



DRAFT PEER REVIEW NOTE

# Monitoring SME policy reforms in the Republic of Moldova

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## FOREWORD

Small and medium-sized enterprises (SMEs) are an essential driver of economic growth and job creation in the Republic of Moldova. In recent years, growth of the SME sector has been hampered by the recession in Russia and reverberations from a banking scandal uncovered in late 2014, which saw the disappearance of approximately USD 1.2 billion (about 15% of GDP) and subsequent collapse of the economy's three largest banks. Ensuring a successful and sustained economic recovery will depend largely on the government's ability to implement the necessary reforms to support the growth of SMEs and take full advantage of opportunities offered by the EU Association Agreement and Deep and Comprehensive Free Trade Area (DCFTA).

Since 2010, the OECD has assisted the government of Moldova in designing a favourable policy environment for SMEs. Within the framework of the project Supporting SME Policy in the Republic of Moldova, the OECD published a report, *Republic of Moldova 2011: Fostering SME Development* (OECD, 2011). This formed the basis for the national SME Sector Development Strategy 2012-2020 – a comprehensive policy document which bears witness to the determination of the Moldovan government to support the development of SMEs.

Based on this initial report, the OECD published two additional studies on enhancing access to finance for SMEs (OECD, 2014a) and fostering business development services (OECD, 2014b), providing detailed recommendations and a targeted policy roadmap to guide reform implementation. These reports were peer-reviewed by expert practitioners from Germany, the Netherlands and Turkey at the OECD Eurasia Competitiveness Roundtable on 4 December 2013 in Paris. The Roundtable is a policy network that provides OECD members and countries from the Eurasia region with a platform to exchange knowledge and good practices, develop policy guidelines and recommendations, and monitor progress in the implementation of reforms.

Following on from the peer review in December 2013, Moldova was invited to undertake a monitoring review to measure progress in implementing the initial recommendations on access to finance and business development services. This report summarises the results of the monitoring assessment, and was developed within the framework of the project Supporting SME Competitiveness Reforms in the Eastern Partner Countries. It builds on the two initial studies published in 2014, as well as the results of the *SME Policy Index: Eastern Partner Countries 2016 – Assessing the Implementation of the Small Business Act for Europe*. This report was developed based on research and extensive consultations with government officials, international organisations, business associations and relevant private sector stakeholders, conducted during fact-finding missions to Chisinau in May 2015 and April 2016. The report will be peer-reviewed by expert practitioners from France and the United Kingdom at the OECD Eurasia Competitiveness Roundtable on 23 November 2016 in Paris.

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## ACRONYMS AND ABBREVIATIONS

ACSA	National Agency for Rural Development
BEEPS	Business Environment and Enterprise Performance Survey
BDS	Business development services
CEP	Competitiveness Enhancement Project
CGF	Credit Guarantee Fund
CHB	Credit History Bureau
DCFTA	Deep and Comprehensive Free Trade Agreement
EBRD	European Bank for Reconstruction and Development
EU	European Union
FDI	Foreign direct investment
GEA	Efficient Business Management Programme
GDP	Gross domestic product
IFI	International financial institution
LPA	Local public authority
MFI	Microfinance institution
MDL	Moldovan leu
NBM	National Bank of Moldova
NCFM	National Commission for Financial Markets
NGO	Non-governmental organisation
ODIMM	Moldovan Organisation for SME Sector Development
OECD	Organisation for Economic Co-operation and Development
PARE	Programme to Attract Remittances to the Economy
PNAET	National Program for Youth Empowerment
R&D	Research and development
SCA	Savings and credit association
SME	Small and medium-sized enterprise
USD	United States dollars



## KEY INDICATORS: MOLDOVA

<b>Country profile</b>	
Population, 2015	3.55 million
Surface area, 2015	33 850 km <sup>2</sup>
GDP (USD, current prices), 2015	6.55 billion
GDP per capita, (USD, current prices), 2015	1 843
Real GDP growth (y-o-y change), 2015	-0.5%
Inflation (average consumer prices, y-o-y change), 2015	9.7%
Exports of goods and services (% of GDP), 2015	43.4%
Imports of goods and services (% of GDP), 2015	73.7%
FDI, net inflows (% of GDP), 2015	4.1%
General government net lending/borrowing (% of GDP), 2015	-2.26%
Unemployment (% of total labour force), 2015	4.9%
Personal remittances, received (% of GDP), 2015	23.4%
Personal remittances (y-o-y change), 2015	-26.7%
<b>SME statistics</b>	
SME share in enterprise population (% of total enterprises), 2015	97.2%
SME share in employment (% of the total number of employees of enterprises), 2015	55.1%
SME share in turnover (% of revenues from total sales in the economy), 2015	30.8%

Source: Adapted from World Bank (2016a), *World Development Indicators* (database), <http://data.worldbank.org/products/wdi>; IMF (2016a), *World Economic Outlook* (database), [www.imf.org/en/data](http://www.imf.org/en/data); National Bureau of Statistics of the Republic of Moldova (2016), "Indicatori vizînd activitatea întreprinderilor mici și mijlocii în anul 2015" (Indicators on the activity of small and medium enterprises in 2015), [www.statistica.md/public/files/serii\\_de\\_timp/antreprenoriat/IMM\\_2015.xls](http://www.statistica.md/public/files/serii_de_timp/antreprenoriat/IMM_2015.xls).

## EXECUTIVE SUMMARY

In 2013, the OECD conducted a peer review of the Republic of Moldova focusing on two areas of essential importance for small and medium-sized enterprises (SMEs): access to finance and business development services. Since then, Moldova has been hit hard by the recession in Russia and a banking scandal in late 2014 that saw the disappearance of USD 1.2 billion (about 15% of GDP) and the collapse of the country's three largest banks. Nevertheless, Moldova has made progress with respect to both issues.

### *Access to finance*

The banking crisis has exposed an urgent need for reforms to improve corporate governance and transparency in the financial sector. In addition, three priorities emerged from the monitoring assessment:















- **Better legal and regulatory frameworks.** Moldova has adopted new laws on the disclosure of lending conditions and the provision of collateral. New legislation regulating microfinance institutions and leasing entities is being prepared, and there has been progress in expanding credit bureau coverage. It would also be helpful to allow for new types of collateral and to extend the requirement for disclosure of lending conditions to non-bank financial institutions.
- **Diversification of sources and types of external finance.** Financial sector turmoil has made it difficult to develop SME-specific financial products, encourage longer grace periods, improve credit risk management or promote the use of credit guarantees. More funding and improved risk management practices would help to increase SME participation in the Credit Guarantee Fund.
- **Improvement of the investment readiness and financial literacy of SMEs.** New training programmes have been designed and are now being implemented. However, most initiatives are fragmented and rely heavily on donor funding. A more structured and comprehensive approach to such programmes could strengthen the programmes and ensure their sustainability.

### *Business development services*

Good progress has been registered in three out of six guidelines from the 2013 assessment of business development services (BDS). Moving forward, the government should focus on three key priorities:

- **Strengthened role of NGOs and business associations.** Further attention could be given to helping established NGOs and business associations to deliver a broader range of services, such as advice on quality infrastructure and certification, export promotion, lobbying and advocacy.
- **A sound regulatory framework for consulting services.** Introducing consulting as a listed profession, developing an internationally recognised certification process and an association of consultants, would help to improve quality and increase confidence in the market for BDS.
- **Development of complex and higher value-added services.** Services such as quality certification and export promotion could be expanded through the use of co-financing initiatives targeted to specific segments of the SME population (e.g. high growth SMEs).

## SUMMARY OF MONITORING ASSESSMENT

Policy area	Overall 2013 recommendation	Detailed 2013 recommendations	2016 monitoring assessment		
			Progress status	The way forward	
<b>Access to finance for SMEs</b>	Improvements to the regulatory framework, availability of financial resources and enhanced SME capacities can address gaps in the financial system for SMEs	1. Enhance the legal and regulatory framework for the financial infrastructure		Approve and implement draft laws on non-bank financial institutions, credit history bureaus, consumer protection and collateral.	
		2. Diversify the sources and types of external finance available		Encourage credit products specifically for SMEs and extended grace periods. Strengthen the public credit guarantee scheme.	
		3. Improve the investment readiness and financial literacy of SMEs		Develop programmes to strengthen SMEs' business planning and financial management capacities. Mobilise co-financing from beneficiaries.	
<b>Business development services</b>	Business development services can help to strengthen entrepreneurial skills and improve the performance and competitiveness of SMEs	1. Strengthen policy co-ordination at national and sub-national level		Establish a dedicated co-ordination forum for BDS policies. Further promote the online database of BDS providers.	
		2. Fill in the gaps in rural provision		Strengthen ODIMM's outreach to rural areas. Provide additional funding for agricultural extension services.	
		3. Build capacity among NGOs and business associations		Undertake a more comprehensive evaluation to strengthen the capacity and sustainability of NGOs and business associations.	
		4. Deepen the emerging BDS market		Develop new co-financing programmes, building on existing initiatives, targeting complex and higher value-added BDS. Introduce consulting as a listed profession.	
		5. Improve quality and increase confidence in BDS provision		Introduce an internationally recognised quality and certification system for BDS providers. Support the development of an association of consultants to further professionalise the consultancy market.	
		6. Address the gaps in the BDS market		Develop additional interventions such as voucher initiatives, co-financing schemes and technical assistance to support complex BDS such as quality certification and export promotion.	
<b>Legend</b>	 Completed	 Close to completion	 Currently being implemented	 Initiated	 Not started

## INTRODUCTION

1. The Republic of Moldova is a landlocked country with limited access to natural resources besides arable land. The economy, which has experienced overall growth since 2000 despite considerable volatility, is primarily driven by trade in agricultural products and basic manufacturing. Rising domestic consumption is largely financed by the flow of remittances, which constituted approximately 23% of gross domestic product (GDP) in 2015.

2. The Moldovan economy was strongly impacted by the global financial crisis in 2009, which caused a significant decline in foreign direct investment (FDI) inflows, trade and remittances. Despite making a quick recovery, the economy contracted again in 2012 due to weak internal demand and a deterioration in agricultural output brought on by unfavourable weather conditions. Since 2013, Moldova has suffered from sluggish growth in the EU and Russia, a sharp decline in remittances, and trade bans imposed by Russia on Moldovan exports of agricultural products. The government signed an Association Agreement with the EU in June 2014, creating opportunities for stronger trade and investment ties under the Deep and Comprehensive Free Trade Area (DCFTA). However, these developments were overshadowed by a large-scale fraud uncovered in late 2014, involving the disappearance of approximately USD 1.2 billion (about 15% of GDP) from the country's three largest banks. The banking scandal created a major economic and political crisis, highlighting significant shortcomings in the business environment and current institutional settings.

*Despite steady improvements, the business climate is still confronted with significant challenges*

3. Regulatory reforms have helped Moldova to steadily advance in the World Bank's Doing Business rankings, from 83rd out of 185 countries in 2013 to 52nd out of 189 countries in 2016. However, progress has been marred by the significant regulatory uncertainty and political upheaval brought on by the banking sector crisis. Despite the government's commitment to further reduce red tape, tackle corruption and stimulate competition, recent reforms have yet to translate into substantial improvements in the investment climate (US Department of State, 2015). The country performs well in registering property (21st position), starting a business (26th) and getting credit (28th). Areas in which there is room for improvement include dealing with construction permits (170th) and getting electricity (104th) (Doing Business, 2016).

4. Moldova still faces significant challenges when it comes to increasing competitiveness and attracting new investment. FDI inflows declined significantly during the global financial crisis, from 12% of GDP in 2008 to just 2.5% of GDP in 2009. FDI inflows have since remained stagnant, reaching 3.6% of GDP in 2013 and 4.1% of GDP in 2015. In terms of FDI per capita, Moldova performed below the average of USD 140 for the Eastern Partnership region in 2015, attracting just USD 76 of FDI inflows per capita compared with USD 165 in Belarus, USD 365 in Georgia, and USD 419 in Azerbaijan (World Bank, 2016a). The recently approved National Strategy for Investment and Export Promotion 2016-2020 recognises the need to accelerate foreign investment and diversify the structure of export activity.

5. The informal sector represents a substantial part of the economy, accounting for about 30% of total employment (EIB, 2013). Corruption is one of the main impediments to business development.

Moldova was ranked 103rd out of 163 countries in Transparency International’s 2015 Corruption Perceptions Index (Transparency International, 2016).<sup>1</sup> Similarly, the 2015-2016 Global Competitiveness Index (World Economic Forum, 2016) highlights corruption as the most problematic factor affecting business development, followed by policy instability, inefficient government bureaucracy, government instability, and access to finance. The Business Environment and Enterprise Performance Survey (BEEPS V) highlights the perception of corruption (23.6% of respondents) as the main barrier to doing business, followed by political instability (18.1%), an inadequately educated workforce (14.5%) and poor access to finance (10.3%). The Global Competitiveness Index highlights the following deterrents to business activity: poor state of road infrastructure (133rd place out of 140), low independence of judiciary (134th) and limited capacity of the country to attract talent (138th) and retain talent (137th) (World Economic Forum, 2016).

***The SME sector is dominated by micro-enterprises***

6. Small and medium-sized enterprises (SMEs) are the backbone of the Moldovan economy and have significantly contributed to job creation and economic prosperity over the last decade. With a total of 49 800 registered enterprises, SMEs represented approximately 97.2% of all enterprises in 2015, and micro-enterprises accounted for 74.5% of all enterprises (see Annex A, Figure 5). The number of SMEs has remained relatively stable over the past three years despite the country’s volatile economic growth. However, the total number of active SMEs in Moldova has been estimated at around 35 000, which suggests that one in three registered SMEs might be inactive (Economisti Associati, 2015).

7. SMEs are defined according to employment size, turnover and balance sheet criteria (Table 1). While the employment criteria are consistent with the EU definition, thresholds for turnover and assets are lower in Moldova and reflect Moldova’s lower per capita incomes. In 2015, SMEs employed more than half of the workforce (55.1%), which is higher than the average for the Eastern Partnership region (38% in 2013) but lower than the EU average (67% in 2014). The average number of employees for each SME category is concentrated at the bottom end of the employment criteria spectrum. Micro-enterprises employ two people on average, and represent an important share of the working population. Small enterprises have an average of 12 employees, while medium-sized enterprises, which represent 2.6% of all enterprises, employ 53 people on average.

**Table 1. Definition of micro, small and medium-sized enterprises in Moldova**

	<b>Micro</b>	<b>Small</b>	<b>Medium</b>
<b>Number of employees</b>	1-9 employees	10-49 employees	50-249 employees
<b>Average annual revenues</b>	< MDL 3 million (EUR 135 000)	< MDL 25 million (EUR 1.1 million)	< MDL 50 million (EUR 2.3 million)
<b>Average annual total assets</b>	< MDL 3 million (EUR 135 000)	< MDL 25 million (EUR 1.1 million)	< MDL 50 million (EUR 2.3 million)

Source: Republic of Moldova (2006), Law No. 206-VXI of 7 July 2006: On Supporting the SME Sector, Republic of Moldova. Note: Exchange rates for EUR amounts as of 1 September 2016.

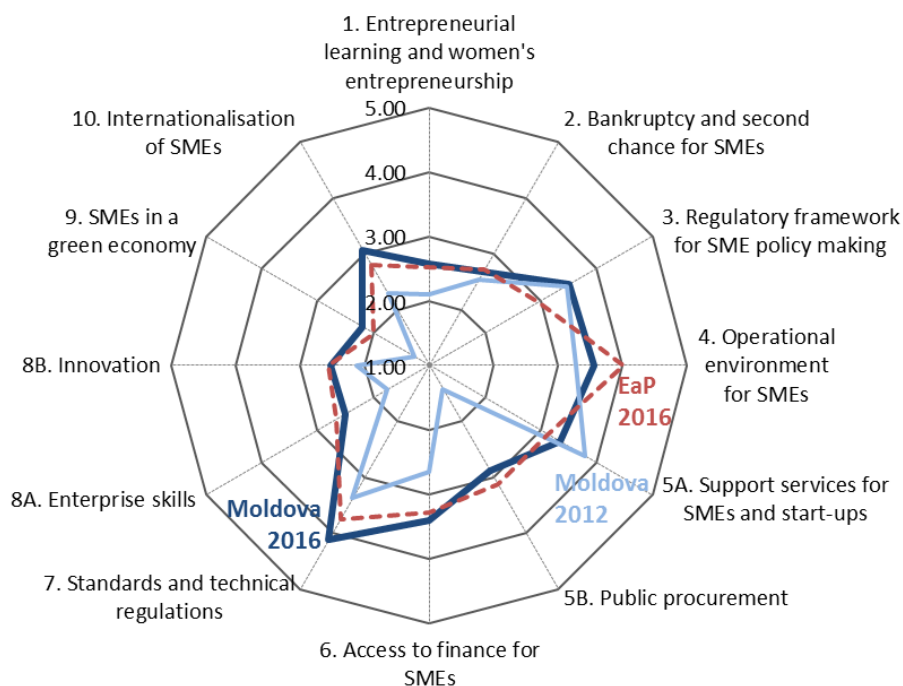
1. Assessments based on perceptions of corruption should not be confused with direct evidence of its extent, although perceptions alone can have an impact on investor sentiment. Perception indexes can be a misleading indicator of corruption levels (as, for example, when a single high-profile case has a big impact on outsiders’ perceptions), but only up to a point. The evidence suggests that countries with a reputation for corruption generally do have serious problems with it; see Olken (2009) for an overview of this literature; see also Mocan (2004).

8. Total turnover generated by SMEs in 2015 was 86.8 billion Moldovan leu (MDL; approximately EUR 4 billion), which amounts to 30.8% of the turnover of all companies operating in Moldova – a substantial decrease from the level of 39.2% observed in 2009. This negative trend was primarily driven by the poor performance of SMEs relative to the large enterprise sector. Between 2009 and 2015, SME revenues declined by 3.7% in real terms and total employment generated by SMEs fell by 11%. As a result, productivity (measured as sales revenue per employee) grew at just 8.2% in the SME sector, compared with 40.4% in the large enterprise sector (National Bureau of Statistics of the Republic of Moldova, 2016). The contribution of SMEs to value added in the Eastern Partnership region was just 28% of GDP in 2013, which is quite low when compared with the EU average (58% in 2014).

9. The wholesale and retail trade sector represents 39.8% of SMEs and constitutes the core of SME activity. Conversely, only 6.2% and 8.5% of firms were operating in the agricultural and manufacturing sectors in 2015 (see Annex A, Figure 6). SMEs are unequally distributed across the country, with about 64.9% operating in Chisinau, the capital, and 4.7% in Balti, the second largest city. Entrepreneurial activity is significantly more pronounced in Chisinau, with 42 SMEs per 1 000 inhabitants versus just 6.7 SMEs per 1 000 inhabitants outside of Chisinau (see Annex A, Figure 7). Efforts to foster the growth and development of the SME sector will necessarily require sustained improvements to the policy environment and a renewed focus on the implementation of SME policy reforms.

***SME policies need to be further supported by effective implementation***

**Figure 1. Small Business Act scores for Moldova and the Eastern Partnership region**



Source: OECD, European Union, EBRD and ETF (2015), *SME Policy Index: Eastern Partner Countries 2016: Assessing the Implementation of the Small Business Act for Europe*, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264246249-en>.

10. Moldova has made some progress in improving its SME policy environment over the past four years across most dimensions assessed in the 2016 SME Policy Index (OECD et al., 2015). For instance, Moldova registered a slight increase in its score for Dimension 3, largely due to improvements in the

institutional environment brought about by the introduction of the national SME Sector Development Strategy 2012-2020. Scores also increased in the areas of SME internationalisation and standards and technical regulations (Dimensions 10 and 7). The country has improved its scores in human capital (Dimensions 1 and 8a), mostly by prioritising these dimensions in its new SME strategy, implementing entrepreneurial learning curricula and teacher training programmes and adopting measures on women's entrepreneurship in the new strategy. Some improvement has also been registered in access to finance (Dimension 6), with Moldova completing significant work on its legal and regulatory framework. Access to banking and non-bank finance is still limited, while a slight deterioration in the score for business support services (Dimension 5a) underlines the need to step up implementation efforts. Policies on innovation and SME greening (Dimensions 8b and 9) continue to offer the most room for improvement.

11. The government continues to face a number of institutional challenges that limit its impact in delivering an improved SME policy framework. For instance, recent years have seen the proliferation of numerous formal strategies, action plans and other policy documents across a wide range of policy areas. However, reforms to the legal and regulatory framework are often not accompanied by adequate support for implementation and enforcement mechanisms. Moreover, the policies and strategies which have been designed are rarely subject to systematic monitoring and evaluation to track progress during the implementation period. Addressing these issues is even more important in the context of the EU Association Agreement and DCFTA. To reap the benefits of EU market access, effective implementation of policy reforms is required to foster the competitiveness of SMEs and to help them overcome the challenges they face in their business development.

#### ***Two areas have been identified as priority policy reforms for fostering SME development***

12. This report measures progress in the implementation of policy recommendations presented to the government of Moldova in 2013 on access to finance and business development services (BDS), and offers a policy roadmap to guide further implementation in these areas. These topics were the subject of two in-depth reviews conducted in 2013 (OECD, 2014a; OECD, 2014b).

13. SMEs need financial resources at each juncture of their business development, be it for start-up activities, further expansion or internationalisation. However, bank lending is relatively underdeveloped in Moldova compared to regional peers. Domestic credit to the private sector in Moldova only represented 35% of GDP in 2015, the second-lowest in the Eastern Partnership region after Belarus (29%) and substantially lower than the EU average of 98%. Deposits were about 45% of Moldova's gross domestic product (GDP) – higher than most peer countries in the Eastern Partnership region but far below the EU average, which stands at 80%. However, banks still constitute the main finance providers for SMEs, accounting for more than 90% of the total supply of credit and with alternative sources of funding remaining limited. Microfinance institutions (MFIs) and savings and credit associations (SCAs) are slowly emerging as potential alternative sources of SME financing, especially in rural areas, largely on account of the banks' high collateral requirements. Other sources of finance, such as leasing, are not yet fully developed in the country.

14. Reforms focusing on enhancing BDS complement policy measures to facilitate access to finance. Indeed, BDS include a comprehensive range of services such as training, consulting, marketing, information provision, technology development and transfer, and business linkage promotion. However, SMEs in Moldova do not always understand the potential benefits and are often unwilling to pay for BDS. According to a survey of 310 Moldovan SMEs conducted by the OECD in 2015, only 8% of firms were aware of government-funded BDS while 51% did not seek external advice or support because they felt that sufficient expertise was already available in-house. This suggests that poor information and weak marketing are constraining demand in the market for BDS, leading to increased search costs for SMEs and the perception that relevant services are not available on the market.

## CHAPTER 1. ACCESS TO FINANCE

15. The 2016 monitoring of access to finance policies in Moldova takes place in a challenging context. Structural weaknesses in the governance of the financial sector led to the disappearance of USD 1.2 billion (about 15% of Moldova's 2014 gross domestic product (GDP) in current USD) from the banking sector, triggering a major crisis in late 2014. The three banks implicated in the scandal – Banca de Economii, Unibank and Banca Sociala – whose assets represented around 30% of the country's banking sector, were liquidated in October 2015 after being placed under special administration of the National Bank of Moldova (NBM) for almost one year. The crisis was amplified by the ongoing recession in Russia, declining remittances, accelerating inflation and a sharp depreciation of the Moldovan leu (MDL) in early 2015. The NBM intervened with aggressive monetary tightening, a liquidity injection of USD 420 million, and requirements on banks to increase their reserves of MDL (EIB, 2016). The crisis exposed the need to strengthen regulatory and supervisory frameworks, improve the transparency of beneficial ownership, and address long-standing governance issues in the Moldovan banking sector (IMF, 2016b).

16. The banking crisis has had considerable adverse implications for bank lending to small and medium-sized enterprises (SMEs). The deterioration in lending conditions was mainly driven by higher interest rates on SME loans (the NBM increased the refinancing rate from 6.5% to a peak of 19.5% in August 2015), the unstable macroeconomic environment with high inflation and volatile exchange rates, and a substantial increase in regulatory and political uncertainty. As in 2013, SME financing in Moldova is dominated by banks, which provide around 90% of the supply of credit, followed by microfinance institutions. However, the banks' SME portfolio remains limited – lending to SMEs represented 26.4% of bank lending<sup>2</sup> in July 2016, a substantial decline from the estimated level of 41.7% in 2012 (EIB, 2013). The portfolio quality also deteriorated significantly, with the balance of non-performing loans rising from 11.6% in December 2013 to 15.9% in July 2016. Non-performing loans represented 17.1% of total lending to SMEs in July 2016, reflecting the higher level of credit risk associated with SME lending. Moreover, the crisis led to the suspension of many government and donor-funded financial support programmes in 2015. It has also had a detrimental impact on investor confidence, and limited the ability of banks to introduce new SME-tailored financial products.

17. SMEs in Moldova tend to face numerous financing constraints – banks typically demand guarantees as a result of unavailable or incomplete credit histories or an increased level of risk in the business activity performed. When granted, loans also tend to be small and have short maturities and grace periods, as well as high interest rates. Banks are mainly concentrated in urban centres, leaving rural SMEs with limited access to banking institutions. In general, banks are reluctant to take on the increased risks associated with lending to SMEs, as they perceive the SME market to be risky, costly and difficult to serve. This is compounded by the fact that SMEs tend to only possess low-value assets and have little access to real estate which could serve as collateral. SMEs also frequently lack the business skills required to obtain bank loans, failing to provide the right information on loan application forms and only having limited credit histories. Furthermore, the lack of a legal framework for enforcing quick recovery of defaulted loans continues to limit the volume of bank credit flowing to SMEs.

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2. For comparison, lending to SMEs represented 36.1% of business loans in Georgia in 2014 (OECD, 2016).



18. Alternative sources of finance are scarce and many SME support instruments continue to be heavily dependent on donor funding. A number of training courses have been developed to help improve the investment readiness and financial literacy of SMEs. However, current offerings remain fragmented and training courses tend to be added as an extra component to larger donor programmes rather than as stand-alone projects; this makes them highly dependent on donor funding.

### **Overview of 2013 recommendations**

19. The 2013 report evaluated access to finance for SMEs in Moldova and provided a targeted policy roadmap structured around three guidelines to improve access to finance for SMEs (OECD, 2014a).

#### ***Guideline 1: Enhance the legal and regulatory framework for the financial infrastructure***

20. The regulation of microfinance institutions and leasing entities should be improved. Credit bureau coverage could be expanded by incorporating information from non-bank financial institutions. Consumer protection for financial products should be enhanced, so that loan costs and conditions are transparent. New types of collateral should be introduced, such as secondary guarantees, accounts receivable and warehouse receipts.

#### ***Guideline 2: Diversify the sources and types of external finance available***

21. Policies should encourage banks to provide credit products tailored for SMEs, such as working capital loans, overdrafts, and domestic and overseas trade financing. Banks should promote their credit products and provide consultations so that SMEs are aware of the range of products available. Better training of bank staff would improve their relations with SMEs. Longer grace periods before borrowers have to start repaying a loan would remove a major impediment to many SMEs' access to credit. Banks should improve their credit risk management practices to reduce risks in expanding their SME loan portfolios. Public credit guarantee schemes should be promoted by extending co-operation with commercial banks and increasing the incentives for SMEs to participate.

#### ***Guideline 3: Improve the investment readiness and financial literacy of SMEs***

22. SMEs should be supported in their business planning and financial management and coached to develop sound business and investment plans as well as comprehensive financial reports. Better information on the financial products available would allow entrepreneurs to make more informed financial decisions and could help to build trust in financial institutions.

### **Findings of the 2016 monitoring assessment**

23. This section details progress in implementing the 2013 policy recommendations on improving access to finance for SMEs in Moldova. The assessment is structured around the three guidelines presented above.

#### ***Guideline 1: The legal and regulatory framework has improved but implementation remains an issue***

24. The government has acted on most of the 2013 recommendations on strengthening the legal and regulatory framework for financial infrastructure. Amendments to the legal framework for collateral were introduced in 2014 to favour the introduction and use of new types of collateral. A law requiring commercial banks to disclose their lending conditions was also passed in 2014 with the objective of improving consumer protection around financial products. Draft laws have been developed and submitted to the government on enhancing the regulation of microfinance institutions and leasing entities and on

expanding the coverage of credit bureaus. The National Bank of Moldova has adopted a number of measures since 2014 to improve consumer protection and increase transparency of bank services. However, effective implementation of the revised legislation still has to be achieved.

#### *Microfinance institutions and leasing entities*

**2013 recommendation:** Review the law on non-bank financial institutions and on leasing, to endorse changes to improve: 1) information and transparency requirements (e.g. ownership and price transparency); 2) capital requirements (e.g. secondary guarantees); 3) financial reporting (e.g. auditing requirements); and 4) standards for credit evaluation and risk management.

25. The National Commission for Financial Markets (NCFM) has been the main body responsible for initiating changes to the legal and regulatory framework that affect non-bank financial institutions. This body is responsible for the regulation of microfinance institutions (MFIs) along with securities markets, insurance markets and the activities of the credit history bureau. In February 2016 the NCFM submitted a new law on non-bank credit organisations for approval to the government. As of October 2016, this law had not been approved by parliament. The draft was initially developed in 2012 and sent back for further revisions after submission to parliament.

26. The proposed changes to the law on non-bank credit organisations pertain to increased information and transparency requirements, the introduction of capital requirements, reporting standards and improvements to internal risk management policies. These amendments cover all of the issues raised in the 2013 assessment and are in line with OECD recommendations. More specifically, the draft law includes the introduction of a common regulatory framework for all non-bank credit activities, which would cover financial leasing and mortgage activities, with minimum levels of statutory capital requirements specific to each type of service provided. It also contains a clear set of procedures for registering with the NCFM in order to conduct non-bank credit activities. Furthermore, the draft law requires credit providers to have internal processes in place for evaluating solvency capacity, disclosing interest rates, calculating penalties and stipulating guarantee conditions, and that these should be formally reviewed and validated internally. In addition, the draft introduces best practices for supervision of the non-bank financial sector. These include the establishment of reporting requirements, mandatory provisioning standards, audit for entities with total assets exceeding MDL 35 million, and provisions for the prevention of money laundering. Additional amendments on loan loss provisioning, additional reporting and registration of MFIs are currently being prepared.

27. Finalising and approving this law would be an important step for regulating and standardising microfinance and leasing activities in the country, as well as for expanding sources of non-bank financing beyond micro financing. Careful attention should be given to consultations with the private sector to determine adequate conditions and ensure that more stringent supervision does not have a negative impact on further growth of the sector. Currently, microfinance is the main type of non-bank SME financing in Moldova. Although leasing and factoring are also available, they only provide limited funding to SMEs. Leasing tends to only cover vehicle leasing (rather than equipment), while factoring is almost non-existent and is not supported by a specific legal framework. The draft law mentioned previously is intended to replace the Law on Microfinance Organizations (No. 280-XV of 22.07.2004) and to amend the Law on Leasing (No. 59-XVI of 28.04.2005). After approval of the law, the government should ensure its effective implementation by enhancing the NCFM's operational mechanisms for oversight.

## *Credit bureaus*

**2013 recommendation:** Expand the coverage of credit bureaus by incorporating information from non-bank financial institutions (e.g. microfinance institutions (MFIs), savings and credit associations (SCAs), leasing companies) and telecommunication companies on enterprises and individuals that are not debtors at any of the financial entities.

28. The coverage of the private Credit History Bureau (CHB) has been progressively expanded but it still covers only a fraction of the country's adult population and companies. Established as a private company in 2008, the CHB processes, stores and presents information about debtors' compliance with their obligations under credit agreements. As of March 2016, CHB's database included information on 255 669 private persons and 12 686 legal entities reported as debtors. While still limited, the CHB's coverage has rapidly increased over the past years, to reach 11.4% of the adult population in 2016, compared to 4.5% in 2013. Differentiated pricing policies introduced by the CHB to attract microfinance organisations and encourage them to share data largely explain the increase in coverage. However, few market participants other than banks provide data. A law to oblige non-bank financial institutions to report credit information failed to materialise in the face of strong opposition; critics claimed that costs were high and that the usefulness of services was limited. The current database includes all banks' debtors, as well as some from non-bank financial institutions. Since 2015, five MFIs have started reporting and others are due to follow. The coverage could be further expanded with the participation of insurance companies and savings and credit associations. SCAs are interested in participation but face technical issues in connecting to the database, while insurance companies still see little benefit in partnering with the credit bureau.

29. A law currently under preparation would enable the CHB to include data from telecommunication and utility companies. If approved, it would help to increase the CHB's coverage, allowing it to reach nearly 100% of the adult population. A second draft law aims at strengthening the regulatory environment covering CHB activities, which should provide the legal foundations necessary for its expansion. Although the CHB is licensed by the NCFM to operate, regulatory oversight of the licensing process is currently limited. The new law seeks to strengthen the supervision and oversight of the CHB's activities and would clarify the regulatory attributions of both the NCFM and the National Bank of Moldova.

30. Finally, the CHB is testing two new types of services which would go beyond the listing of borrowers in payment arrears. In particular, it is experimenting with a warning system which would notify clients on the financial situation of their borrowers and alert debtors when their credit history is being checked. The inclusion of positive credit histories in the CHB's database would help further reduce information asymmetries and allow for the extension of loans to solvent clients who have previously been excluded from borrowing.

## *Consumer protection*

**2013 recommendation:** Increase transparency of costs and conditions (e.g. effective interest rates and commission fees) of loans from both banks and non-bank financial institutions (e.g. through publication on the Central Bank website).

31. Some progress has been made in increasing the transparency of financial service terms and conditions. However, this has not yet been extended to non-bank financial institutions. More specifically,

the National Bank of Moldova (NBM) has adopted measures to improve consumer protection and increase the transparency of bank services. A new regulation on disclosure of information on the financial activity of licensed banks was approved by the NBM on 20 March 2014, requiring commercial banks to disclose their lending conditions (National Bank of Moldova, 2015). This law also obliges banks to provide a loan simulation feature on their websites, which a potential borrower can use to determine the loan amount that he or she would be eligible for, and to estimate the interest rate and repayment instalments that would be applied. In addition, the NBM publishes monthly reports that present average interest rates applied by commercial banks in Moldova on loans and deposits. It is recommended that non-bank financial institutions be legally compelled to provide the same information.

### *Collateral*

**2013 recommendation:** New types of collateral (e.g. secondary guarantees, accounts receivable and warehouse receipts) should be introduced through an amendment of the Law on Collateral.

32. Government efforts have focused on strengthening the legal framework to support the use of new types of collateral. The legal framework for collateral was amended in July 2014, in order to facilitate the use of movable collateral. However, implementation remains a problem, since the enforcement of titles is subject to lengthy and unpredictable court proceedings. In addition, it remains cumbersome to re-sell collateral in Moldova.

33. The government has set up a working group on collateral with the objective of addressing and stimulating the active use of new types of collateral. Projects have been initiated to establish a collateral registry for movable assets and a single securities depository. The Ministry of Justice has led the work on the creation of an electronic online registry for movable assets that includes all movable assets in a single registry, similar to the single registry for real estate. This registry has been operational since April 2016. The NBM is also working on the single securities depository, in which all types of securities, including stocks, equity, bonds and other instruments will be listed, and detailed information on their owners provided. A supervisory entity will be established by the NBM to monitor this securities depository. There is no specific list of assets eligible as collateral. While any asset that is liquid enough to be easily traded can be used as collateral, data collected by the NBM shows that commercial and residential real estate remains the most common type of asset used as collateral. They respectively represented around 40% and 15% of banks' collateral in 2015. To further support SME lending, the NBM has also increased authorised limits on non-collateralised lending from MDL 100 000 to MDL 500 000.

34. To complement these initiatives, the working group on collateral could specifically focus its efforts on the introduction and the effective use of new types of collateral such as accounts receivable, warehouse receipts or secondary guarantees in order to offer a broader range of options that would encourage and facilitate lending to SMEs.

### ***Guideline 2: Sources and types of external finance need to be further diversified***

35. The turmoil of the banking sector crisis has considerably limited the implementation of measures aimed to diversify sources and types of external finance for SMEs. Although some progress has been made in promoting credit products, consultations and training, new credit products targeting SMEs have not been introduced, the use of grace periods remains limited and credit risk management processes need to be improved. Initiatives have been taken to disseminate information on funding opportunities for SMEs with the launch of a governmental website. The reorganisation of the credit guarantee scheme has been initiated but will require continuous effort and reforms to lead to an increased uptake of its guarantee products.

### *New credit products for SMEs*

**2013 recommendation:** Encourage specific credit products for SMEs (e.g. working capital loans, overdrafts, revolving loans, domestic and overseas trade financing, investment loans, start-up loans, bank guarantees and rural and agricultural financing loans). Banks could develop marketing strategies to better target SMEs (e.g. offering special services such as free consultancy and market research in conjunction with new products).

36. Recent financial sector turmoil has considerably hindered banks' opportunities to introduce new financial products and develop marketing strategies that are targeted at SMEs. A number of donor-funded financing initiatives are available for SMEs, including the European Bank for Reconstruction and Development's (EBRD) Small Business Support programme and the World Bank's Second Competitiveness Enhancement Project (CEP II), which includes a matching grant facility. Grants awarded under the matching grant facility aim to support SMEs in accessing new markets through business development services, targeted technological process upgrades, marketing support and investments in quality infrastructure. CEP II also provides banks with credit lines for medium to long-term financing of export-oriented SMEs, for working capital and investment projects (World Bank, 2014). Given the importance of the SME sector in the Moldovan economy, specific initiatives could be designed to encourage banks to offer tailored services to SMEs.

### *Decentralisation of banking services*

**2013 recommendation:** Encourage banks to decentralise services by establishing branches and agencies in rural areas, and provide information and consultancy directly to potential clients, particularly in the rural areas. Banks could also improve customer service through staff training in approaching and dealing with clients.

37. Limited progress has been made in decentralising financial services, with banking services remaining mostly concentrated in Chisinau. As of July 2016, the banking sector was composed of 11 licensed banks, with 287 branches spread throughout the country. Half of all bank branches were located in Chisinau, Balti and Gagauzia, and more than 16% were located in six districts: Cahul, Hincesti, Orhei, Ungheni, Edinet and Soroca. Banks provide information and consultancy services to businesses, and customer services have improved overall. Consultations and training designed to encourage banks to expand their services in rural areas are organised through the Moldovan Organisation for SME Sector Development (ODIMM) in the framework of two projects: the National Programme for Youth Empowerment (PNAET) and the Programme to Attract Remittances to the Economy (PARE 1+1). In order to improve the provision of information to potential clients and to allow SMEs to independently assess bank services and products, banks print out and distribute free materials disclosing information on the terms and conditions of their services and products. Banks should regularly provide updates to consumers on any amendments to their internal regulations.

38. Initiatives already in place to increase product offerings, consultations and staff training could be further expanded and should be supported by stable funding, which would be independent from donor-funded programmes. Further decentralisation of bank services can also be achieved through online banking, which is highly dependent on the quality of internet access in rural areas.

### *Grace periods*

**2013 recommendation:** Encourage extensions to grace periods, including through increased use of external sources of finance to commercial banks, earmarked for lending to SMEs (e.g. EBRD lines of credit).

39. The most important developments in this area have centred on the dissemination of information on funding opportunities provided by international financial institutions (IFIs) and foreign government agencies. A number of IFIs offer credit lines to banks for SME lending, including the EBRD and World Bank. Although a recently launched government website provides an inventory of these sources of funding, it does not present their funding conditions in detail. So far, no specific measure has been taken to encourage the use of extended grace periods. Special programmes could be developed in partnership with IFIs to establish revolving lines of credit for commercial banks that would be dedicated to SME lending and would also offer extended grace periods.

### *Credit risk management*

**2013 recommendation:** Improve credit risk management by implementing measures such as: 1) better understanding of the SME market (e.g. by segmenting the SME market by risk profile or gathering information on SME success factors); 2) develop products and services (e.g. innovative forms of collateral such as accounts receivable, risk-based loan pricing models); 3) acquire and screen SME clients (e.g. using external data on SME financial performance such as credit bureau reports); and 4) manage information, staff and knowledge (e.g. spot early signs of SME default, provide advisory services to assist SMEs in cash flow management and use portfolio data to customise models for statistical credit scoring).

40. Progress has been made in enhancing procedures for managing credit risk. In order to optimise the calculations of assets and conditional commitment losses, banks are required to conduct an asset and commitment classification exercise on at least a monthly basis, as well as on the last day of the reporting period. In addition, specific provisions have been established to limit credit risk. This initiative specifically aims to reduce the number of loans with a high degree of leverage that might become nonperforming. Asset classifications have also been established for cases in which a debtor's liabilities represent more than 30 times the company's own funds. This requirement shall not apply, however, if the cumulative value of credits and conditional commitments is lower than MDL 1 million. Since the banking crisis, the Moldovan authorities are partnering with international financial institutions to improve the regulation and supervision of the banking sector. This context provides a unique opportunity for encouraging banks to improve their credit risk management procedures and to develop specific assessment tools tailored to the needs and activities of SMEs.

### *Public credit guarantee scheme*

**2013 recommendation:** Promote the use of public credit guarantee schemes by introducing financial incentives to encourage take-up, or possibly by establishing a new risk-sharing facility.

41. A well-designed credit guarantee scheme is able to effectively share the loan risk among the lender, the borrower and the guarantors. High coverage rates reduce default risk and can lead to moral

hazard from the borrower, creating incentives for strategic default. As such, offering additional incentives to lenders and SME borrowers can serve to encourage greater participation and bolster the attractiveness of the scheme. Moreover, risk management mechanisms such as counter-guarantees can help to diversify risk and reduce the exposure of schemes to default (OECD, 2009).

42. Developments in this area have been concentrated on revamping the existing Credit Guarantee Fund (CGF), which is managed by ODIMM and has been operating since 2007. The CGF currently offers five guarantee products dedicated to start-ups and women entrepreneurs (70% coverage), active firms, exporting companies and young entrepreneurs (50% coverage). However, the programme is underused and the number of beneficiaries is low. As of end-December 2015, there were 127 active financial guarantees with a total value of MDL 26.2 million (EUR 1.2 million), which allowed for the disbursement of MDL 72.8 million (EUR 3.3 million) in loans, and investments in the economy of MDL 122.8 million (EUR 5.6 million). Among the nine partnership agreements signed with financial institutions, only three are actively working with the CGF.

43. To increase the CGF's operational efficiency, ODIMM commissioned an external evaluation supported by the World Bank in 2014, which reviewed the processes, methodologies and design of its operations. The recommendations covered: 1) new product design; 2) promotion strategies among existing and potential partner institutions and SME target segments; 3) revised organisational structure to prevent risk of interference; 4) developing a modern management information system; 5) developing an operational manual detailing comprehensive policies and procedures; and 6) criteria for selecting partner institutions. As a result, ODIMM introduced important changes to the operational framework for the CGF to further encourage participation: the registration fee has been reduced from 2% to 0.5%, and a time limit of 90 days has been established for the settlement of claims. Furthermore, ODIMM is working to develop a portfolio-based mechanism allowing the loan and guarantee approval process to be handled by the lender. Its contracts with seven of its nine banks will be terminated by November 2016, and new CGF products are expected to be introduced at this time. The CGF has also suffered from a lack of stable funding. A bill submitted to parliament for review in 2015 proposed that a share of the national budget should be annually committed to funding the guarantee scheme, in order to secure its operations.

44. To further increase SME participation and improve the effectiveness of the CGF, ODIMM could better align the design and implementation of the CGF with international best practices (see Box 1). Procedures to issue guarantees and claim pay-outs could be streamlined, corporate governance and risk management practices can be further strengthened, and procedures for partnering with banks could be formally defined based on reliable methodologies to screen and select banks, conduct due diligence assessments and periodically review bank operations. The NBM can play an important role in encouraging banks to participate in the CGF, by ensuring that guarantees issued result in reduced capital requirements and prudential ratios for lenders, which are specified in the relevant regulations for credit risk mitigation (World Bank and FIRST Initiative, 2015). Securing a stable source of funding (such as the credit lines for SME lending offered by IFIs) and implementing the recommended changes would also help to improve the effectiveness of the CGF. Moreover, as the recently introduced changes are likely to result in a substantial increase in operational costs, the CGF should adopt a comprehensive risk management framework with exposure limits by sector and geographical area. ODIMM can also mitigate the CGF's risk exposure through the use of counter-guarantees such as InnovFin. Finally, participation in relevant networks (such as AECM – the European Association of Guarantee Institutions) would allow ODIMM to benefit from the accumulated knowledge and experience of credit guarantee funds in other countries.

### Box 1. KredEx: The Estonian credit guarantee fund

KredEx was established by the Ministry of Economic Affairs and Communications of Estonia in 2001, offering loans, guarantees and other financial products to help improve access to finance for SMEs. KredEx provides guarantees for up to 75% of the loan amount, with a contract fee of 1% of the guarantee amount and minimum guarantee fees of 0.4%-3.8% of the guarantee balance per annum, depending on the financial product. In 2015, KredEx provided EUR 66.3 million of guarantees and financing to a total of 401 companies, allowing enterprises to obtain an additional EUR 112.3 million of funding. In November 2015, KredEx signed a counter-guarantee agreement within the framework of the EU programme Competitiveness of Enterprises and SMEs (COSME), allowing KredEx to expand its portfolio to cover riskier projects and increase financing opportunities across the SME sector.

Since 2001, KredEx has provided EUR 1.04 billion of guarantees for bank loans, bank guarantees and leasing transactions, for a total of 3 205 companies. Guarantees provided by KredEx are backed by the state, which gives the scheme higher credibility within the banking sector. KredEx continuously seeks opportunities to improve co-operation with partner banks and simplify procedures. The institution is governed by a management board, which oversees daily activities, and a supervisory board, which is responsible for strategic decisions relating to the budget, strategy, activity goals, risk management and co-operation with credit institutions. The supervisory board includes representatives from the Ministry of Economic Affairs and Communications and the Ministry of Finance. KredEx also places a strong emphasis on staff training and long-term employment – the average seniority in the team of 34 employees is 7.7 years.

To ensure sustainability, KredEx has established strong internal controls and abides by strict risk management principles, which include: 1) the risk taken and fee collected are in proportion to one another; 2) risks are sufficiently spread, with the loss from a single risk not too large in comparison to the capital; and 3) all risk that is not re-insured has been covered with sufficient capital and provisions. Furthermore, qualified auditors are periodically selected by public procurement to examine the fund's activities, and submit regular reports to the management and supervisory boards.

Source: KredEx (2016), *Foundation KredEx: Annual Report 2015*, Foundation KredEx, [www.kredex.ee/public/Aastaraamatud/KredEx\\_aastaraamat\\_2015\\_ENG\\_.pdf](http://www.kredex.ee/public/Aastaraamatud/KredEx_aastaraamat_2015_ENG_.pdf); OECD (2009) *Facilitating Access to Finance: Discussion Paper on Credit Guarantee Schemes*, OECD Publishing, Paris, [www.oecd.org/globalrelations/45324327.pdf](http://www.oecd.org/globalrelations/45324327.pdf).

### *Guideline 3: Need to further improve the investment readiness and financial literacy of SMEs*

45. Efforts have been made to improve the investment readiness and financial literacy of SMEs by offering a number of training programmes. However, the catalogue of training remains fragmented and does not have stable funding sources to rely on. A national strategy on financial education is currently being developed.

#### *SME business planning and financial management*

**2013 recommendation:** Support initiatives can include: 1) financial coaching to develop business plans and financial reports; 2) credit counselling on dealing with debt situations; and 3) establishing links to appropriate donor and government programmes.

46. A number of SME financial literacy programmes have been designed and implemented nationwide, but these initiatives remain fragmented and rely mostly on donor funding. Within the framework of its Efficient Business Management programme, ODIMM organises two days of training on access to finance, negotiations and administration of credit and financial management. The programme is composed of training courses with around ten modules that are updated annually. The Youth Economic Empowerment Programme and the PARE 1+1 programme include one day of training dedicated to



financial management. Modules on business planning and marketing are also included. ODIMM also proposes individual consultations as part of its Business Consultancy and Assistance Centre.

47. The NBM, along with other government authorities committed to supporting financial education, has started to develop a national strategy on financial education. The strategy aims to raise the level of financial education of various groups, such as those planning to start and run a company. The strategy envisages the development and implementation of different training courses and programmes on business planning and financial management, as well as the creation of a platform to disseminate information. A first draft of the strategy has been developed and will soon be submitted to a range of relevant government institutions for review. The NBM plans to submit the strategy to the government for review and approval by the end of 2016. A review of past and ongoing training programmes that look at business planning and financial management for SMEs could be conducted, integrating the lessons learnt into the design of a systemic approach. It should ensure that training programmes occur on a continuous basis, have a stable source of funding, and ideally include some co-financing from the beneficiary.

*Accessible and transparent information on the credit system*

**2013 recommendation:** Provide information and training on financial sources available for SMEs, loan application processes and overall lending costs (including fees and interest rates).

48. In 2013, the government launched a web portal ([www.finantare.gov.md](http://www.finantare.gov.md)) to provide information on financing provided by IFIs and foreign government agencies on preferential terms. This information is regularly updated by the State Chancellery and covers loans, leasing, financial guarantees and grants, mostly for SMEs. As of mid-2016, the portal contained information on 29 financing programmes totalling MDL 646.9 million. Further support could be provided for credit information and education campaigns, to help build SMEs' knowledge on available sources of financing.

*SME ability to access finance*

**2013 recommendation:** Adopt schemes that would develop the capacity of SMEs to promote their business ideas and increase their ability to negotiate a loan with a financial institution.

49. At the end of 2014 the government established a National Committee with the goal of facilitating access to finance. The Governor of the NBM, the Head of the National Commission for Financial Markets, the Minister of Economy, the Minister of Finance, and the Minister of Justice are members of this Committee alongside other representatives of public institutions. Its mandate is to monitor and co-ordinate financing activities in the country, to evaluate legislation and to identify other issues that affect access to finance. It also proposes improvements.

50. Within the Efficient Business Management (GEA) Programme, ODIMM offers two modules dedicated to enhancing SMEs' negotiation skills, techniques for selling and merchandising, and procedures for participation in European projects. An additional module on negotiating loans with national and international financial institutions will be included in the GEA programme. Similar modules might also be added to the PARE 1+1 and PNAET programmes.

51. Schemes specifically dedicated to SMEs capacity building should be established to ensure that training is available on a continuous basis and is not tied up with donor-funded projects or programmes.

## **The way forward**

### *Guideline 1: Enhance the legal and regulatory framework for the financial infrastructure*

52. Building on the progress achieved in strengthening the regulatory framework for financial institutions in Moldova, further improvements could be made by prioritising the review and approval of draft laws on the regulation of microfinance and leasing institutions and on the expansion and oversight of credit bureau activities. A “quick win” policy would also be to extend legislation on the disclosure of lending conditions currently applied to commercial banks to non-bank financial institutions. The compilation of positive credit histories by the credit bureau would further support access to finance by reducing information asymmetries between borrowers and lenders. To complement the progress being made in improving the legal framework for collateral, the government’s working group on collateral should focus its efforts on the introduction and effective use of new types of collateral such as account receivables, warehouse receipts or secondary guarantees.

### *Guideline 2: Diversify the sources and types of external finance available*

53. Planned reforms to reduce structural weaknesses in the financial sector and improve the regulation and supervision of the banking sector will provide opportunities to introduce measures to diversify the sources of finance available for SMEs. As the financial sector continues to stabilise, banks could be encouraged to develop credit products that are tailored to the specific needs of SMEs. Initiatives to increase product offerings and the provision of consultations to clients (particularly in rural areas) could be further expanded and tied to stable funding resources, outside of one-off donor-funded programmes. Special programmes could be developed in partnership with IFIs to establish revolving lines of credit for commercial banks that would be dedicated to SME lending and would offer extended grace periods. More measures on credit risk management could be introduced in order to better assess the SME market, develop SME-specific products and services, screen SME clients and anticipate risks associated with SME loan portfolios. Implementing these recommendations will be demanding, requiring a medium-term timeframe, as well as a strong commitment from and consensus among IFIs, the state and key financial sector stakeholders.

### *Guideline 3: Improve the investment readiness and financial literacy of SMEs*

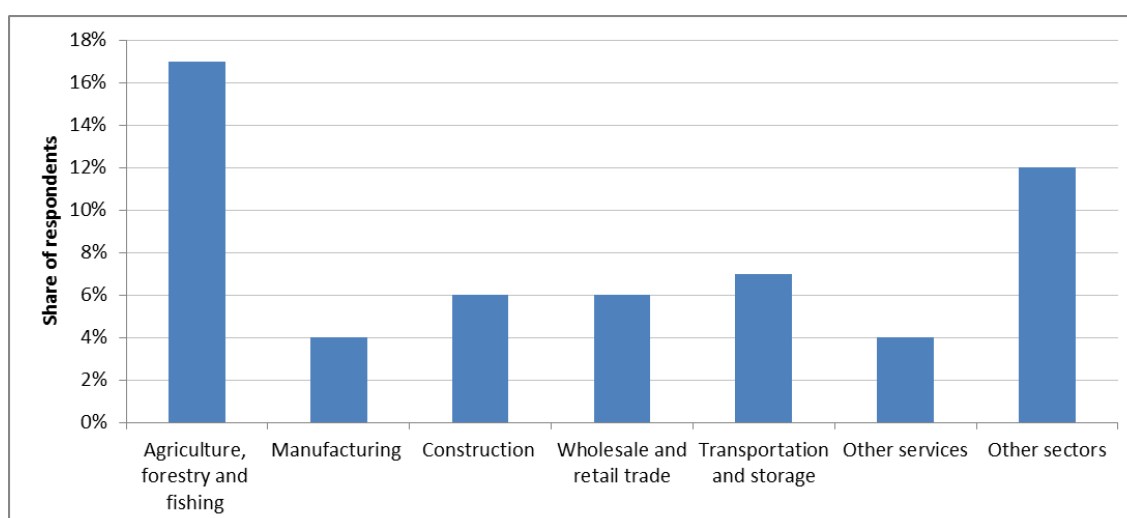
54. Further improving the investment readiness and financial literacy of SMEs will require a structured approach that builds on the various training programmes and actions already initiated and integrates lessons learnt into a comprehensive catalogue of services. The objective is to move away from the current fragmented approach to ensure securing a continuous and financially sustainable programme of training outside of donor-funded projects or programmes. A change in approach will require a committed and direct involvement of the state to carry out assessments of past and ongoing capacity building programmes on topics such as SME business planning and financial management, financial literacy, promotion of business ideas or negotiation of loans with financial institutions. The identification of sustainable funding resources would ensure the continuous support of the investment readiness and financial literacy capacities of SMEs.

## CHAPTER 2. BUSINESS DEVELOPMENT SERVICES

55. Business development services (BDS) are defined as “services that improve the performance of the enterprise, its access to markets, and its ability to compete” (CDASED, 2001). BDS include an array of business services such as training, consulting, marketing, information provision, technology development and transfer, and business linkage promotion. In Moldova, the development of a sound business support infrastructure can help to foster entrepreneurship, strengthen entrepreneurial skills and competencies, and improve the sustainability of businesses and new start-ups. Entrepreneurs lacking the skills and knowledge to start and operate a business can benefit significantly from services which save time and resources, help to evaluate potential business opportunities, and encourage them to enter and explore new markets. Furthermore, governments can use BDS to complement and improve the effectiveness of various forms of financial assistance such as grants, loans and subsidies (OECD/European Union, 2014).

56. The market for BDS in Moldova is evolving and has a diverse range of providers, including government institutions, agencies, non-governmental organisations (NGOs), international organisations and private providers. However, companies do not always understand the potential benefits and are often unwilling or unable to pay for BDS, and many are unaware of government-funded BDS. In a survey of 310 Moldovan SMEs conducted by the OECD in 2015, a number of questions were asked to measure firms’ demand for BDS. While the results are only indicative as the survey sample represents just 0.6% of registered SMEs in Moldova, the results suggest that 74% of firms would consider using external advisory services such as management training, business strategy and legal advisory. However, only 8% of firms were aware of government-funded BDS. Levels of awareness are generally quite low but vary considerably across sectors, from 17% of surveyed firms in the agricultural sector (perhaps due to the effectiveness of the agricultural extension service network) to 4% in manufacturing and other services (Figure 2). This suggests that the market for BDS is hampered by poor information and weak marketing, which adds to SMEs’ search costs and leads to the perception that relevant services are not available on the market.

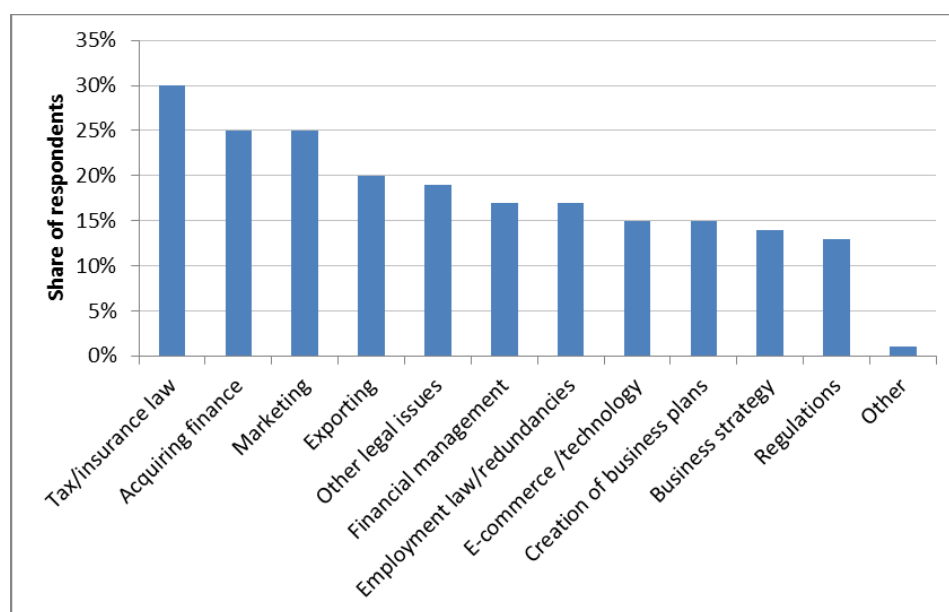
**Figure 2. Awareness of government-funded BDS by sector**



Source: OECD (2015), SME survey in Moldova, unpublished.

57. In addition to a general lack of awareness of business support services among SMEs, respondents highlighted a number of other factors that may explain the low uptake of BDS in Moldova. Reasons for not seeking external advice or support include, among others, the perception that there is already sufficient expertise within the company (51%), that services offered are too expensive (11%), that specific services needed are not available on the local market (6%), and that available services are of a poor quality (6%). When asked about the type of business support services that companies would be willing to pay for, respondents showed a strong preference for the provision of more complex services relating to tax, national insurance law and payments (30% of all respondents), advice on acquiring finance (25%), and marketing (25%). Other priority services include exporting (20%) and other legal issues (19%) (see Figure 3).

**Figure 3. Willingness to pay for BDS**



Source: OECD (2015), SME survey in Moldova, unpublished.

### Overview of 2013 recommendations

58. The 2013 report evaluated the market for BDS and outlined six guidelines to strengthen the provision of BDS in Moldova (OECD, 2014b).

#### ***Guideline 1: Strengthen policy co-ordination at national and sub-national level***

59. Policy makers should establish a co-ordination forum and take stock of all BDS providers in order to provide a comprehensive database of suppliers. Regular monitoring and evaluation should be carried out to assess whether public funds are well used and how effective the different models of BDS provision are.

#### ***Guideline 2: Fill in the gaps in rural provision***

60. The government could review the current status of the Moldovan Organisation for SME Sector Development (ODIMM) network of SME specialists in the local administrative districts and establish a full-time SME contact at rayon-level in regions where there is no ODIMM infrastructure. All relevant information could be channelled through the SME contacts to the relevant BDS providers. Co-ordination

and co-operation with the rayons, especially their economic divisions, could be strengthened. The agricultural extension services could be strengthened and made sustainable; non-agricultural economic development in rural areas could be promoted.

***Guideline 3: Build capacity among NGOs and business associations***

61. The existing NGO BDS providers need to be assessed, and public funds concentrated on those that are most effective. Business associations providing BDS could also be reviewed, assessing their capacities, services and funds, and a plan for technical support to deliver BDS provision outlined.

***Guideline 4: Deepen the emerging BDS market***

62. The government could reassess which services are provided free of charge in order to avoid market distortions. The state could move to provide fewer services directly, increasingly acting as a contractor and/or regulator in the BDS market.

***Guideline 5: Improve quality and increase confidence in BDS provision***

63. The regulatory base for BDS providers could be reformed to allow consulting to be a listed profession. BDS standards could be raised through the use of internationally recognised certification and re-certification, training, and education. The creation of an association of consultants would help to professionalise the sector. The government, business associations, media, and other stakeholders could act together to raise awareness of the potential benefits of BDS.

***Guideline 6: Address the gaps in the BDS market***

64. A number of interventions could address gaps in the BDS market, particularly the development of more complex services. These interventions include: creating a database of BDS firms to facilitate access to service providers, co-financing initiatives to promote the development of more complex BDS provision, voucher schemes to encourage first-time use of BDS by SMEs, and technical assistance to build the capacity of BDS suppliers to serve SMEs.

**Findings of the 2016 monitoring assessment**

65. This section details progress in implementing the 2013 policy recommendations on strengthening BDS in Moldova. The assessment is structured around the six guidelines presented above.

***Guideline 1: The government has launched a database of BDS providers and conducts regular monitoring of the business support infrastructure***

66. Important progress has been registered in the implementation of this guideline: an online database of BDS providers is now available, the government regularly monitors the effectiveness of business incubators and support programmes, and a series of policy recommendations to foster BDS have been outlined by the Ministry of Economy in the Action Plan for the Implementation of the SME Sector Development Strategy for 2015-2017. Further attention could be given to the establishment of a dedicated platform to co-ordinate and elaborate BDS-related policy reforms, and monitoring of SMEs by ODIMM as they exit the Business Incubator Network to better understand their prospects for survival and growth.

*Establish a co-ordination forum for BDS policies*

**2013 recommendation:** Establish a co-ordination forum: key actors such as the Ministry of Economy, ODIMM, the Academy of Sciences, the Agency for Innovation and Technology Transfer, academic institutions and other ministries (such as the Ministry of Agriculture and Food Industry and the Ministry of Regional Development), could meet on a quarterly basis to align BDS policy and wider SME development measures. The Ministry of Economy could be the lead institution for policy co-ordination.

67. Institutional co-ordination is essential to ensure policy coherence and effective use of public funds allocated to support BDS. While the government has established a number of initiatives to co-ordinate policies to improve the business environment in recent years, a dedicated forum for the co-ordination of BDS policies is still lacking. For instance, the Ministry of Economy has created working groups on an ad hoc basis to discuss reform priorities in specific areas, such as regulatory impact analysis or women's entrepreneurship. The Ministry of Economy also co-ordinates implementation of the national *SME Sector Development Strategy 2012-2020*, which includes measures to support BDS providers and broaden the scope of services available to SMEs. However, there have been no working groups established to discuss and develop reforms to strengthen the business support infrastructure.

68. The establishment of a Consultative Council for SMEs, as proposed in the draft law on SMEs adopted by parliament in July 2016, could be an effective platform to co-ordinate policy reforms and discuss issues pertaining to BDS. Including the Chamber of Commerce and Industry, business associations and other relevant stakeholders as members of the Consultative Council would help to facilitate effective public-private dialogue and practical exchanges on issues affecting the market for BDS, as well as alignment with broader SME development measures. The Consultative Council for SMEs could adopt an approach based on technical consultative meetings with the business community and public authorities similar to that of the Prime Minister's Economic Council in order to develop the business support infrastructure. The Economic Council was established in 2013 with support from the European Bank of Reconstruction and Development (EBRD), to promote public-private dialogue, strengthen the business climate, reduce bureaucracy and improve the quality of public services. Meetings chaired by the prime minister were held in 2014 and 2015, to discuss various business climate related topics such as access to financial resources, the development of agriculture, export promotion, launching new electronic services for the business community, and easing company registration procedures. Appointing a dedicated secretariat, ensuring high-level ownership and visibility, and designating an immediate task or review for completion (such as a comprehensive policy document and action plan based on an assessment of the needs of the business community) would help to ensure that the Consultative Council operates efficiently with high visibility and tangible results achieved.

*Establish an online database of BDS providers*

**2013 recommendation:** Undertake a comprehensive "stock take" of the existing business support infrastructure by creating a database of BDS providers, services and contact information, led by ODIMM. The database should be made available on ODIMM's and other public websites and should be regularly updated.

69. ODIMM recently launched an online database of BDS providers (<http://odimm.md/ro/suport-in-afaceri/prestatori-sda.html>), which allows users to filter results by geographic location and field of activity. A total of 92 BDS providers are listed, including government institutions, private consulting service

providers, business associations and other NGOs. The database is regularly updated and maintained by ODIMM, and business service providers that are not currently part of the database can apply to be included by filling out an online application form on the ODIMM website (<http://odimm.md/ro/sda-form>).

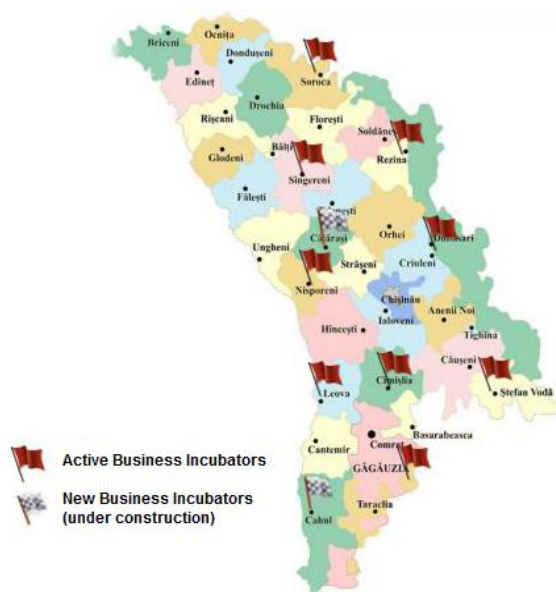
70. The database could be further strengthened by allowing users to provide feedback and evaluate the strengths and weaknesses of individual service providers. Moreover, the general feedback survey on the webpage of the BDS database has received few responses, suggesting that there is limited awareness among entrepreneurs in Moldova. ODIMM could therefore take steps to make the database available on other public websites, promote its usage more widely within the SME community, and consider leveraging the network of business service providers to implement specific programmes.

*Conduct regular monitoring and evaluation of the business support infrastructure*

**2013 recommendation:** Monitor and evaluate the country's business support infrastructure including incubators and regional development agencies for impact, and in terms of locations, services, effectiveness and sustainability. Develop policy recommendations to strengthen the business support infrastructure, based on regular co-ordination meetings and monitoring and evaluation. The policy recommendations could also consider ways of filling any market gaps. Once the business support infrastructure policy priorities have been determined, national and donor funds could be mobilised for the effective development of the business support infrastructure.

71. ODIMM established the Business Incubator Network of Moldova, which is based in Chisinau and serves as a platform to foster co-operation among the nine business incubators that are currently active throughout the country (see [www.riam.md](http://www.riam.md)). The network (see Figure 4) encourages the development of joint projects among business incubators, supports experience sharing and best practices, facilitates policy dialogue with the government, and provides tailored advisory services to its members.

**Figure 4. Network of business incubators in Moldova**



Source: Business Incubator Network of Moldova (n.d.), "Membrii fondatori ai rețelei" (Founder members of the network), <http://riam.md/membri/>.

72. Monitoring reports are published annually to evaluate the range of services offered, as well as the impact, activities and financial sustainability of the incubators. ODIMM also receives monthly and quarterly progress reports from all business incubators, which are prepared according to the incubators' action plans. According to the most recent monitoring report, on 31 December 2015, the network of nine active incubators was supporting 155 beneficiary companies with a combined turnover of MDL 85 million (EUR 3.8 million) and 611 employees. This represents a substantial increase from 2013, when the network included just five active incubators supporting 71 companies with only 238 employees. Occupancy rates (measured as the share of occupied floor space) vary substantially across individual incubators, but reach 75% for incubators that have been operating for more than two years, which is not far from the rates of 80-85% observed in business incubators in the EU (ODIMM, 2016). Business incubators also benefit from mentoring by local and international experts. Local experts visit business incubators on a monthly basis to monitor performance and enhance their operations. International mentors evaluate progress on a half-yearly basis, and conduct capacity building and training sessions to further support the incubators' development. Further monitoring of SMEs would help ODIMM to better understand the survival and growth rate of start-ups as they mature and exit the incubation phase.

73. The government recognises the importance of strengthening business support infrastructure in Moldova and has made this an integral part of the national SME Sector Development Strategy 2012-2020. Specific reform priorities have been included within the Action Plan for the Implementation of the SME Sector Development Strategy for 2015-2017. In particular, Objective 3.2 of the action plan includes measures to foster the formation of a network of business service providers, develop a quality and certification system for BDS providers, enhance the scope of services offered by ODIMM's Business Consultancy and Assistance Centre, and extend the provision of mentoring for entrepreneurs. Objective 3.3 outlines provisions relating to the development of information and advisory services for SMEs, Objective 4.1 suggests measures to strengthen the innovation infrastructure, and Objective 4.2 aims to leverage the network of business incubators to develop clusters of SMEs engaged in entrepreneurial activities.

***Guideline 2: While increased support is available for SMEs in rural areas, there is scope to further expand the agricultural extension services***

74. The government has made substantial efforts to increase the provision of SME support services in rural areas. ODIMM provides a range of information, training and consultancy opportunities to SMEs through its network of business incubators and SME specialists. To improve outreach in rural areas, ODIMM could increase collaboration with business associations and producer organisations. The agricultural extension service network has also been operating successfully, although additional resources could be allocated to help expand coverage.

*Dissemination of information, training and consultancy opportunities in rural areas*

**2013 recommendation:** Information, training and consultancy opportunities need to be made available in rural areas through initiatives such as reviewing the current nature and effectiveness of the ODIMM network of SME contacts in the districts, establishing full-time SME contacts at the district level, and channelling information about all relevant training and consulting opportunities available throughout the districts via the SME contact and then out to all relevant BDS providers.

The economic departments should improve the linkage, information flow, co-ordination and co-operation within the local administrative districts, especially those that are mainly rural. Capacity building is required to ensure that the economic departments do not focus only on data collection but develop a fuller understanding of enterprise/SME development, including the range of business support services, thus enabling them to play a fuller role.



75. ODIMM has significantly expanded its outreach to rural entrepreneurs since 2013, both by leveraging traditional means of communication and by developing new methods to channel information about training and consulting opportunities to SMEs. ODIMM regularly collaborates with a wide range of media partners including TV channels, local radio stations, newspapers and magazines to broadcast and publish information about training events, forums and seminars. Events are also promoted on ODIMM's website ([www.odimm.md](http://www.odimm.md)) and through the website of the SME business portal (<http://businessportal.md>), although the latter seems to be updated somewhat infrequently. ODIMM also conducted over 10 000 consultations by phone and internet in 2015 (compared with 7 500 in 2013), and has recently strengthened its presence on social media by promoting new events and activities on Facebook and Twitter.

76. ODIMM works closely with a network of SME specialists in the local public authorities (LPAs) to disseminate information about training and consultancy opportunities to the business community. The collaboration seems to have intensified since 2013, with increasing participation and a broader range of seminars, conferences and focus groups taking place in the regions. Events are typically directed at specific target groups, such as women, the unemployed, young entrepreneurs, and start-ups. .

77. SME specialists are periodically trained by ODIMM and often invited to attend national and regional seminars and events. However, high staff turnover in the LPAs is a significant issue, with SME specialists often leaving their positions shortly after attending training and capacity building seminars. In addition, due to staff shortages in rural areas, SME specialists are often asked to perform tasks unrelated to SME development and not within their scope of responsibilities. To address this issue, ODIMM has drafted a job description and list of duties for the SME specialists. However, only a few districts agreed to use the job description, and those that did approve it were not entirely diligent in enforcing it.

78. In spite of the wide range of efforts made, there is scope to further improve the dissemination of information, training and consultancy opportunities in rural areas. Traffic on the ODIMM website fell slightly from 48 000 unique visitors in 2013 to 43 000 in 2015. Similarly, traffic on the SME business portal has fallen from 113 000 unique visitors in 2013 to 80 000 visitors in 2015. ODIMM should continue to intensify its promotional activities, while strengthening the capacities of SME specialists and improving mechanisms to allow BDS providers to directly inform SMEs about training and consulting opportunities. One possible solution would be to bolster ODIMM's regional presence by setting up offices to cover the northern and southern parts of the country. To ensure that sufficient support is given to less developed regions, the locations for new business support infrastructure should be decided based on close co-ordination between key government institutions in charge of regional development, including the Ministry of Economy and the Ministry of Regional Development and Construction. ODIMM could also focus efforts on collaborating with partners that are known to be more effective in supporting the SME community, such as business associations and producer organisations. While ODIMM does work closely with various players such as regional development agencies and the Chamber of Commerce and Industry, collaboration with the existing business associations is currently limited and could be further strengthened.

*Strengthen agricultural extension services in rural areas*

**2013 recommendation:** Strengthen the agricultural extension services and make them self-sustaining. Currently these are the principal sources of support in rural areas and are delivered almost exclusively by AgroInform and the National Agency for Rural Development. These important services continue to be reliant on state and international funding. The continuing lack of sustainability of these services is a matter of concern for all, not just the Ministry of Agriculture. This could be combined with a stronger emphasis on non-agricultural economic development in rural areas.

79. Agriculture accounts for 12% of employment, 23% of value-added and an estimated 22% of SME exports in Moldova (Economisti Associati, 2015). Given the importance of the agricultural sector, extension services are an essential component of the business support infrastructure. At present these services are mostly provided by AgroInform and the National Agency for Rural Development (ACSA). The government has outlined three main priorities in the National Agriculture and Rural Development Strategy 2014-2020: 1) enhanced competitiveness through restructuring and modernisation; 2) sustainable management of natural resources; and 3) improved conditions for living and working in agricultural and rural areas. Around MDL 1.14 billion (EUR 51 million) – more than 80% of direct budget spending on agriculture – is allocated to the first pillar. From this, a total of MDL 388 million (about EUR 18 million, or 34% of the direct budget spending in this pillar) is allocated for enhanced agricultural education, research and extension services. Although the extension services have proved to be efficient and popular as assessed by farmers, the funding remains limited (World Bank, 2015a).

80. ACSA developed an agricultural extension and advisory service in early 2000, with support from the World Bank and Swedish International Development Co-operation Agency. The government took over financing of the service in mid-2013, when donor funding ceased. The network provides services to farmers free of charge, particularly small-scale subsistence farms, which form the largest group of beneficiaries. The advice offered relates to production technologies (52% of services in 2014), marketing (16%), business consultancy (20%) and legal advice (12%). The network includes 35 regional offices, 75 regional consultants and 350 local consultants operating at the village level (World Bank, 2015a).

81. The agricultural extension service network has an important role to play in developing management skills and technical knowledge, and in disseminating information on production technologies. The network is broadly viewed as effective and coverage is high, estimated at over 40% of villages and 50% of farms. However, systemic deficiencies in the agricultural education and research and development (R&D) system are a constraint to developing the extension service network. Education and R&D accounts for about 10% of total agricultural spending, but curricula and teaching methods are outdated, the institutional structure is cumbersome, and collaboration with the private sector and international R&D systems is limited.

82. The government can take a number of steps to strengthen and improve the efficiency of extension services. First, given the positive results from the extension network, a larger share of budgetary funds for agriculture should be allocated to boost the availability of extension services across the country. Second, closer co-operation with the Seeds Commission and private seed companies could help producers to gain access to seed varieties that are well-suited to the Moldovan environment and in high demand on international markets (World Bank, 2016b). Third, there is scope to upgrade the quality of the agricultural education and R&D infrastructure, and facilitate research spillovers and linkages with extension services.

***Guideline 3: A review of business service providers has been conducted***

83. Some progress has been made in identifying the policy options to increase the capacity and scope of services provided by NGOs and business associations. ODIMM conducted a survey of BDS providers and outlined the various challenges they face in a report published in 2015 (ODIMM, 2015c). A more comprehensive evaluation of NGOs and business associations in Moldova could help to identify concrete measures to improve their sustainability.

*Improve the targeting of public funds for NGOs and business associations*

**2013 recommendation:** Evaluate which NGOs with an entrepreneurial orientation are no longer active, or depend on sporadic public funds. Concentrate public funds on those which are active BDS providers, targeting support on fewer, more effective institutions. NGOs should improve the quality of their services, evaluating their effectiveness, broadening the range of services they provide and ensuring their financial sustainability.

84. The government has yet to conduct a comprehensive evaluation and assessment of NGOs providing BDS in Moldova. ODIMM conducted a study of the BDS market in 2015, and found that 59% of surveyed business service providers were registered as NGOs (non-commercial “public associations”). Many of these NGOs are either inactive or lack the necessary capacity, expertise and financial base to operate sustainably and deliver complex consulting and advisory services to SMEs (OECD, 2014b). However, the launch of East Invest 2 in November 2014 has provided additional resources to support the institutional development of NGOs and business associations. Under East Invest 2, business support organisations in the OECD’s Eastern Partnership region can benefit from technical assistance through audits, capacity building, twinning missions of up to 12 months with business associations in the EU, staff exchange programmes, seminars and management training academies.

85. During a focus group held at the European Business Association in April 2016, representatives of various NGOs and business associations suggested that in order to ensure financial sustainability, membership fees should make up a significant share of the budget. However, business associations often struggle to collect fees from their members, due to a lack of confidence in the potential added value of the association’s activities. As such, associations are often heavily reliant on donor funding and lack the necessary knowledge, experience and institutional development to respond to the needs of their members.

86. There is a need to strengthen the capacity of NGOs and business associations and assist them in delivering a broader range of services to their members, including information, consulting, advice on quality infrastructure and certification, export promotion, lobbying and advocacy. The government could consider using established NGOs and business associations as delivery channels for public support programmes. Furthermore, by establishing a more inclusive platform for public-private consultations and policy dialogue, the government could help to strengthen the advocacy function of business associations, and in turn increase members’ willingness to pay a fee which is not directly linked to a service.

*Assess the capacity and sustainability of NGOs and business associations*

**2013 recommendation:** Review business associations currently delivering information, training and consultancy support. These associations vary in capacity: some are highly commercial, others are inactive and still others are experiencing financial difficulties. The review would assess their capacities, services and financial position and provide recommendations and technical support to improve their BDS provision and their sustainability.

87. The government recognises the importance of strengthening the capacity and sustainability of business associations in Moldova and has conducted an initial assessment of the market for BDS. The report prepared by ODIMM in 2015 found that established business associations tend to be small (77% of surveyed BDS providers employ fewer than five permanent staff) and focus heavily on the provision of basic services, such as business planning, financial management and accounting (ODIMM, 2015c).

Complex services such as market research, taxation and support for adherence to International Financial Reporting Standards are far less widespread. Additional barriers include a lack of co-operation between business associations and other BDS providers, and few incentives offered to attract new members. The report concludes with a set of recommendations to strengthen the business support infrastructure, as follows: 1) promote knowledge transfer among BDS providers; 2) encourage entrepreneurial learning; 3) establish a single association of BDS providers; 4) improve the online database to facilitate partnerships among BDS providers; 5) develop promotional materials; 6) facilitate international exchange programmes; 7) develop grant programmes; 8) encourage technological upgrading; and 9) support the training of consultants.

88. As a next step, the study and its implications should be discussed by an appropriate platform, such as the Consultative Council for SMEs or the Prime Minister's Economic Council. Although the Economic Council includes about 25 business associations in its membership, they have yet to conduct a targeted review of business associations and suggest policy proposals to strengthen the current system.

***Guideline 4: A regulatory framework for consulting services would boost demand for BDS***

89. Progress in the implementation of this guideline has been somewhat limited. While ODIMM delivers training and consulting programmes to SMEs through a network of sub-contractors and qualified experts, there are very few co-financing programmes for BDS in place. Notable exceptions include ODIMM's matching grant programme to attract remittances to the economy (PARE 1+1), and donor initiatives financed by the EBRD and World Bank. Furthermore, the government has yet to establish an effective regulatory framework for consulting services, which could help to boost demand for BDS.

*Encourage co-financing and enhance sub-contracting of BDS*

**2013 recommendation:** Reassess and refocus the current emphasis on the provision of free services, to avoid crowding out and/or market distortions. The Ministry of Economy and ODIMM could support this process by developing a more nuanced BDS policy.

State institutions could reconsider the extent to which they deliver information, training and consultancy directly. As the market matures, state institutions must commission and subcontract existing providers to deliver better BDS services. Their role must increasingly become that of contractor and the application of quality control, monitoring and evaluation.

90. Since 2013, ODIMM and the Chamber of Commerce and Industry have made progress by increasingly sub-contracting the delivery of training and consulting programmes to private BDS providers and qualified experts. These programmes are typically provided free of charge and targeted to micro and small-sized companies, on the assumption that micro-entrepreneurs have limited willingness (or ability) to pay for such services. At present, the co-financing of consulting and business support services is mainly limited to ODIMM's Programme to Attract Remittances to the Economy (PARE 1+1) and donor initiatives financed by the EBRD and World Bank.

91. The PARE 1+1 programme is designed to encourage migrant workers and their immediate relatives to invest in establishing or expanding businesses in Moldova. Entrepreneurs can benefit from matching grants of up to MDL 200 000 (approximately EUR 9 000), as well as the provision of business training and entrepreneurial support services. The programme is widely viewed as a success and expanded steadily from its inception in 2010 up to 2014, but suffered from a funding freeze in 2015 due to the local banking crisis. Consequently, a total of 198 entrepreneurs benefited from entrepreneurial training under the

PARE 1+1 programme in 2015, compared with 498 in 2014. The approval rate for funding applications also plummeted sharply, from 93% of all applications submitted in 2013 to 62% in 2014 and just 35% in 2015 (ODIMM, 2015a; 2015b). The drop in the approval rate from 2013 to 2014 was accompanied by an increase in the number of applications, and could in part reflect rising demand and thus greater selectivity. However, the fall in funding applications (from 309 in 2014 to 217 in 2015) and approvals (from 191 to 77) reflects the severe impact of funding shortfalls in 2015.

92. The EBRD's Small Business Support programme provides grants to businesses to purchase consulting services and conduct training of consultants. The programme has been operating since 2005, and typically implements about 70 projects and 2 to 3 training courses per year. Over the past few years, EBRD officials report that they have observed a growing maturity in the BDS market, with increased applications from SMEs for consulting services, and a diversification in the scope of services demanded beyond the traditionally popular areas of IT, marketing and engineering studies.

93. The World Bank's Second Competitiveness Enhancement Project (CEP II) also includes a component similar to the EBRD's SBS programme, which provides matching grants for technological process upgrades, business development services, market upgrades, and investments in quality infrastructure. The CEP II's matching grant facility opened in November 2015, and since then about 14 to 15 companies have benefited from the scheme. The project targets direct exporters, indirect exporters and enterprises wishing to export. The USD 3 million facility will allocate funding to about 250 companies, with grants of approximately EUR 10 000 allocated to support SMEs in undertaking business improvement projects to develop new export-oriented activities (World Bank, 2014). The World Bank's Agriculture Competitiveness Project also includes a matching grant facility, but this typically involves larger grants targeted to the development of post-harvest and export-oriented infrastructure for agricultural co-operatives and producer associations.

94. Moving forward, the government could build on the experiences of existing co-financing initiatives and develop new co-financing schemes to expand the provision of BDS. These could be targeted to the provision of specific services or segments of the SME population (for instance, high-growth SMEs with export potential as outlined in the ODIMM Strategic Development Programme for 2016-2018).

*Establish an effective regulatory framework for consultancy services*

**2013 recommendation:** Assess and reform the regulatory base for the BDS and consultancy market. Consultancy is not a listed profession and the resulting lack of a definition of consultancy services or projects means that state bodies are unable to recognise and commission consultancy activities. This acts as a constraint on the market.

95. This recommendation has not been implemented yet, as consulting is currently not a listed profession in Moldova. This has two negative implications. First, with the exception of education or training services, consulting services are not eligible for a tax credit. This reduces incentives for SMEs to purchase such services. Second, it constrains government procurement of these services. A legal change to formally consider consulting as a listed profession – without creating any additional administrative requirements for consultants – could help to stimulate the market and encourage further professionalisation of consulting services.

***Guideline 5: Reforms have been planned to improve quality and increase confidence in BDS provision***

96. The government has indicated it plans to develop a quality and certification system for BDS providers in the Action Plan for the Implementation of the SME Sector Development Strategy for 2015-2017. The introduction of internationally recognised standards can help to increase confidence in BDS providers and stimulate demand for their services. The development of an association of consultants could also help to support further development of the BDS market.

*Develop recognised certification for BDS providers and establish an association of consultants*

**2013 recommendation:** Improve the quality of individual BDS providers so as to increase confidence in them and trust in their business services. This could be done through a process of internationally recognised certification and re-certification, and regular training and education, resulting in higher levels of knowledge, skill and experience. This would ultimately raise standards, and increase levels of trust and willingness on the part of SMEs to commission BDS services.

Assist in the development of an association of consultants to professionalise the growing BDS/consultancy sector, among both public and private providers.

97. The government can take a number of steps to improve the quality of individual BDS providers, including by introducing a recognised certification process for BDS providers. Under Objective 3.2 of the Action Plan for the Implementation of the SME Sector Development Strategy 2015-2017, the government plans to encourage the formation of a network of business service providers, develop a quality and certification system for BDS providers, enhance the scope of services offered by the ODIMM's Business Consultancy and Assistance Centre, and extend the provision of mentoring for entrepreneurs (Ministry of Economy, 2015). ODIMM is in the process of developing a business provider accreditation system and has contracted an expert to support this process. The government can also encourage internationally recognised standards for consultants, such as the certifications offered by the Association of Accredited Small Business Consultants, Certified Management Consultant or the Institute of Certified Business Consultants. ODIMM also recognises the need to foster the development of consultancy services, and has been working with the Japan International Co-operation Agency to develop a handbook for consultants, training manuals for staff at business incubators, and a concept paper to provide further support to SMEs through specialised consulting firms.

98. An association of engineering consultants was established in 2012 ([www.armic.md](http://www.armic.md)), including nine engineering firms that employ approximately 250 consultants in total. The development of a more broad-based association of professional consultants is currently under consideration, and would help to support further development of the market for private BDS providers.

*Promote the potential benefits of BDS among entrepreneurs and SMEs*

**2013 recommendation:** Promote the potential benefits of BDSs among entrepreneurs, especially among growing, maturing and export-oriented enterprises and their ability to increase know-how, productivity, efficiency, market share and profitability. This should be done in partnership with the government, business associations, the association of consultants (once created), the media and other stakeholders.

99. Since 2013, the Ministry of Economy, ODIMM and other government agencies have increased their efforts to promote the benefits of BDS among entrepreneurs and SMEs. In 2015, the Ministry of Economy worked with ODIMM and the Business Incubator Network to organise a series of Regional Business Days to promote and publicise business support opportunities for SMEs in regions across Moldova (Ministry of Economy, 2016). ODIMM also provides information on business support services for SMEs on its website and on the website of the SME business portal (<http://businessportal.md>). However, information is sometimes outdated and SMEs do not view these resources as a comprehensive source of business information.

100. There is a need for more communication and information to enhance awareness among SMEs of the benefits of participating in business associations. The Ministry of Economy plans to step up its efforts to encourage SMEs to form or join business associations. This will ultimately improve the efficiency of the delivery of business services by reducing transaction costs when adhering to EU standards and requirements (e.g. sorting, packaging, quality standards). Moving forward, the government could ensure that tools to disseminate information on training and consulting opportunities for SMEs are regularly updated and maintained, to ensure that entrepreneurs and SMEs are well-informed of potential opportunities and the benefits of BDS.

***Guideline 6: Further efforts are needed to address the remaining gaps in the BDS market***

101. While some initial efforts have been taken to improve the provision of information to potential consumers of BDS, progress in the overall implementation of this guideline is lacking. Further efforts are needed to support the development of more complex and higher value-added services.

*Support the development of more complex and higher value-added services*

**2013 recommendation:** Design a variety of interventions, with donor support, to address the gaps in the BDS market, especially the development of more complex and higher value-added services (information for potential consumers of BDS, co-financing initiatives, voucher initiatives, technical assistance for BDS development and commercialisation).

102. There has been limited progress in implementing the deeper reforms needed to stimulate the BDS market in Moldova, particularly the development of the more complex and higher value-added services that are demanded by SMEs. Information for potential consumers of BDS is currently disseminated by the Ministry of Economy, ODIMM, LPAs and business incubators in the regions, but outreach to SMEs in rural areas remains limited. To further increase support to entrepreneurs in rural areas, ODIMM plans to establish four additional business incubators, of which two will be located in the districts of Cahul and Calarasi. These had initially been planned for 2015, but funding was temporarily frozen due to the banking sector crisis. In order to have a more complete coverage in rural areas of Moldova, business incubators sometimes provide information to entrepreneurs and SMEs in neighbouring districts.

103. Over time, business incubators could become a focal point in rural areas to disseminate information to SMEs and serve as a platform for the introduction and delivery of more complex and higher value-added services for SMEs. The government can build on existing co-financing initiatives, such as the EBRD and World Bank initiatives, to help stimulate the market for new and more complex value-adding services. Voucher initiatives and technical assistance for BDS providers can also support the delivery of new services.

## **The way forward**

### *Guideline 1: Strengthen policy co-ordination at national and sub-national level*

104. To further build on the reforms that have been completed, the government should establish a dedicated forum to monitor and co-ordinate BDS policy reforms. The co-ordination forum should serve as an effective platform for public-private dialogue, including relevant public and private sector stakeholders such as the Ministry of Agriculture and Food Industry, ODIMM, the Chamber of Commerce and Industry, and established business associations and producer organisations. Potentially, the Consultative Council for SMEs could serve as an effective platform to co-ordinate the policy reform process, building on the experience of successful initiatives such as the Prime Minister's Economic Council.

105. ODIMM can also work to improve the online database of BDS providers on its webpage, by allowing users to provide feedback and evaluate the strengths and weaknesses of individual service providers. Efforts to promote its usage more widely within the SME community could help to raise awareness among entrepreneurs and SMEs of training and consulting opportunities. Furthermore, ODIMM should monitor SMEs as they exit the business incubator network to better understand their growth rates and chances of survival.

### *Guideline 2: Fill in the gaps in rural provision*

106. There have been substantial improvements in the provision of support services in rural areas. ODIMM should continue its outreach efforts and take steps to collaborate more closely with established business associations and BDS providers. The network of business incubators could serve as a platform for the dissemination of information and the delivery of more complex and higher value-added services for SMEs. In addition, the extension and advisory service under the National Agency for Rural Development should be further strengthened through additional budgetary funds, closer co-operation with the Seeds Commission and improved linkages with the agricultural education and R&D system. Efforts to reform and restructure the agricultural education and R&D system could generate positive research spillovers and facilitate linkages with the extension service network.

### *Guideline 3: Build capacity among NGOs and business associations*

107. As a necessary first step, the results of the 2015 study on the BDS market conducted by ODIMM could be discussed by the government and other relevant stakeholders, with a view to formulating and implementing the policy proposals outlined in the document. To build on progress initiated in this area, the government could also conduct a more comprehensive review to assess the capacity and sustainability of business associations and NGOs that provide BDS. A focus on strengthening the capacity of NGOs and business associations would help them to deliver a broader range of services to their members. The government could consider using NGOs and business associations to deliver public support programmes and could help to strengthen their advocacy function by including relevant associations in policy dialogue on BDS-related reforms.

### *Guideline 4: Deepen the emerging BDS market*

108. The government could develop new BDS initiatives requiring co-financing from the beneficiaries, particularly for complex and higher value-added services. New programmes could be targeted to specific segments of the SME population, such as high-growth SMEs with export potential. They could also benefit from the experience of established programmes, such as ODIMM's PARE 1+1 programme, or donor initiatives such as those run by the EBRD and World Bank. In addition, the BDS market would benefit



from a legal change to define consulting as a listed profession, which would allow these services to be eligible for tax credits and incentivise government procurement of consulting services.

*Guideline 5: Improve quality and increase confidence in BDS provision*

109. While some progress has been made in promoting the benefits of BDS among entrepreneurs and SMEs, there is much that can be done to further stimulate demand and increase confidence in the market. The government could introduce a recognised certification process for BDS providers, encourage the development of internationally recognised standards for consultants and assist in the development of an association of consultants to professionalise the growing consultancy sector. Further efforts could also be taken to encourage SMEs to participate in business associations and to ensure that they are well-informed of potential training and consulting opportunities.

*Guideline 6: Address the gaps in the BDS market*

110. The government could introduce a number of initiatives to address the remaining gaps in the BDS market. These include better dissemination of information to SMEs, the development of targeted co-financing initiatives, voucher schemes to encourage first-time use of BDS by SMEs, and technical assistance to build the capacity of BDS providers and support the development of more complex and higher value-added services. Finally, Moldova has a highly active donor community, with a substantial amount of funding allocated to strengthen the market for BDS. The government should ensure that it maintains sufficient capacity to absorb donor funds, that there is adequate and effective co-ordination between the various donor programmes, and that donor initiatives do not displace (and rather reinforce) the existing capacity within the government (Gaibu et al., 2011).

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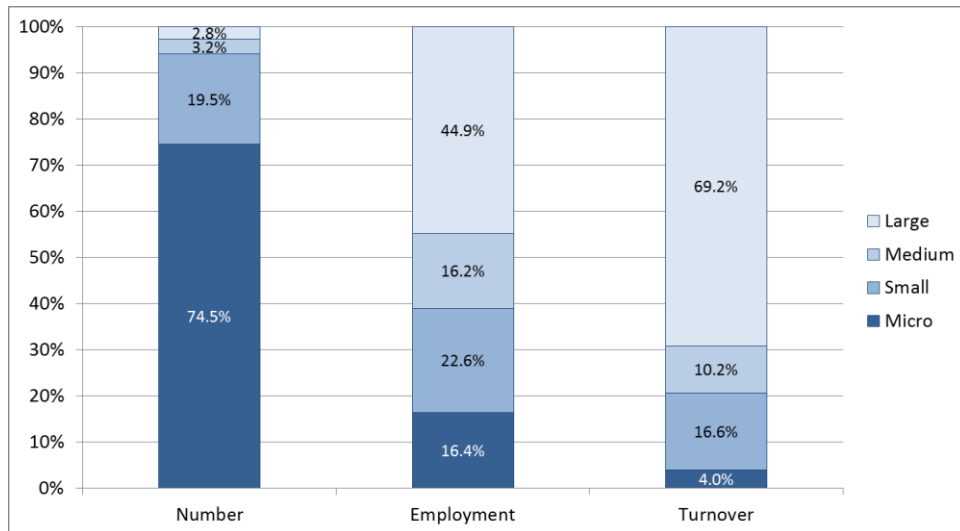
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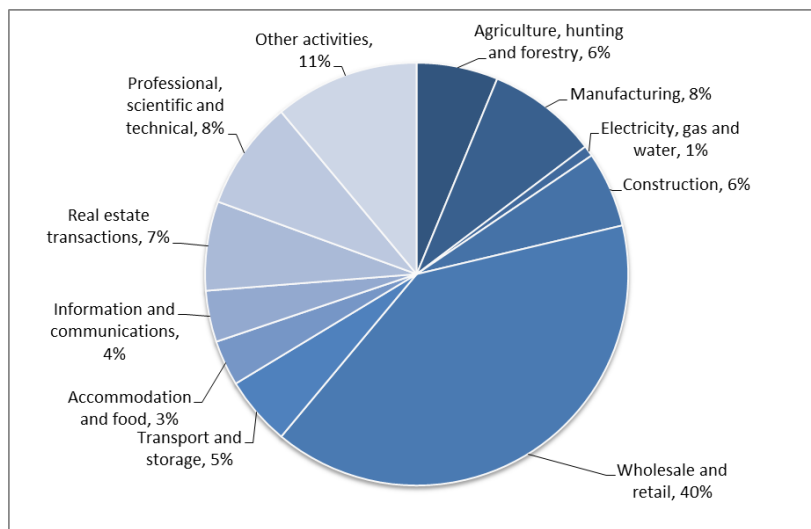
## ANNEX A: FIGURES

**Figure 5. Structure of the SME sector in Moldova, 2015**



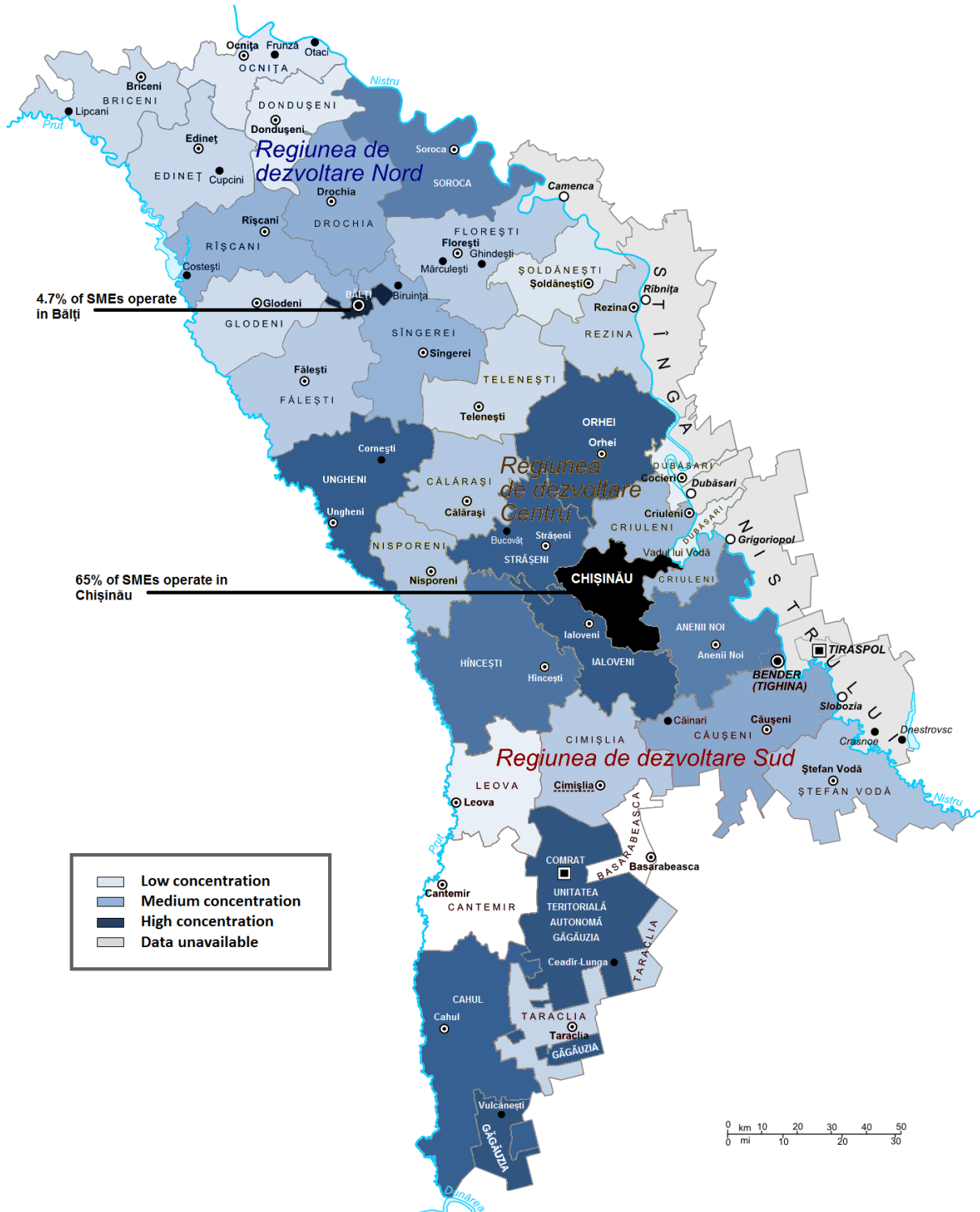
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**Figure 6. Sectoral distribution of SMEs in Moldova, 2015**



Source: National Bureau of Statistics of the Republic of Moldova (2016), "Indicatori vizînd activitatea întreprinderilor mici și mijlocii în anul 2015" (Indicators on the activity of small and medium enterprises in 2015), [www.statistica.md/public/files/serii\\_de\\_timp/antreprenoriat/IMM\\_2015.xls](http://www.statistica.md/public/files/serii_de_timp/antreprenoriat/IMM_2015.xls).

Figure 7. Geographical distribution of SMEs in Moldova, 2015



Source: National Bureau of Statistics of the Republic of Moldova (2016), "Indicatori vizînd activitatea întreprinderilor mici și mijlocii în anul 2015" (Indicators on the activity of small and medium enterprises in 2015), [www.statistica.md/public/files/serii\\_de\\_timp/antreprenariat/IMM\\_2015.xls](http://www.statistica.md/public/files/serii_de_timp/antreprenariat/IMM_2015.xls).



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