588 |
| SCA assets (EUR millions) | 20.9 | 19.9 | 17.6 | 21.0 | 40.1 |

*Notes:* † *Number of associations that reported to the NCFM / number of registered associations*
*Source:* *NCFM*

**Performance:** The SCA sector has not recovered from the economic recession. The sector rapidly grew its total assets and loan portfolio through 2008 at a 5-year CAGR of 36.5% and 38.5%, respectively. In 2009, savings shrank by approximately one third, while loans and assets almost halved. This considerable decrease was due to a sharp decline in external credit and a substantial deterioration of loan portfolio quality, which resulted in huge loan loss provisions.

**Regulation:** The SCA sector is closely supervised and regulated by the NCFM and is governed by the Law on Savings and Credit Associations (No. 139-XVI from 21 June 2007). In addition, NCFM developed prudential requirements for SCAs, minimum requirements for SCA management, instructions on how to develop a business plan, and other normative acts that regulate SCAs' activity.

**Funding:** There are three types of SCAs with different funding possibilities. The majority of SCAs (291) are classified as type A and are similar to MFOs in that they are not allowed to take deposits. The strongest SCAs (68) were given type B license and the right to attract customer deposits. Two SCAs were established as apex institutions. As in the banking sector, customer deposits quickly became the main source of funding for type B SCAs (about 75% of funding in 2012). Unlike deposits with commercial banks, however, savings deposits in the SCA sector are not insured. Other funds come from local banks and MFOs (Microinvest and RFC).

### 3.5.3 The stock exchange

**Structure:** There are two stock exchanges in Moldova. The Chisinau Stock Exchange obtained its license only in 2012 and has no activity yet. The Stock Exchange of Moldova (SEM) has 21 accredited members.

**Performance:** The securities market in Moldova is generally underdeveloped. New issues take place on SEM and include IPOs and additional issues by existing companies. The share of IPOs is rather small, with the exception of 2012, when nine insurance companies raised their first public capital. The number of transactions on the secondary market fell significantly after the crisis, although the average volume per transaction became considerably higher. More than half of the trading volume is made over the counter.

**Development of the securities market**

| | 2012 | 2011 | 2010 | 2009 | 2008 |
|---|---|---|---|---|---|
| New emissions (EUR mln) | 69.1 | 92.2 | 53.2 | 36.5 | 55.2 |
| Number of new emissions | 113 | 137 | 84 | 133 | 156 |
| Secondary market (EUR mln) | 78.2 | 128.7 | 34.7 | 35.3 | 148.8 |
| Number of transactions | 4,398 | 5,313 | 5,683 | 219,837 | 232,028 |

*Source: NCFM*

**Regulation:** NCFM, as the regulator of the non-banking sector, adopted a Corporate Governance Code and passed new regulations intended to simplify the issuance of corporate securities and increase the transparency of transactions on the stock exchange. In 2011, the GoM adopted a new Strategy for the Development of the Non-Banking Financial Strategy through 2014 that focuses on adopting European standards in financial market regulation and supervision. Amendments were passed in 2011 to the law on joint-stock companies to strengthen minority shareholder rights and improve disclosure obligations for transactions involving conflicts of interest. A new capital markets law that transposes European Union regulations is soon to come into effect. It is designed to open up capital markets to foreign investors, strengthen NCFM's powers as independent regulator and sets higher capital requirements on capital market participants.

# 4. DEMAND ANALYSIS[21]

***Conclusion:*** SMEs in Moldova play an important role in terms of output and employment. In a consumption-oriented economy, trade still dominates and drives the SME sector. The agriculture and IT sectors have the largest potential for growth.

***Key findings:***
- *Total demand for MSME loans is estimated at EUR 1.4 billion, the largest part of which comes from micro-businesses.*
- *Trade is still by far the leading sector, but the IT industry is considered to be one of the most dynamic in the country, while agriculture has much potential for expansion.*

## 4.1 Size and growth of the segment

**Size and definition of the sector:** According to the National Bureau of Statistics (NBS), there were 50,681 enterprises in 2012, out of which 49,444, or 97.6%, were MSMEs. A total number of 38,336 micro enterprises account for more than three quarters (75.6%) of all enterprises. Small and medium enterprises hold a share of 18.9% (9,570 enterprises) and 3.0% (1,538 enterprises), respectively. Despite an impressive growth of the number of large enterprises in recent years, their share has never been above 2.5% of total number of enterprises and stood at 2.4% in 2012.

The definition of micro, small, and medium enterprises is given by the Law on Support to the SME Sector and is based on three parameters: number of employees, annual turnover, and total assets.

**Definition of micro, small, and medium enterprises in the Republic of Moldova**

| | Average number of employees | Average annual turnover | Average annual total assets |
|---|---|---|---|
| Micro | < 10 | < MDL 3 million (EUR 176,500) | < MDL 3 million (EUR 176,500) |
| Small | < 50 | < MDL 25 million (EUR 1.5 million) | < MDL 25 million (EUR 1.5 million) |
| Medium | < 250 | < MDL 50 million (EUR 3 million) | < MDL 50 million (EUR 3 million) |

*Source: Law on Support to the SME Sector (#206-VXI of 07 July 2006)*

**Importance of the sector:** In 2012, the MSME sector accounted for 57.7% of total employment (micro – 17.4%, small – 23.5%, medium – 16.8%). Since 2005, MSMEs' contribution to employment stood at 55-60%, which is a bit below the 60-70% share in OECD countries. Employment in MSMEs has steadily decreased between 2007 and 2011, as it did in large enterprises. The trend reversed in 2012, when employment in MSMEs increased by 2.1% over 2011.

In 2012, the share of MSMEs in total turnover was 34.5% (micro – 4.6%, small – 18.1%, medium – 11.8%), down from 46.2% in 2006. About half of the MSME turnover is generated by firms in the area of retail and wholesale trade. Despite their increasing number and ever growing turnover, MSMEs' share in total turnover has been decreasing over the last years due to a higher growth rate in the turnover generated by large enterprises.

[21] Based on data taken from the National Bureau of Statistics unless otherwise noted.

**Accuracy of estimate:** Official numbers of MSMEs shown above are based on the financial reports presented to NBS by legal entities and do not include individual entrepreneurs[22], patent holders[23] or farmers[24], who represent an important proportion of microbusiness. Furthermore, as with any other official data, information on Transnistria is not captured.

**Growth rate:** The total number of enterprises has been growing at a CAGR of 6.3% since 2005. The growth is primarily driven by micro enterprises, whose number increased from 24,347 in 2005 to 38,336 in 2012. The share of MSMEs in total number of enterprises has been rather stable, fluctuating between 97.5% and 98.3% over the last eight years. Despite an impressive growth of the number of large enterprises from 697 in 2005 to 1,237 in 2012, their share has never exceeded 2.5%. To be mentioned is the trend of further polarization in recent years, the reduction of an already thin share of medium enterprises from 5.0% in 2005 to 3.0% in 2012. The number of medium-sized enterprises decreased in 2007-2011 by 15.3% but saw a 2.3% increase in 2012. However, employment in medium-sized firms continues to decrease. It dropped by 39.7% in 2005-2012. This negative performance is mainly due to the financial crisis, which seems to have hit medium-sized enterprises particularly hard.

## 4.2 Characteristics of SMEs

**Economic activity:** About 20,000 enterprises, or 40.5% of all MSMEs, carry out their activities in the field of trade. Since this economic sector generates high turnover, it accounted for 49.7% of total MSME sales revenues in 2012. Wholesale and retail trade is also the largest employer, accounting for 26.6% of total employment. Other important economic sectors include agriculture, processing industry, and real estate transactions.

**Breakdown of MSMEs by economic sector, 2012**

| Economic sector | Number of enterprises | Number of employees | Annual turnover |
|---|---|---|---|
| Agriculture, hunting and forestry | 5.0% | 12.1% | 6.7% |
| Processing industry | 9.8% | 15.4% | 13.0% |
| Electrical energy, gas and water | 0.5% | 0.9% | 0.4% |
| Construction | 5.5% | 7.5% | 7.3% |
| Wholesale and retail trade | 40.5% | 26.6% | 49.7% |
| Hotels and restaurants | 3.4% | 4.0% | 1.9% |
| Transportation, storage and communications | 6.7% | 7.6% | 9.4% |
| Real estate transactions | 17.2% | 13.2% | 7.1% |
| Other activities | 11.5% | 12.8% | 4.5% |

*Source: NBS*

**Ownership:** Most MSMEs are privately owned. It is estimated that the share of public capital is about 1.5-1.8%. However, enterprises with public capital account for 9-10% of total employment in the sector. Foreign investors own 4-8% of the MSMEs' capital, and firms with foreign capital contribute 9% to total employment.

[22] According to the State Chamber of Registration, there were 65,381 individual entrepreneurs registered as of 1 September 2013.
[23] There is no official source for the number of patent holders. Estimates that can be found in press vary significantly from 17,500 to 35,000. In addition, statistics on patent holders and individual entrepreneurs suffer from a partial overlap between the two categories.
[24] The number of unregistered farmers (about 380,000) is approximated by the number of land owners as recorded in the State Cadaster.

**Regional distribution:** Traditionally, about two thirds of all MSMEs are located in the capital city of Chisinau. These firms account for about 55% of total employment and 63.5%-65.0% of total turnover in the sector. Northern, central, and southern regions account for 12%, 14%, and 8% of total MSMEs, respectively. There were no significant changes to the regional distribution of MSMEs, their contribution to employment and turnover over the last several years.

## 4.3 Performance

**Performance by economic activity:** The high share of wholesalers and retailers among MSMEs is explained by attractive profitability that this sector offers. Together with real estate operators, they contributed the most to the aggregated earnings before tax of all MSMEs in 2012. Agriculture, processing industry, and construction used to be profitable sectors as well but their margins reduced significantly in 2012. The first two sectors were hit by the severe drought.

**Contribution of MSMEs to earnings before tax by economic sector, 2009-2012 (MDL mln)**

| Economic sector | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|
| Agriculture, hunting and forestry | (39.8) | 863.4 | 951.8 | (53.5) |
| Processing industry | 264.5 | 720.9 | 503.7 | 9.8 |
| Electrical energy, gas and water | (24.1) | (19.0) | (23.8) | (42.4) |
| Construction | 286.5 | 569.6 | 517.1 | 97.0 |
| Wholesale and retail trade | 939.5 | 1,954.4 | 1,751.6 | 695.4 |
| Hotels and restaurants | (45.6) | (58.9) | (47.6) | (119.9) |
| Transportation, storage and communications | 267.8 | 287.2 | 299.2 | (37.1) |
| Real estate transactions | 543.3 | 1,063.2 | 975.7 | 469.1 |
| Other activities | 51.1 | 76.1 | 252.6 | 66.2 |
| **TOTAL** | **2,243.2** | **5,456.9** | **5,180.2** | **1,084.6** |

*Source: NBS*

**Performance by size:** Based on enterprise size, in 2012 particularly good results were shown by medium and small enterprises in wholesale and retail trade and small and micro firms in real estate transactions. In previous years, small and medium enterprises in agriculture, processing, and construction were among the most profitable as well. In general, small enterprises show better performance, while microbusinesses contribute the least to overall earnings before tax.

**Contribution of MSMEs to earnings before tax by economic sector and size, 2012**

| Economic sector | All MSMEs | Medium | Small | Micro |
|---|---|---|---|---|
| Agriculture, hunting and forestry | -4.9% | 2.7% | -3.8% | -3.8% |
| Processing industry | 0.9% | 2.9% | -0.3% | -1.8% |
| Electrical energy, gas and water | -3.9% | -2.1% | -1.6% | -0.2% |
| Construction | 8.9% | -0.4% | 7.8% | 1.5% |
| Wholesale and retail trade | 64.1% | 25.0% | 49.8% | -10.8% |
| Hotels and restaurants | -11.1% | -1.3% | -5.3% | -4.4% |
| Transportation, storage and communications | -3.4% | -0.6% | -4.5% | 1.7% |
| Real estate transactions | 43.3% | 6.6% | 23.2% | 13.4% |
| Other activities | 6.1% | 3.4% | 0.7% | 2.0% |
| **TOTAL** | **100.0%** | **36.3%** | **66.0%** | **-2.3%** |

*Source: NBS*

**IT sector:** The IT industry in Moldova is considered to be one the most dynamic in the country. The IT and software development outsourcing industry accounts for 10% of the budget contributions. Tax incentives for IT companies lead to many international firms opening up their development centers in Chisinau.

## 4.4 Institutional and regulatory issues[25]

Moldova ranked 83 out of 185 countries in the World Bank's Doing Business 2013. Moldova climbed three positions primarily due to improvements made in protecting investors and resolving insolvency. Besides traditional bottlenecks (such as dealing with construction permits, getting electricity, and trading across borders, where no reforms have been made to improve the situation), some recent reforms made doing business more difficult. These include reintroduction of corporate income tax and abolishment of specialized economic courts.

**Paying taxes:** Moldova made paying taxes more costly for companies by reintroducing the corporate income tax in 2012—but also made tax compliance easier by encouraging electronic filing and payment. At the same time Moldova reduced the withholding tax for dividends from 15% to 6% and lowered the withholding tax for payments other than dividends from 15% to 12%, thus leaving suppliers with more working capital. This is especially beneficial to SMEs, who have limited access to external finance and have to rely on internal resources. In addition, it introduced a new (optional) tax regime for SMEs under which small businesses can pay a single tax of 3% of revenues from operational activities instead of corporate income tax.

**Enforcing contracts:** In 2011, Moldova made enforcement of judgments more efficient by introducing private bailiffs. However, the subsequent abolishment of the specialized economic courts made enforcing contracts more difficult.

**Bankruptcy:** Laws and regulations on bankruptcy procedures are established through the Insolvency Law and its subsequent amendments, which are considered to be in line with international standards. The law distinguishes three forms of insolvency procedures: foreclosure, liquidation and re-organization. Implementation of the law, however, appears to be less efficient. In order to improve the efficiency of the insolvency process, reforms should be taken to reduce delays in the procedure. Measures may also be taken to ensure that the officials in charge of administrating insolvency procedures have received sufficient training.

**Green economy:** The Moldovan government does not provide any reference in its policy framework to eco-efficient business and eco-innovation. Although a number of organizations propose and implement projects on energy efficiency and other environmental issues, it is often not clear if these projects are addressed to SMEs. The Moldovan government does not promote the use of environmental management systems or standards. Companies in Moldova decide on their own behalf to adopt and apply these systems if they are willing to correspond to market requirements or have strong principles of social responsibility.

## 4.5 Innovation

**Level of innovation:** Overall, there are only a limited number of innovative companies in Moldova, whereas the R&D capacities and resources (financial and human) are concentrated in the public sector. The Academy of Sciences of Moldova, along with its 19 research institutes, is the leading research organization in the country. Cooperation between research and business is a major challenge in Moldova. The business environment is not encouraged enough to implement the scientific achievements, while research activity is not necessarily based on the real needs of the

[25] Based on data from Doing Business 2013 and SME Policy Index for Eastern Partner Countries 2012 (Implementation of the Small Business Act).

market. The innovation system suffers from the focus of enterprises on trading and low tech products. Most innovative companies are restrained in their activities by a lack of access to credit and by limited external (venture) financing.[26]

**Innovative sectors:** On the company level, most innovation is done in the IT sector, with many international firms opening their offices in Moldova. Importation of new technologies from abroad takes place in healthcare (diagnostic and treatment equipment), agriculture (intensive horticulture, modern pest management, etc.), industry (technology), construction (energy efficiency), and other sectors. Most of research and innovation is done, however, on the scientific level in various fields.

**Box 1: Example of an innovative SME – RITLabs SRL**

RITLabs (www.ritlabs.com) is a software company specialized in communication products. Its best known product is the e-mail client *The Bat!*, first launched in 1998 and then continuously improved. The company also launched *The Bat! Voyager*, a portable version of *The Bat!*, and *Secure Bat!*, a highly protected version of *The Bat!* The product is regarded as an alternative e-mail client for advanced e-mail users. It is often praised for its focus on security, as well as user interface customization and filtering capabilities. RITLabs' software is used by millions of users in more than 190 countries. The company has representative offices in more than 20 countries. In 2004, RITLabs received the *Best Exporter of Moldova* award.

**Government support:** The Code on Science and Innovations is the basic legal document regulating science, research and innovation activities in Moldova. The Academy of Sciences of Moldova, through its Agency for Innovation and Technology Transfer, is responsible for the co-ordination of activities related to science and innovation. Some innovation stimulation measures are implemented, but funding for innovation remains modest and, overall, there is only little support for start-ups and spin-offs. Procedures for public procurement of innovative good and services are missing.

**Supporting environment:** There is a need to ensure a more favorable economic environment for innovation. Although incentives and tax benefits are provided, legislative reforms should provide researchers the ability to create spin-off companies or start-ups from research organizations. In terms of finance, the lack of venture capital is an important constraint.

## 4.6 Demand for finance

**Overview:** In order to further realize their growth potential, MSMEs in Moldova need to be able to integrate modern technology (be it innovations developed abroad or innovative ideas of their own). Because of their limited capacities, MSMEs face difficulties in independently sustaining the investments needed for growth. Limited internal financial capacity creates demand for external funding.

Financial institutions, however, report a rather low demand for finance on behalf of MSMEs and are of the opinion that access to finance is not the biggest constraint to MSME growth in general. They cite instead lack of feasible business projects and poor level of entrepreneurial and financial literacy. The entrepreneurial and financial literacy level in Moldova is indeed low amongst MSMEs. GoM is therefore funding training and information programs, implemented by ODIMM. ODIMM carries out

[26] Nevertheless, Moldova climbed five positions in the Global Innovation Index 2013. The country ranked 45 out of 142 and is one of 18 high- and middle-income countries, so-called innovation learners, which demonstrate rising levels of innovation results. Moldova tops the lower-middle income group of 36 economies.

information campaigns among entrepreneurs throughout the country and organizes workshops and conferences on financial products for SMEs. EBRD BAS, USAID and some commercial banks have also developed programs and seminars to enhance the level of knowledge in financial services.

**Characteristics of demand:** Trade (both retail and wholesale) by far dominates the MSME sector and still drives the MSME portfolio growth. The share of construction significantly diminished after the crisis. Agriculture and agribusiness are considered to have the most potential in the mid-term, which should drive greater demand from those segments. Investments in intensive orchards, greenhouses, storage facilities, post-harvest centers, replacement of the outdated agricultural equipment, all need external financing. Loans will continue to be the main instruments demanded, followed by leases.

**Estimation of demand:** Total demand for MSME loans is estimated at EUR 1.4 billion, consisting of EUR 869.6 million in micro loans, EUR 355.8 million in small business loans, and EUR 158.4 million in medium business loans. These figures were derived using loan volume breakdowns collected from seven MSME lenders, data from NBS and the Registration Chamber, and World Bank estimates of firms not needing a loan. The calculation was made as follows:

**Table 2. Estimated demand for MSME loans**

| Step in calculation | Micro* | Small | Medium | Total | Source |
|---|---|---|---|---|---|
| A. Number of businesses | 103,717 | 9,570 | 1,538 | 114,825 | NBS, State Chamber of Registration |
| B. Average loan size demanded (EUR) | 12,515 | 55,488 | 138,273 | | BFC survey of local lenders |
| C. % of firms not needing a loan | 33.0% | 33.0% | 25.5% | | World Bank Enterprise Surveys |
| **D. Total demand (EUR millions)** | **869.6** | **355.8** | **158.4** | **1,383.9** | **= A * B * (1 – C)** |

** The number of micro-enterprises includes 65,381 registered individual entrepreneurs.*

The demand estimate is only intended to give a general idea of the level of demand. The methodology of the calculation is simplistic and is based on a number of assumptions. Since there is no available survey data on the loan size demanded from MSMEs, the average loan size disbursed was used as a proxy for loan size demanded based on a survey of lenders. Each data source uses a different definition of MSMEs, which reduces the accuracy of the estimate. There are no reliable data that could be used to estimate the demand for non-loan products, such as equity, leases and letters of credit.

# 5. SUPPLY ANALYSIS

***Conclusion:***

Bank loans are the main source of MSME funding, with other elements of the financial sector being poorly developed (such as capital markets) or having a low share (microfinance and non-bank crediting, leasing, investment funds and risk capital).

***Key findings:***

- *The total supply of MSME financing is estimated at EUR 1 billion.*
- *More than 90% of MSME financing consists of bank loans.*
- *There are two guarantee funds – one private and one state-run – but each is modest in size, and additional guarantee funds supported by IFIs would benefit the market.*
- *The predominance of customer deposits as a funding source limits long-term lending.*
- *The role of non-bank intermediaries remains modest.*
- *Private equity and venture capital is virtually non-existent for MSMEs.*

## 5.1 Number and type of intermediaries

**Banks:** The banking system is the basic component of the financial sector in Moldova. The Moldovan banking system is made up of 2 levels, represented by the National Bank of Moldova (NBM) and 14 commercial banks, including 4 subsidiaries of international banks and financial groups. As of mid-2013, there were a total of 1,275 subdivisions of banks, including 334 branches, 937 agencies and 4 exchange offices. All banks serve the SME sector, although to various degrees. ProCredit Bank is the only purely MSME-oriented bank. The share of SME credit in the total loan portfolio of the banking sector is estimated at 27%[27], based on a survey of seven banks.

**Microfinance organizations (MFOs):** Liberal regulations continue to attract new operators into this segment, leading to dramatic growth in the number of MFOs over the last few years. As of 30 April 2013, there were 76 licensed MFOs in Moldova, compared to only 13 in 2007. Despite the increased number of registered MFOs, only three (Microinvest, RFC, and Prime Capital) are offering significant amounts of finance to the MSME sector. Microinvest and Prime Capital are more focused on SMEs, while RFC's main clients are microenterprises. The other MFOs provide consumer or mortgage loans, have small microenterprise portfolios, or are not active at all.

**Savings and Credit Associations (SCAs):** Due to the adverse effects of the economic recession, the number of SCAs has dropped from 422 in 2009 to 360 in 2013. SCAs are associations of individuals at the local level and they lend only to members of their associations. To limit credit risk, enterprises are not allowed membership in SCAs. As a result, SCAs do not represent a significant source of SME funding[28].

**Leasing companies:** In 2012, there were 25 active leasing companies, up from 20 in 2011 but down from 27 in 2008. Motor vehicles, and specifically passenger cars, have traditionally been the key driver of the sector, accounting for 80-90% (60-80% for passenger cars) of the total assets leased. Due to relative unattractiveness of leasing compared to lending, some leasing companies transform into MFOs. So far, leasing remains a small source of funding for SMEs.

[27] The share of MSME portfolio (i.e. including micro-enterprises) has been about 40-45% in recent years.
[28] Occasionally, however, a business owner, member of an SCA, can take a personal loan but use it for business purposes.

**Support programs:** The main state support programs for SMEs are the National Program for Economic Empowerment of Youth (PNAET), Pilot Project for Attracting Remittances into the Economy (PARE 1+1), and Loan Guarantee Fund. There are also a number of other projects and programs, financed by international community, which have a financial component for SMEs. These include the Program of Co-financing Energy Efficiency Projects (TAM-BAS), Program for Support and Development of SMEs (Government of Japan), Competitiveness Enhancement and Enterprise Development project (USAID). Two projects financed by the Government of Japan (JNPGA and 2KR) aim at further developing leasing in Moldova.

**Guarantee funds:** There are two funds in Moldova. GarantInvest was established as an inter-bank guarantee society to ease access to finance for those entrepreneurs who lack the necessary collateral[29]. Seven banks and one MFO participate in the scheme. The second loan guarantee fund was set up by the Ministry of Economy for SMEs only and is managed by ODIMM. This fund is open for banks only. In addition, financial institutions have access to USAID's Development Credit Authority (DCA) loan portfolio guarantee (a collective facility of USD 27 million in 2004-2010 to seven financial institutions). However, USAID/DCA prohibits its guarantees from being used with donor credit lines, including, for example other US Government credit programs such as OPIC[30]. Further details on GarantInvest and the Ministry of Economy's fund are provided in Annex 8.

Financial institutions interviewed for this study in Moldova would welcome a new guarantee fund supported by an IFI such as EIB. They believe that micro and small enterprises would benefit substantially from such a guarantee program. Monthly loan disbursements to SMEs, using this guarantee fund, could be increased by as much as 20% by some institutions, but the impact will depend on such factors as the maximum amount covered by the guarantee and eligibility criteria for SMEs.

**Other intermediaries:** Other elements of the financial sector are poorly developed (capital markets) or are virtually non-existent (investment funds and risk capital). There are no venture capital funds active in Moldova. Five regional equity funds include Moldova as a possible target country, but only two of them have made investments in Moldova (see Annex 5).

## 5.2 Type of funding instruments

**Loans:** Bank loans are the main source of funding for SMEs. The maturity of new bank loans, however, is often below one year. Unsecured credit is only issued in small amounts, and hard collateral such as real estate, vehicles and machinery, is generally required.

**Loan guarantee:** Under certain conditions (e.g. caps on the loan amount and term, purpose of the loan) loans can be extended with a guarantee from one of the two loan guarantee funds. For established businesses, the guarantee cannot exceed 50% of the loan amount, while for start-ups the guarantee can go up to 70%. Due to difficulties that banks encounter in case of guarantee payment, they try to avoid this instrument. In addition, the cost of the loan goes up anywhere between 1.5% and 2.5% per year, which diminishes its attractiveness.

**Lease:** The total lease portfolio of leasing companies is EUR 51 million, a small fraction of bank lending, and the majority of leases are for consumer car leasing. Furthermore, the growth of lease portfolios in Moldova has stagnated in recent years. Leasing alone has two big disadvantages: a) since leased equipment is not possessed by the client, it is not eligible for subsidies; and b) VAT

[29] Collateral-based lending is widely used in Moldova. Few financial institutions try to use cash-flow-based approach and assess the client's future profitability and feasibility of the project ideas.
[30] Evaluation of DCA guarantee to FinComBank, USAID, June 2011.

cannot be claimed in full, only per lease installment. Equipment represents only 8% of total lease portfolio. However, leasing continues to be the best option for vehicles. A couple of leasing companies (e.g. Total Leasing and Express Leasing) started micro-lending along their core leasing activity.

**Letters of credit and trade finance guarantees:** In Moldova, the most common trade finance instruments available are guarantees and letter of credit. As of end 2012, the outstanding amounts of guarantees and letters of credit issued to SMEs by seven surveyed banks stood at EUR 45.2 million and EUR 0.5 million, respectively. Compared to the aggregate SME loan portfolio of these seven banks of EUR 492.8 million, trade finance represents 9.3%. Although banks can offer letters of credit to SMEs, this product is generally used by larger clients.

**Factoring:** Factoring services have also been introduced in Moldova and are defined as a form of credit which may limit the ability of the factor to collect the account receivables from its customer in case of bankruptcy. Such an impediment may contribute to the limited development of the sector in the country.

**Risk capital:** A few regional private equity funds have Moldova in their geographic coverage, but only two of them have visible investments in the country (see Annex 5). None of them deals with SMEs directly, having a minimum investment amount that is high enough to exclude SMEs from the list of potential clients. Instead, they invested in financial institutions that serve SMEs. For example, Horizon Capital's Western NIS Enterprise Fund took a 24.62% stake in FinComBank, and NCH Funds purchased 100% stakes in Prime Capital and Express Leasing. Venture capital does not exist in Moldova.

## 5.3 Characteristics of funding recipients

**Economic sector:** Given that the MSME sector is dominated by the companies that are involved in trade, about 40% of the estimated MSME portfolio is loans made to the trade sector. Other important recipients of funding are manufacturers (about 20%) and service providers (about 15%). Agriculture accounts for only 10% of the MSME loan portfolio[31].

**Regional distribution:** Since the southern part of Moldova is characterized by a higher concentration of large enterprises (especially in winemaking industry), the number of MSMEs is lower in comparison to the central and northern parts. Consequently, MSMEs from the south account for a smaller share of total supply.

**Rural versus urban:** MSME lending is concentrated in urban areas in Moldova, although some banks have a rather sophisticated branch network across the country and are well suited to on-lend funds from various development and support programs in the regions. MFOs tend to be more active in rural areas than banks. Nevertheless, the majority of MSMEs operates in urban areas (about 65% of all MSMEs are located in the capital city of Chisinau[32]), which explains the urban nature of the MSME loan portfolio.

## 5.4 Institutional and regulatory issues

The institutional and regulatory environment in Moldova has been improving over the years. However, there are a number of issues that limit the ability of the financial institutions to better serve SMEs. While NBM is generally perceived by the banks as a strong regulator, NCFM (the regular

[31] Source: BFC bank survey.
[32] NBS data.

of all non-banking system) is a relatively new entity and is still in the process of capacity building. The regulatory environment for the non-banking sector is currently being revised. Several key issues and constraints are described below.

**Credit history:** Only banks are required to provide information to the credit bureau. MFOs and leasing companies have an option to do so, which they have not exercised yet. This represents a constraint for SMEs, particularly those which have a credit history with an MFO and wish to obtain a loan from a bank. Furthermore, current legislation makes it impossible for the credit bureau to cooperate with retailers and utility companies. A draft law which corrects these weaknesses is on hold for two years.

**Regulation of non-banking sector:** While the banking system is generally well supervised and the NBM is perceived by the banks as strong regulator, there is need for stronger regulation of the non-banking sector. The only responsibility of microfinance institutions is to submit annual reports to the NCFM. The leasing sector is not under the supervision umbrella of the NCFM. Non-banking institutions, with the exception of SCAs, do not have prudential requirements. Loose or absent regulation creates an environment in which financial institutions have sufficient room for irresponsible finance and unfair competition. This, in turn, may reduce the trust of MSMEs in the financial sector.

**Disclosure of real cost:** Even though NBM requires banks to reveal information regarding terms of lending and price of loans, banks are not obliged to provide this information in a clear manner, easily understood by the clients. Moreover, none of the financial institutions is obliged to disclose the effective interest rate. For this reason, information regarding the interest rates offered by some market players is oftentimes misleading, with attractive nominal interest rates but hidden commissions. Clients may be unaware of the total loan cost and are not able to make an informed decision or to correctly compare the different financing alternatives.

**Legal framework for private equity and venture capital:** The lack of adequate legislation for private equity and venture capital activity in Moldova postpones the establishment of domestic funds and limits participation of foreign investors, which ultimately constrains the development of innovative SMEs and startups.

**Loan guarantee schemes:** Although the presence of loan guarantee funds in the country is positive, only banks have access to them; MFOs have no access. They also have limited resources, both financial and human, so the volume of guarantees provided is relatively small. Finally, the cumbersome process of receiving payments from the fund makes some banks avoid using the fund.

## 5.5 Funding of intermediaries

**Banks:** The main funding source for the banks is deposits placed by clients, who usually tend to make placements on short term basis. Although a big part of customer deposits are renewed and prolonged at maturity, banks tend to lower the maturity gap by extending loans with similar maturity. In this way, loan portfolios are skewed towards short-term lending. Long-term borrowings from IFIs and international development programs account for just 15-20% of total funding[33]. Almost all loans with maturities above one year are financed by programs of international donors (see section 6.4 for an overview of main foreign and international lenders for the SME sector in Moldova). Loan terms are significantly below the payback period that can be expected from companies seeking to modernize their production facilities or launch expansion projects. This

[33] NBM data.

prevalence of short-term lending is a constraint for MSMEs, as they may not be able to finance the potentially long-term investment necessary to improve productivity.

**MFOs:** Since they are not allowed to take deposits, the two main sources of funding for MFOs are local and international financial institutions. Given that a number of local commercial banks have serious plans to develop their own MSME portfolios, the opportunities for borrowing funds from the local banking system are limited. At the same time, the small size of most MFOs makes it difficult to access foreign funding as well (with the exception of several MFOs that have ties with foreign investors). As a result, the interviewed MFOs reported to have excessive demand from MSMEs that they cannot meet because of insufficient funding.

## 5.6 Supply estimate

The total supply of MSME loan and lease financing in Moldova is estimated at EUR 1 billion in 2012, which represents 41.7% of the total financing. Banks account for more than 90%, with the balance being split among non-bank financial institutions.

**Estimated supply of MSME finance in 2012**

| Source | Total portfolio, EUR million | Est. MSME portfolio, EUR million | Share of MSME in total portfolio | Share in total MSME portfolio |
|---|---|---|---|---|
| Banks | 2,271.8 | 946.9 | 41.7% | 92.8% |
| MFOs | 93.1 | 21.9 | 23.5% | 2.1% |
| SCAs | 17.1 | 14.8 | 86.3% | 1.4% |
| Leasing companies (credit) | 12.1 | 7.7 | 64.0% | 0.8% |
| Leasing companies (lease) | 51.0 | 29.2 | 57.2% | 2.9% |
| **TOTAL** | **2,445.2** | **1,020.4** | **41.7%** | **100.0%** |

*Source: NBM, NBS, NCFM, BFC survey*

The estimate may somewhat understate or overstate the real supply due to a number of approximations made:

- the share of MSME portfolio in the banking sector is based on the average calculated on data collected from nine banks (accounting for 75.5% of the total loan portfolio) and then extrapolated to the entire sector;
- MSME portfolio of MFOs is based on estimates made for three large MFOs (accounting for 51.6% of total MFO portfolio) known to serve the small business and does not include potentially existing MSME portfolios of other MFOs; other MFOs are thought to have insignificant MSME lending activity, if any;
- at least two leasing companies are known to also provide loans; their credit portfolio could potentially be included in the total portfolio of the lease sector, as reported by the NBS;
- the estimation does not take into account finance coming from development projects.

# 6. GAPS IN PRIVATE SECTOR FINANCING

***Conclusion:***
Access to finance, and especially access to non-loan finance, is a constraint for MSME development. IFIs play an important role in funding intermediaries in Moldova, but there is significant opportunity to further address MSME financing gaps.

***Key findings:***

- *Bank loans significantly dominate the supply of MSME finance.*
- *Supply of non-bank financing for MSMEs is very limited (microfinance and leasing) or virtually non-existent (private equity and venture capital).*
- *The major gap in funding is general lack of long-term financing.*
- *Investment opportunities for IFIs include long-term loans, subordinated loans, and equity investments in intermediaries that facilitate SME finance. In addition to financial support, IFIs could be more active in providing proper technical assistance.*

## 6.1 Gaps by instrument

**Loan:** The funding gap for loans is most noticeable for long-term loans, since lenders offer relatively short-term loans due their mostly short-term funding base. Despite relatively low interest rates, and flexible payment conditions, SME lending expansion is constraint by still high collateral requirements (well over 100% coverage, with an overwhelming focus on real estate), too complicated procedure to obtain a loan, and poor disclosure by the financial institutions of real cost of borrowing. The two loan guarantee funds are weak and ineffective to compensate for insufficient collateral. The gap is also due to generally poor level of entrepreneurial and financial literacy among MSMEs and scarcity of feasible business projects.

**Lease:** Supply of leasing is very small, accounting for less than 3% of total MSME finance supply. Demand for leasing is currently reduced due to the relative unattractiveness of leasing compared to loans. Nevertheless, leasing continues to be the best option for vehicles and has significant potential in the mid- and long term for equipment, especially agricultural machinery.

**Risk capital:** With virtually non-existing supply of private equity and venture capital for MSMEs, the gap is determined by the potential demand, quantification of which proved difficult. Limited innovation activity, a poor link between the academic and business sectors, and lack of an adequate legislation are among the main reasons that contribute to delay in establishment of domestic private equity and venture capital funds and a more active participation of foreign investors.

**Trade finance:** Both supply and demand for trade finance are currently small. With an improved macroeconomic environment and export opportunities for Moldovan SMEs, demand for trade finance is expected to grow.

## 6.2 Gaps by type of SME

**Economic sector:** Partly because of inadequate collateral, partly because of the higher perceived risks, agriculture is underserved by the financial sector. Existing supply is largely limited to funds within various projects financed by international development institutions. Considerable unmet demand exists, however, for investments in modern agricultural technologies, storage and post-harvest facilities, and replacement of the outdated equipment.

**Enterprise size:** The smaller the business, the more difficult its access to finance. Depending on their size, SMEs generally have one or two of the following options: remittances, informal lenders, savings and credit associations, microfinance institutions, leasing companies, commercial banks. Gaps are higher for micro and very small businesses. Banks cite a huge communication gap between themselves and SMEs, whereas non-bank institutions have limited capacity to serve these unbankable clients.

**Rural versus urban:** There is a large segment of SMEs, which lack appropriate and/or sufficient collateral and thus have limited access to banks. With the current focus on real estate as collateral and low value of houses outside urban areas, such entities are more likely to be in rural areas and classified as either micro or small enterprises.

## 6.3 Gaps in funding of intermediaries

**Banks:** The major gap in bank funding is general lack of long-term financing. Banks in Moldova heavily depend on customer deposits, which tend to be rather short term. Because lending in foreign currency to customers without foreign income streams is no longer an option due to severe provisioning requirements for such loans, foreign currency funding has become less appealing to banks. Currently, credit lines by IFIs are playing a critical role in providing longer-term finance to banks. However, further diversification of long-term finance should be sought.

**Non-bank institutions:** Given the prohibition to take deposits, MFOs and leasing companies rely on their own capital, as well as loans and borrowings from local and foreign financial institutions. Surveyed organizations reported that they have limited access to borrowings due to their small size compared to banks. The mismatch between high demand for loans and insufficient funding contributes to the existing SME financing gap. In order to further expand their activities, microfinance providers need to be able to raise additional funds.

## 6.4 Potential and capability of IFIs to fill gaps

International financial and development institutions play an important role in funding intermediaries in Moldova. However, there is significant opportunity to address SME financing gaps by further diversification of their funding instruments, including long-term loans, subordinated loans, and equity investments in intermediaries that facilitate SME finance (e.g. recapitalization of existing loan guarantee funds, MFOs, leasing companies). Investing in a local private equity fund could be an option once the appropriate legal framework is in place. In addition to financial support, IFIs could be more active in providing proper technical assistance, especially with the transfer of technology for SME lending. A summary of the current MSME-related programs is presented below.

**European Bank for Reconstruction and Development (EBRD):** Since the start of its operations in 1994, the EBRD has signed 100 investment projects in Moldova across the energy, transport, agribusiness, general industry and banking sectors, for a cumulative EUR 897 million. In order to enable Moldova to take full advantage of its new EU neighborhood status, the EBRD is going to give priority to infrastructure projects that promote regional integration and interconnection with neighboring countries[34]. Under the Moldova Financial Sector Framework Facility (EUR 70 million in 2008 and EUR 80 million in 2013), the EBRD provides its six partner financial institutions (four commercial banks and two leasing companies) with credit lines for SMEs and leasing finance[35]. The

[34] EBRD's strategy in Moldova (http://www.ebrd.com/pages/country/moldova.shtml)

[35] The facility envisages provision of full range of financial products, including mortgage financing, SME credit-lines, consumer finance, energy efficiency credit-lines, leasing finance, guarantee facilities, syndicated loans, subordinated debt, and equity investments. Eligible partner institutions include existing and new partner banks and non-bank financial institutions such as leasing, mortgage and insurance companies.

implementation of the framework is supported with technical assistance of EUR 700,000. In addition, the bank has been providing senior loans and credit lines to commercial banks to be on-lent to SMEs in Moldova. Under the Moldovan Sustainable Energy Finance Facility (EUR 22 million in 2012), the bank addresses the demand for energy efficiency and renewable energy investments in the country. Three commercial banks have the EBRD among their shareholders.

**The World Bank Group (IDA, IFC, MIGA, IBRD):** Since Moldova joined the World Bank in 1992, over USD 1 billion has been allocated to 49 operations in the country. Currently, the World Bank portfolio includes 11 active projects with total commitments of USD 205.7 million. Areas of support include regulatory reform and business development, education, social assistance, e-governance, healthcare, water and sanitation, agriculture, and others. The new Country Partnership Strategy for the Republic of Moldova for 2014-17 foresees total financial support by the World Bank Group of USD 570 million.

**International Development Association (IDA):** In 1997, Moldova became an IDA-only country, with much of the assistance focused on the infrastructure and human development. IDA has also helped the government's efforts to eliminate bottlenecks to growth, in particular, through improvements in trade facilitation and the business environment. Several notable ways IDA has helped strengthen the private sector are through simplifying business registration and licensing procedures, upgrading the quality of infrastructure, and supplying affordable long-term financing to export-oriented businesses. Among a wide range of IDA's projects in Moldova, two on-going SME-related projects are the Rural Investment and Services Project (RISP) and Competitiveness Enhancement Project (CEP).

**International Finance Corporation (IFC):** Moldova became a member of IFC in 1995. As of mid-2013, IFC has provided total investments in the amount of USD 191 million. IFC is focusing its investment services on increasing access to finance by supporting the development of local financial institutions, especially ones that concentrate on SMEs and agribusiness. In particular, IFC has loan agreements with several commercial banks for on-lending to SMEs. IFC is implementing[36] the Moldovan Investment Climate Reform advisory project with the overall goal of helping the GoM to (i) address regulatory weaknesses in the priority areas of inspections, construction permits, and insolvency, and (ii) streamline agribusiness-related regulations and set the stage for increased investments in the agribusiness sector. IFC also invested in the country's agribusiness and telecommunications sectors.

**Multilateral Investment Guarantee Agency (MIGA)** has provided guarantees totaling USD 95 million. Among the guarantee holders are Raiffeisen Bank (Romania) and ProCredit Holding (Germany). Guarantees covered shareholder investments in their subsidiaries in Moldova.

**International Fund for Agricultural Development (IFAD):** Since 1999, IFAD has invested a total of USD 68.9 million in five programs and projects for a total cost of USD 116.3 million. The overall goal of IFAD's strategy in Moldova is to reduce poverty by supporting the development of a rural market economy that is based on family-owned and managed on- and off-farm businesses. The two on-going operations are the Rural Financial Services and Marketing Program and Rural Financial Services and Agribusiness Development Project.

**Black Sea Trade and Development Bank (BSTDB):** In Moldova, the bank has a total of 21 projects for EUR 81 million. Supporting the development of the SME sector in the countries of the Black Sea region is a strategic objective of the bank. BSTDB provides financing to SMEs in the following ways: 1) financing through local financial intermediaries in the member countries (special credit lines), 2)

[36] In partnership with the Government of Sweden, the Austrian Ministry of Finance, and the Netherlands Ministry of Foreign Affairs.

financing through leasing companies, 3) direct financing from BSTDB (loans, equity, guarantees), and 4) financing through equity funds. As of end 2012, BSTDB's portfolio in Moldova amounted to EUR 30.5 million in 10 operations, including loans to three commercial banks and two leasing companies.

**European Fund for Southeast Europe (EFSE)** provides funding to commercial banks, microfinance banks, microcredit organisations and non-bank financial institutions such as leasing companies, for on-lending. The ultimate target group includes MSEs and low-income private households. EFSE also has a Development Facility endowed with grants to enable technical assistance, consulting and training measures to strengthen financial institutions in the region. The fund currently has loan agreements with four financial institutions in Moldova (three commercial banks and one MFO).

# ANNEX 1: MACROECONOMIC INDICATORS

| Indicator | 2012 | 2011 | 2010 | 2009 | 2008 |
|---|---|---|---|---|---|
| GDP (nominal, EUR millions) | 5,644.5 | 5,040.7 | 4,383.4 | 3,892.5 | 4,114.8 |
| Population (millions) | 3.559 | 3.560 | 3.560 | 3.564 | 3.568 |
| GDP (nominal) per capita (EUR) | 1,586 | 1,416 | 1,231 | 1,092 | 1,153 |
| GDP (PPP) per capita (USD) | 3,423.8 | 3,370.5 | 3,100.3 | 2,853.9 | 3,005.4 |
| Real GDP growth rate | -0.8% | 6.8% | 7.1% | -6.0% | 7.8% |
| Inflation rate (CPI) | 4.7% | 7.7% | 7.4% | 0.0% | 12.7% |
| Exchange rate (EUR, end of period) | 15.9967 | 15.0737 | 16.1045 | 17.6252 | 14.7408 |
| Change in exchange rate | 6.1% | -6.4% | -8.6% | 19.6% | -11.4% |
| Unemployment rate (official) | 5.6% | 6.7% | 7.4% | 6.4% | 4.0% |
| Poverty rate (WB, $1.25 per day) | n/a | n/a | 0.39% | 0.44% | 1.05% |
| Current account balance (% of GDP) | -9.4% | -11.3% | -7.7% | -8.2% | -16.1% |
| Trade balance (% of GDP) | -40.6% | -40.9% | -39.3% | -36.6% | -53.1% |
| Capital account balance (% of GDP) | 6.4% | 10.5% | 7.7% | 7.9% | 15.3% |
| Net FDI (% of GDP) | 2.3% | 4.2% | 3.5% | 2.5% | 12.0% |
| Central bank reserves (% of GDP) | 34.7% | 28.0% | 29.5% | 27.2% | 27.6% |
| Public debt (% of GDP) | 33.0% | 30.2% | 31.9% | 28.7% | 22.1% |
| Fiscal balance (% of GDP) | -2.1% | -2.3% | -2.5% | -6.3% | -1.0% |

*Source: NBS, World Bank, IMF*

**Sectoral distribution of GDP (% of total)**

| Sector/activity | 2012 | 2011 |
|---|---|---|
| Agriculture, forestry, and fishery | 10.9% | 12.3% |
| Industry | 11.3% | 11.4% |
| Electricity, gas, and water supply | 2.2% | 2.2% |
| Construction | 3.5% | 3.3% |
| Trade, hotels and restaurants | 15.2% | 14.7% |
| Transportation, communications | 10.8% | 10.9% |
| Public administration, education, health and social work | 14.6% | 14.0% |
| Other | 14.9% | 14.3% |
| Net taxes on products | 16.5% | 17.0% |
| **TOTAL** | **100%** | **100%** |

*Source: NBS*

# ANNEX 2: FINANCIAL SECTOR INDICATORS

**Banking sector indicators**

| Indicator | 2012 | 2011 | 2010 | 2009 | 2008 |
|---|---|---|---|---|---|
| **STRUCTURE OF THE BANKING SECTOR** | | | | | |
| Number of licensed banks | 14 | 15 | 15 | 15 | 16 |
| Number of state-owned banks | 1 | 1 | 1 | 1 | 1 |
| Assets of SOBs to total bank assets | 11.4% | 12.2% | 12.5% | 12.8% | 9.1% |
| 5-bank concentration ratio | 70.3% | 70.1% | 69.3% | 67.9% | 63.3% |
| Bank branches per 100,000 pop. | 35.5 | 35.1 | 32.6 | 32.2 | 32.6 |
| **FINANCIAL INDICATORS (EUR million)** | | | | | |
| Total assets | 3,644.8 | 3,165.0 | 2,624.7 | 2,265.9 | 2,650.3 |
| Total gross loans | 2,271.8 | 1,977.8 | 1,583.3 | 1,272.5 | 1,680.5 |
| Total net loans | 2,128.8 | 1,840.8 | 1,447.9 | 1,148.7 | 1,595.9 |
| Total deposits | 2,486.3 | 2,164.8 | 1,783.3 | 1,498.8 | 1,845.0 |
| Total equity | 640.5 | 537.0 | 450.7 | 392.9 | 473.6 |
| Total regulatory capital | 438.1 | 504.5 | 424.7 | 371.8 | 448.5 |
| Total net profit | 36.8 | 53.8 | 13.4 | -9.4 | 83.1 |
| **FINANCIAL RATIOS** | | | | | |
| *Capital adequacy:* | | | | | |
| Tier 1 CAR | n/a | n/a | n/a | n/a | n/a |
| Total CAR (≥16%) | 24.3% | 30.1% | 30.0% | 32.1% | 32.1% |
| Equity to total assets | 17.6% | 17.0% | 17.2% | 17.3% | 17.9% |
| *Liquidity:* | | | | | |
| Loans to deposits | 85.6% | 85.0% | 81.2% | 76.6% | 86.5% |
| Growth rate of deposits | 14.8% | 21.4% | 19.0% | -18.8% | 32.9% |
| Long-term liquidity ratio (≤1) | 0.7 | 0.7 | 0.7 | 0.6 | 0.6 |
| Liquid assets to total assets (≥20%) | 32.9% | 33.2% | 34.2% | 38.3% | 30.7% |
| *Profitability:* | | | | | |
| Return on average assets | 1.1% | 1.8% | 0.5% | -0.5% | 3.4% |
| Return on average equity | 5.6% | 10.6% | 2.6% | -2.5% | 19.1% |
| Net interest margin | 5.1% | 6.4% | 6.4% | 4.6% | 5.8% |
| Efficiency ratio | 112.6% | 178.9% | 150.0% | 148.4% | 186.9% |
| *Asset quality:* | | | | | |
| Growth rate of loan portfolio | 21.9% | 16.9% | 13.7% | -9.5% | 19.4% |
| NPL ratio | 14.5% | 10.7% | 13.3% | 16.4% | 5.9% |
| Others: | | | | | |
| Growth rate of total assets | 22.2% | 12.9% | 5.8% | 2.2% | 22.1% |
| Bank assets to fin. sector assets (%) | 95.0% | 94.1% | 94.2% | 93.6% | 90.1% |

*Source: NBM*

**Microfinance sector indicators**

| Indicator | 2012 | 2011 | 2010 | 2009 | 2008 |
|---|---|---|---|---|---|
| Number of MFOs† | 60/73 | 48/59 | 37/43 | 29/35 | 23/24 |
| MFO assets (EUR millions) | 60/73 | 48/59 | 37/43 | 29/35 | 23/24 |
| Number of SCAs† | 320/361 | 351/377 | 352/399 | 379/395 | 422/ |
| Number of members | 126,746 | 137,342 | 131,675 | 124,139 | 123,588 |
| SCA assets (EUR millions) | 20.9 | 19.9 | 17.6 | 21.0 | 40.1 |
| Number of active leasing companies | 25 | 20 | 23 | 24 | 27 |
| Share of top 5 companies in total assets leased | 67% | 72% | 73% | 60% | 67% |
| Total assets leased (EUR million), including | 51.0 | 55.5 | 33.2 | 23.4 | 84.6 |

*Notes:* † *Number of institutions that reported to the NCFM / number of registered institutions*
*Source:* *NCFM, NBS*

# ANNEX 3: PRUDENTIAL RATIOS FOR BANKS

| Ratio | Definition | Criteria |
|---|---|---|
| Capital adequacy | Total regulatory capital / Total risk-weighted assets | ≥ 16% |
| Long-term liquidity | Assets with a maturity of more than 2 years / Financial resources with a maturity of more than 2 years | ≤ 1 |
| Current liquidity | Liquid assets (cash, deposits with the NBM, liquid securities, and net interbank credits with maturity of up to one month) / Total assets | ≥ 20% |
| Allowance for losses (assets and conditional commitments) | Standard<br>Supervised<br>Substandard<br>Doubtful (uncertain)<br>Compromised (losses) | 2%<br>5%<br>30%<br>60%<br>100% |
| Credit concentration | Ten largest net loans / Total net loan portfolio | ≤ 30% |
| Single exposure | Net exposure to a single borrower / Total regulatory capital (TRC)[37] | ≤ 15% |
| Total large exposure | Total large exposure / TRC | ≤ 5x |
| Exposure to an affiliated person | Net exposure to an affiliated person / TRC | ≤ 10% |
| Total exposure to affiliated persons | Net exposure to all affiliated persons / TRC | ≤ 20% |
| Exposure to employees | Net exposure to employees / TRC | ≤ 10% |
| Exposures to individuals, linked to foreign currency rate | Net exposure to individuals, linked to foreign currency rate / TRC | ≤ 30% |
| Exposures to individuals, linked to foreign currency rate (other than mortgage) | Net exposure to individuals, linked to foreign currency rate (other than mortgage) / TRC | ≤ 10% |
| Open position in a single foreign currency | Net position in a single foreign currency / TRC | within ± 10% |
| Open position in all foreign currencies | Net position in all foreign currencies / TRC | within ± 20% |
| Investments in tangible assets | Total long-term investments in tangible assets / TRC | ≤ 50% |
| Investments in tangible assets and equity of other businesses | Total long-term investments in tangible assets and equity investments / TRC | ≤ 100% |

[37] Total Tier I capital and Tier II capital minus participation shares in other banks' capital.

# ANNEX 4: KEY BANKING REGULATIONS

| Category | Brief description |
|---|---|
| Financial reporting standards | As of 1 January 2012, the following financial reporting standards are set for Moldova's banks:<br>• bookkeeping and financial reporting based on IAS and IFRS;<br>• records according to the Chart of Accounts, approved by the NBM, taking into account IFRS;<br>• reporting to the NBM according to the FINREP reporting framework (individual and consolidated level, 27 FIN);<br>• submission of the prudential reports to the NBM. |
| Corporate governance standards | According to the Law on Financial Institutions, banks are established as joint stock companies under the Law on Joint Stock Companies. Each bank is managed by the general shareholder meeting, Board of Directors, Executive Board and Audit Committee. The general shareholder meeting approves the bank's corporate governance code.<br><br>The Board of Directors is the administrative authority of the bank that carries out supervision functions and establishes and ensures the bank policy operation. Attributions of the Board of Directors are specified in the charter and internal regulations of the bank.<br><br>The Audit Committee:<br>• establishes appropriate accounting procedures and accounting controls for the bank, according to the NBM regulations, supervises compliance with such procedures, and audits the bank's accounts and records;<br>• monitors compliance with the laws and regulations applicable to the bank and reports to the Board of Directors thereon;<br>• advises on any matters submitted to it by the Board of Directors or that it wishes to address.<br><br>According to the Regulation on Internal Control Systems within Banks, the banks develop internal control procedures as follows:<br>• organizational and administrative controls;<br>• methods of governance;<br>• segregation of functions and obligations;<br>• procedures related to the authorization and approval activities;<br>• bookkeeping procedures;<br>• security procedures;<br>• verification procedures;<br>• evaluation procedures;<br>• procedures on risk management and control;<br>• procedures for ensuring the continuity of bank's operations. |
| Ownership restrictions | The Law on Financial Institutions (art.15 - 158) establishes criteria for evaluation of the banks' shareholders and envisages rules of sanctioning. Article 15 establishes restrictions on participation in the |

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| | banks' capital. The same article envisages the modalities of acquiring of a significant share in a bank's capital or of a capital increase reaching or exceeding the limits of 20%, 33% or 50%, as well as the procedure of requesting and obtaining a prior permission from NBM. |
| Capital adequacy standards | As of 30 June 2012, banks have to maintain the risk weighted capital adequacy ratio at a level of at least 16 %. Banks of the Republic of Moldova comply only with the Basel I provisions; and all the NBM regulations are in line with the provisions of Basel I. Currently, a Twinning project is drafted aimed at strengthening the NBM's capacity in the field of banking regulation and supervision in the context of Basel II Accord. |
| Minimum capital requirements | As of 31 December 2012, the minimum required capital for banks is MDL 200 million. |
| Interest rate caps or floors | Regulation on Managing Interest Rate Risk establishes requirements on bank's policies in the context of interest rate, including the necessity to create a committee on assets and liabilities management.<br><br>Standing facilities (overnight deposit facility and overnight credit facility) are offered by the NBM to banks for the purpose of absorbing and providing short-term liquidity (with overnight maturity) and narrowing the short-term interest rates fluctuations on the interbank monetary market through the corridor set by the NBM on interest rates related to deposit and credit facility. The licensed banks may resort, upon their own initiative, to standing facilities offered by the NBM. In the context of a high liquidity in the banking system over the last years, the banks have not resorted to overnight credit facility; they used only overnight deposit facility.<br><br>Deposit facility allows banks to place an overnight deposit with the NBM (with overnight maturity), at a pre-established interest rate (deposit facility rate usually represents a floor of overnight interest rate on the interbank monetary market). Credit facility allows banks to get an overnight credit with the NBM (with overnight maturity), for the purpose of covering the overdraft at the end of the operational day, as well as for filling the liquidity gap, guaranteed with securities pledged with the NBM, at a pre-established interest rate (this interest rate usually represents a ceiling of overnight interest rate on the interbank monetary market).<br><br>Interest rates on the NBM standing facilities are established in a symmetrical corridor, the deviations from the monetary policy rate constituting 3.0 percentage points. The current annual interest rates on the deposit and credit facility are 0.5% and 6.5%, respectively. |
| Definition of NPL | Assets and conditional commitments classified as substandard, doubtful and compromised are considered non-performing. The main quantitative criterion is loans 91+ days overdue. A number of other criteria are also applied. |

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| Loan write-off policy | Taking into account that banks have started reporting in accordance with IAS and the fact that risk assessment for impairment is performed in accordance with IAS 39, there is no prudential requirement for writing off compromised loans. Such a requirement was used before the banking system had switched to IFRS (i.e. until 31 December 2011). Simultaneously, in addition to accounting assessment of credit risk (impairment test), banks are required under the Regulation on assets and contingent liabilities to set up loan loss provisions for prudential purposes, which influences the total regulatory capital. The difference between accounting impairment and calculated prudential provisions for losses diminishes the tier I capital of the bank. |
| Loan classification and provisioning policy | Assets are classified both in terms of IFRS (under IAS 37) and according to prudential regulation on assets and contingent liabilities. The reductions for impairment losses are reflected in the accounting records according to IFRS. Losses on assets measured according to prudential regulations are reflected as off balance-sheet items (memorandum accounts). The difference between the amount of reductions on assets and contingent liabilities calculated according to prudential requirements and the balance sheet value of impairment losses will be created from retained earnings of the bank at the end of the year as general provisions to cover banking risks, reducing its Tier I capital. |
| Deposit insurance | According to the Law on the guarantee of the individuals' deposits in the banking system, the Deposit Guarantee Fund guarantees the deposits in national and foreign currency hold by resident and non-resident individuals in licensed banks. The deposit guarantee limit of a licensed bank is MDL 6,000 (about EUR 350), regardless the number and value of the deposits or currency in which they were established. All banks are obliged to contribute quarterly (0.25% of guaranteed deposits) to the formation of the Deposit Guarantee Fund.<br><br>All the banks that hold an NBM license have their deposits guaranteed. |
| Reserve requirements | Pursuant to Art.17 of the Law on the National Bank of Moldova no.548-XIII of July 21, 1995, the NBM shall establish requirements to banks for the maintenance of required reserves. Required reserves represent banks' funds in MDL and freely convertible currency (USD and EUR), held on accounts opened with the NBM. The main functions of required reserves held in MDL are the monetary control (in close correlation with liquidity management by the NBM) and the influence of demand for money. The main role of required reserves in freely convertible currency is to mitigate the expansion of foreign exchange loans.<br><br>The main characteristics of the required reserve regime are:<br>• The calculation base of required reserves is established as the average daily balances (during the tracking period) of class II „Liabilities" of banks' balance sheets (except interbank liabilities |

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| | and equity, liabilities to the NBM and own capital), separately in MDL and freely convertible currency.<br>• The tracking period of funds attracted and the maintenance period of required reserves are of one month and consecutive (the tracking period of attracted means is from the 8th of the previous month to the 7th of the current month and the maintenance period of the required reserves starts with the 8th of the current month and ends on the 7th of the next month).<br>• The required reserve ratio of the calculation base (attracted funds) is the same for the liability items of the same type and do not differ in terms of currency. A required reserve ratio of 0% shall apply to the liability items included in the calculation base with a maturity over 2 years.<br>• The required reserves held in MDL are maintained with the NBM on bank's Loro account and represents the average daily balances held with the NBM during the maintenance period or on the account of required reserves in national currency in the value set by the NBM for the respective tracking period.<br>• The required reserves held in freely convertible currency are maintained with the NBM on bank's Loro account and represents the average daily balances held with the NBM during the maintenance period or on the account of required reserves in freely convertible currency in the value set by the NBM for the respective tracking period.<br>• The NBM shall pay banks an interest rate on the portion of required reserves balances that exceeds 5% of liabilities, which is calculated based on these required reserves. Required reserves in MDL and in foreign currency are remunerated at distinct rates, applying the overnight deposit rate of interest rate corridor of the NBM for required reserves maintained in MDL, and for required reserves maintained in foreign currency – the average rate on interest-bearing sight deposits attracted by the banking system in FCC in the respective month.<br><br>The currently required reserve ratio is 14.0%. |
| Foreign currency operations | The Law on Foreign Exchanges Regulation (no.62-XVI as of 21 March 2008) establishes the general principles of foreign exchange regulation in the Republic of Moldova, the rights and the obligations of residents and non-residents related to the foreign exchange operations, as well as the powers of the authorities of foreign exchange control and the competence of agents of foreign exchange control. Under the Law, there are no restrictions on payments and transfers on current foreign exchange operations. The Law applies to all residents and there are no special provisions in the Law for SMEs.<br><br>Residents, including SME and banks, have the right to obtain loans and guarantees from abroad, some types of such loans being subject to notification of the NBM for statistical purposes. Furthermore, residents are free to perform direct investments abroad or to receive foreign direct investments. Regarding other capital transactions that imply |

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| | capital outflow, the NBM approval is required for some of them (for example, for granting financial loans /credits /guarantees, operations with foreign financial instruments, opening of accounts abroad etc.), a range of exceptions being provided especially for resident banks.<br><br>Residents, including SME, may obtain loans from the local banks in foreign currency for certain purposes, the range of which is wide enough, especially in order to ensure external payments /transfers of residents. Thus, the licensed banks are entitled to grant foreign currency credits to residents for the purpose of payments and transfers with non-residents, repayment of other credits received from licensed banks for the purpose of payments and transfers with non-residents, for purposes provided for in credit agreements, concluded between the GoM and non-residents, between licensed banks and international financial organizations; to resident legal entities performing the export of goods (including lease items) and services against financial means in foreign currency, to legal entities performing insurance, leasing, microfinance activity, as well as to licensed banks for the purpose of carrying out the financial activities thereof.<br><br>There are no restrictions for residents to perform with licensed banks foreign currency purchase and sale operations against the national currency or another foreign currency. The exchange rates applied for such operations are freely established by banks based on FX demand and supply.<br><br>In order to diminish FX risk of Moldovan banks, the NBM regulation establishes some limits on banks foreign currency position. Thus, foreign currency balance-sheet assets may not exceed 125% or be less than 75% of foreign currency balance-sheet liabilities. The open foreign exchange position limit for each currency shall not exceed ±10% of the regulatory capital. The open foreign exchange position limit for all currencies shall not exceed ±20% of regulatory capital. |
| Related party transactions | According to the Regulation on bank transactions with its affiliated persons, a transaction with affiliated parties represents any fund transfer or contractual obligations between the affiliated party and the bank, whether a payment was envisaged or not. The respective transactions with affiliated persons shall reflect the bank’s interests and shall not be carried out in more advantageous conditions than with non-affiliated persons (except the bank employees that are not affiliated to the bank) and approved by the bank’s Council. Affiliated persons have a responsibility to the bank to ensure that they do not put their personal interests above those of the bank.<br><br>The limit of the bank’s exposure to one of its affiliated person shall not exceed 10% of the bank's TRC. The total amount of bank exposure to affiliated persons and/or a group of inter-related persons of the bank shall not exceed 20% of the amount of the bank's TRC. |

# ANNEX 5: PRIVATE EQUITY FUNDS WITH ACTIVITY IN MOLDOVA

| Fund manager | Selected funds | Region | Investment strategy | Selected investments in Moldova |
|---|---|---|---|---|
| Horizon Capital | Western NIS Enterprise Fund (USD 150 mln) | Ukraine Moldova | small and medium-sized companies | EEGF; Glass Container Company; Glass Container Prim; ProCredit Moldova (exit 2007); Moldova Agroindbank (exit 2006); Vitanta (exit 2003) |
| | Emerging Europe Growth Fund (USD 132 mln) | Ukraine Belarus Moldova | mid-cap companies | FinComBank; Natur Bravo (exit 2009) |
| | Emerging Europe Growth Fund II (USD 370 mln) | | | Bostavan Wineries Group |
| NCH Capital | Since 1993, it launched 24 funds and already liquidated 13 funds (USD 3 bln) | CIS and Eastern Europe | listed equity, real estate, agri-business and private equity | Credit Rapid; Prime Capital; Express Leasing |
| | NCH Agribusiness Partners | Russia Ukraine Moldova Bulgaria | farmland and agribusiness-related activities | |
| Dragon Capital | Europe Virgin Fund (USD 57 mln) | Ukraine Belarus Moldova | medium-sized businesses | |
| Agribusiness Management Company | Agribusiness Partners International Fund (USD 100 mln) | CIS and Eastern Europe | agribusiness | FoodMaster Dairy Products Company (exit 2004) |
| Fribourg Capital | GreenLight Invest, Fribourg East Investments | Eastern Europe and CIS (Moldova and Romania - priority) | early and late stage of business in: oil & gas, mining , financial services & banking, various industrial projects, real estate development (focus on techno & industrial parks), and IT & e-Commerce | |

*Source: Fund managers' web-sites.*

# ANNEX 6: LIST OF TECHNOLOGICAL PARKS AND INCUBATORS

| Techno-park | Specialization | Number of residents |
|---|---|---|
| Academica | Universal | 27 |
| Inagro | Intensive and ecological agriculture | 8 |
| Micronanoteh | Microelectronics and nanotechnologies | n/a |
| **Innovation Incubator (place)** | **Specialization** | **Number of residents** |
| Innovator (Chişinău) | Universal | 4 |
| Politehnica (Chişinău) | Engineering, industrial and information technologies | currently selecting |
| Universcience (Chişinău) | Capitalization of intellectual, innovation and education capacities | currently selecting |
| **Business Incubator (place)** | **Specialization** | **Number of residents** |
| ELIRI-INC (Chişinău) | Universal | n/a |
| ASEM (Chişinău) | Universal | n/a |
| Casa Antreprenoria-tului (Ungheni) | Universal | n/a |
| Impuls (Bălţi) | Universal | n/a |
| Soroca (Soroca) | Universal | 17 |

Source: *Agency for Innovation and Technology Transfer, ODIMM*

# ANNEX 7: PROSPECTS OF THE LARGE ENTERPRISE SECTOR

In 2012, out of 50,681 registered enterprises in Moldova, 1237 (or 2.4%) were classified as large. The number of large enterprises has been significantly increasing over the last years (2005: 697). The increase took place in all but one economic sector. The number of agricultural large enterprises more than halved from 2005 to 2012, from 132 to 61 entities (over the same period of time, share of agriculture in annual turnover of large enterprises has also dropped, from 3.5% to 1.7%). Similar to the MSME sector, many large companies (458, or 37.0%) carry out their activities in the field of trade. Other important economic sectors include processing industry (212, or 17.1%), half of which is presented by food and beverages sector, and real estate transactions (169, or 13.7%).

According to the NBM, business loans accounted for 83.5% of the total bank loan portfolio. It is estimated that the aggregate business portfolio is evenly split between large enterprises and MSMEs. The breakdown, however, varies significantly across individual banks. For example, large enterprises represent only a fraction of ProCredit Bank's loan portfolio and more than 75% at Moldova Agroindbank.

Large enterprises are normally loyal to their financial institutions. Among large clients, borrowers with credit history of more than five years and less than one year at a financial institution account for an estimated 70% and 5%, respectively. Besides funding, large enterprises extensively use other bank services, such as current accounts, salary projects, and foreign exchange. The large corporate segment remains thus attractive and financial institutions try to keep their large corporate customers by offering various special deals.

There are several funding programs available for large enterprises, including the EBRD Sustainable Energy Efficiency Facility (MoSEFF), EIB programme for wine sector restructuring, and US Millennium Challenge project for supporting agriculture. The EBRD and IFC provide trade finance (letters of credit and bank guarantees) to support Moldovan exporters.

# ANNEX 8: DETAILS ON GUARANTEE FUNDS

**State Guarantee Fund for SME Loans**

As of 1 October 2013, the state guarantee fund had a size of MDL 36,751,000, or EUR 2.1 million. Only micro and small enterprises (i.e. # employees < 50, turnover < MDL 25 million, total assets < MDL 25 million) are eligible. In the first nine months of 2013, the fund has issued 59 guarantees (2012: 37; 2011: 14) for a total loan amount of MDL 27. 4 million, or EUR 1.7 million (2012: MDL 13.8 million, or EUR 0.9 million; 2011: MDL 10.7 million, or EUR 0.7 million). Contracts are signed with eight commercial banks (FinComBank, Moldova-Agroindbank, Moldinconbank, Victoriabank, Banca de Economii, BCR Chisinau, Unibank, ProCredit Bank), but only three (the first three in the list above) use their guarantees. Negotiations are being held with three more institutions (MicroInvest, Rural Finance Corporation, and Comertbank).

The fund offers guarantees for five groups of clients: start-ups, established MSEs, exporters, young entrepreneurs, and working migrants. Guarantee terms a slightly different, as shown in the table below.

**Table 3. Guarantee products of the State Guarantee Fund for SME loans**

| Beneficiary | Maximum coverage | Maximum guarantee amount | Maximum guarantee term | Commission* |
|---|---|---|---|---|
| Start-ups | 70% | MDL 0.5 million | 5 years | 1.5% |
| Established MSEs | 50% | MDL 1 million | 5 years | 2.0% |
| Exporters | 50% | MDL 2 million | 5 years | 1.5% |
| Yong entrepreneurs | 50% | MDL 150,000 | 5 years | 1.5% |
| Working migrants | 50% | MDL 200,000 | 5 years | 1.5% |

*Note:* * *The commission is based on the guarantee amount and is shown for the first year. For each subsequent year, commission goes down by 0.5 percentage points until it reaches the minimum amount of 0.5% in year 3 or 4 depending on the beneficiary type.*

*Source:* www.fgc.odimm.md

According to the fund representative, high requirements of the banks towards MSEs (including but not limited to strict collateral requirements) are the main constraint to MSME finance development and, respectively, to the fund's growth.

**Inter-bank Guarantee Society GARANTINVEST**

The fund was established in 2005 by seven banks (Victoriabank, Moldova-Agroindbank, Banca Sociala, Banca de Economii, Eximbank, Energbank, Mobiasbanca) and one MFO (Rural Finance Corporation), as well as an NGO. Over the last three years, the portfolio of active guarantees has been about MDL 18 million, or EUR 1.1 million. The fund primarily targets SMEs, especially ones in rural areas. Many guarantees are issued for the loans disbursed from the financial resources of the programs financed by the international development organizations.

**Table 4. Guarantees issued by GARANTINVEST**

| Year | No. of guarantees | Total amount of the guarantees issued (MDL) | Total amount of the loans guaranteed (MDL) | Average guarantee coverage (%) | Average guarantee amount (MDL) |
|---|---|---|---|---|---|
| 2005 | 4 | 84,088 | 208,176 | 40 | 21,022 |
| 2006 | 16 | 777,000 | 2,122,000 | 36 | 48,562 |
| 2007 | 13 | 2,967,500 | 8,671,082 | 34 | 228,270 |

| | | | | | |
|---|---|---|---|---|---|
| 2008 | 18 | 4,630,501 | 9,692,002 | 48 | 257,250 |
| 2009 | 27 | 5,526,377 | 14,031,522 | 40 | 204,680 |
| 2010 | 38 | 9,616,410 | 23,092,681 | 40 | 241,090 |
| 2011 | 54 | 14,922,500 | 41,842,565 | 36 | 276,343 |
| 2012 | 42 | 10,503,288 | 29,247,726 | 36 | 250,078 |
| 2013 (H1) | 24 | 4,742,100 | 14,421,700 | 33 | 197,588 |
| **Total** | **236** | **53,769,764** | **143,329,453** | | |

*Source:* *GARANTINVEST*

**Table 5. Guarantee products of GARANTINVEST**

| Beneficiary | Maximum coverage | Minimum and maximum guarantee amount | Maximum guarantee term | Commission* |
|---|---|---|---|---|
| Eligible SMEs | 50% | MDL 5,000<br>MDL 1.1 million | 5 years | 2.5% |

*Note:* * *The commission is based on the outstanding guarantee amount. In case of full prepayment, the commission is 2.0% for long-term loans.*

*Source:* www.garantinvest.md

According to the fund representative, the main barrier to fund growth is insufficient capitalization of the fund.

**Reaction of banks**

In general, banks agree that guarantee schemes help SMEs to get funding. Eligibility criteria are not too strict and costs are bearable. However, due to difficulties that banks encounter in case of guarantee payment, they try to avoid this instrument.

European
Investment
Bank


## Contacts

**Economics Department**
(+352) 43 79 - 86147
(+352) 43 79 - 67799

**European Investment Bank**
98-100, boulevard Konrad Adenauer
L-2950 Luxembourg
(+352) 43 79 - 1
(+352) 43 77 04
www.eib.org