

ALTERNATIVES FOR BANK
LOANS ON MOLDOVAN MARKET

Cristina PANFIL ¹, scientific researcher,
National Institute for Economic Research

“Money often costs too much.”
Ralph Waldo Emerson

Difficulties in bank lending can strain economic path. In case of exaggerate restraints, SMEs which have at the sole of their activities credits will be in trouble, as the interest rates are high, it is difficult to contract loans and it is tough to keep up with the loan reimbursement schedule. For banks lending to SMEs is a consistent and weighty source of business activity. Due to recent disruptions in banking activity, the base rate raised and other banking regulations regarding crediting were negatively affected. As a rule these regulations have a tendency to tighten the lending activity as crediting terms are tougher. The goal of this paper is to draft the alternatives of financial support for SMEs which could supplant bank loans in order to stimulate efficient entrepreneurship growth.

Key words: small and medium enterprises, banking loans, leasing, microfinance, grants, economic growth.

Dificult țiile în procesul de contractare a creditelor bancare pot tensiona cre terea economic . În cazul unor restricții exagerate, IMM-urile care au la baza activit ții lor credite se vor confrunta cu probleme, deoarece ratele dobânzilor sunt ridicate, este dificil de a apela la împrumuturi i este greu s se respecte graficul de rambursare al creditului. Pentru IMM-uri creditele bancare sunt o surs semnificativ de sus inere a afaceri. Din cauza perturba iilor recente în activitatea bancar , rata de baz s-a ridicat i a alte condi ii bancare privind creditarea au fost afectate negativ. De regul , asemenea reglement ri au tendința de a constrânge activitatea de creditare, întrucât termenii de creditare sunt mai duri. Scopul acestei lucr ri este de a prezenta alternative de sprijin financiar pentru IMM-uri, ce ar putea s substituie creditele bancare, în scopul de a stimula cre terea eficient a antreprenoriatului.

Cuvinte-cheie: întreprinderi mici i mijlocii, credite bancare, leasing, microfinan are, granturi, cre tere economic .

1. Importance of SMEs development in Republic of Moldova

During the transitional period crossed by Moldova’s economy, most SMEs do not have sufficient reserves to finance their businesses, and do not always have the opportunity to turn to bank loans. According to World Bank, Republic of Moldova is among the countries with the smallest share in GDP of domestic credit to private sector – 37,1% (Ukraine- 76,3% ,Romania -31.2%, Czech Republic -50,4%, Japan-187,6%). This indicates that the access to financing is limited and SMEs can’t grow in order to raise their productivity and competitiveness.

Causes of the bottlenecks are a couple: high interest rates, risky, uncertain business environment, regulatory barriers and excessive bureaucracy of state bodies, underground economy, and incapacity to return credit tranches on time. In our country the rate of bank nonperforming loans to total gross loans is equal to 14,4% (Ukraine- 24,3% ,Romania -13,9%, Czech Republic -5,6%, Japan-1,6%). Moldovan banks make some efforts to keep the same size of credit portfolio. But this is not enough for achieving SMEs growth.

After the period of 2015-2016 which was marked by a range of economic failures, Republic of Moldova is especially weak. In 2016, the country economy confronts with stagnation. Comparing to developed countries, there are a lot of issues that need improvement.

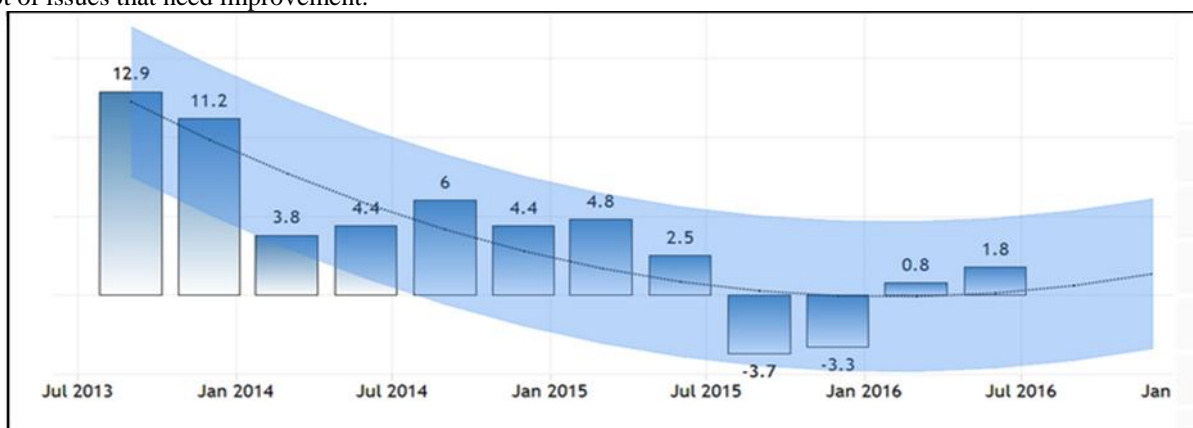


Fig. 1. GDP evolution and its trend line in Republic of Moldova

Source: Trading Economics (<http://www.tradingeconomics.com/>)

¹ Panfil Cristina, cristina.panfil@yahoo.com

The sustainable growth wasn't long term, as there were falls too. At the Moment Moldova is placed among the poorest countries with the lowest GDP level per capita from Europe. In the past 20 years the SMEs sector in the Republic of Moldova has improved both quantitatively and qualitatively. It is obvious, global financial and economic crisis in years 2008-2009 and 2014-2016 has had an adverse effect on SMEs.

Enterprises have a significant influence on GDP formation. In the last years authorities fortunately paid more attention to entrepreneurship development. Yet, there still are bottlenecks. SMEs to a great extent deal with fluctuations in activity, and require loans at certain points of their business activity. Besides that, economy itself is cyclical, financial flows are not constant. The share of SMEs in the total enterprise population comprises 97,4%, but the revenue of SMEs in the total of enterprises is 31,8% in 2014. In compliance with data from World Bank site, up to 33 percent of national income (GDP) in emerging economies is generated by SMEs. Compared to high income countries where the weight of SMEs contribution in GDP exceeds 40%. This ratio is an evidence of the fact that potential for development of Moldovan SMEs is not fully exploited.

In the Republic of Moldova SMEs are intensively participating in trading (about 40% of SMEs), manufacturing of goods (about 10% of SMEs) and services, fulfilling demand on the domestic market. The number of people who work in small and medium enterprises during the reference period are 298 400 people, covering 56.9% of the total number of employees of enterprises.¹

In developing countries, as Republic of Moldova, SMEs contribution to national turnover is relatively lower than its contribution to the supporting employment, which is explained by lower level of labor productivity in the small entities than in big enterprises.

After the first semester of 2016, in the country was acknowledged economic stagnation. In order to surpass this condition it is urgent to support production, investment, exports by a range of economic measures. For Republic of Moldova, which has a developed financial and banking infrastructure, most commonly used financial instruments in national economy and in particular for small and medium enterprises sector are: bank loans, microfinance institutions, savings and loans associations (mainly used by farmers) and leasing.

In order to detect the gaps in crediting mechanism within the, it is necessary to analyze the main components separately.

2. The situation on bank loans market

Crediting system analysis in Republic of Moldova reveals a tensed situation. Even if crisis started in 2014, the data showed the following facts. Credits remain the main financial resource for enterprises, just during crisis their share falls. During the last two years major changes occurred in the structure of banking institutions. The number of crediting institutions is reduced by 3 banks as a consequence of the liquidation of banks with fraudulent activities: Banca de Economii, Unibank and Banca Social , which started to be performed in the 4th quarter of 2015

Table 1. Share of bank loans in the total

| Loans by sectors: | 2013 | 2014 | Weight of each sector, % | 2015 |
|--------------------------------------|---------|---------|--------------------------|-----------|
| Banking sector | 42177.3 | 42295.3 | 93.71 | 42140.0 |
| Microfinance Institutions, mil. | 1897,0 | 2427,5 | 5.38 | ** |
| Savings and loans associations, mil. | 331.9 | 409,3 | 0.91 | 477.05* |
| Total private sector loans, mil. | 44406,2 | 45132.1 | 100 | 42617,05* |

*- preliminary data; **- no data for this year

Source: drafted by the author, relying on data from National Bank and National Commission for Financial Markets.

At the moment, in banking system operate 11 banks, from which 4 with majority private foreign capital (because of reduced capital transparency in Moldovan banking, it is quite difficult to judge which is the situation regarding banks' owners, except for some "real" foreign investors, such as: Group Societe Generale in Mobiasbanca, Gruppo Veneto Banca in Eximbank, ProCredit Holding in ProCredit Bank) and a Romanian branch - Erste Bank/BCR in BCR Chisinau, none of Moldovan banks has capital majority, or entire capital owned by the state.

According to the data collected it is evident that the share of the bank loans is the main type of financial resource, and fulfills about 94% from credit requests. The dominant share of credit loans in the graph is a proof of how involved and what a big impact has banking sector in enterprise activity.

¹ Data collected from National Bureau of Statistics

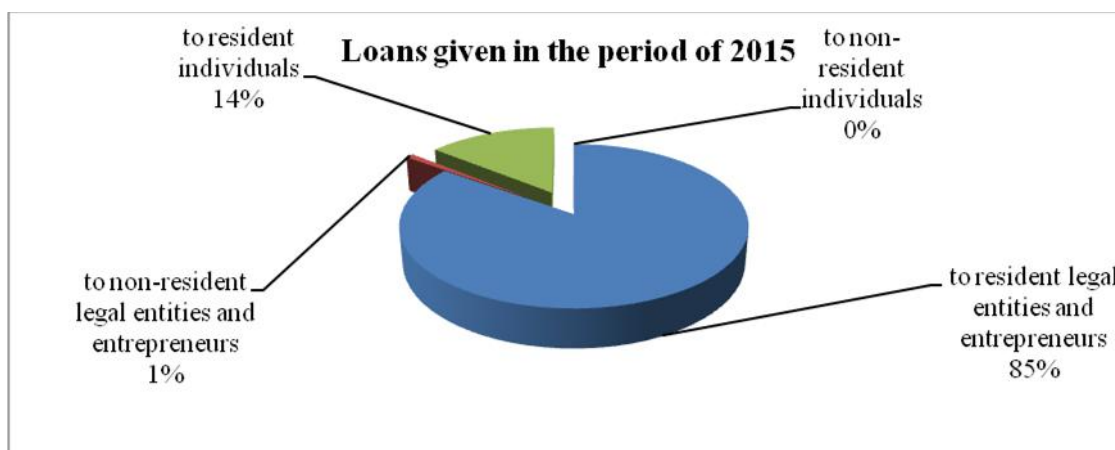


Fig. 2. Structure of Credit portfolio for in banks

Source: drafted by the author, relying on data from National Bank of Moldova

The relationship between SMES and banks is important for both sides, because legal entities represent a consistent share from customers and form 86% from the portfolio. The number of banks comparing to other Eastern European countries, is smaller, therefore, the competition is also less intense. We can state an oligopolistic competition, for the top three banks Agroindbank, Moldindcombank and Victoriabank which are forming a dominant position. In recent years customers for banking services were geared towards quality and safety, manifested confidence in the banking system which, unfortunately, has been totally compromised and will require actions and resources to restore customers trust and confidence.

Main causes SMEs face problems while requiring access to finances in the banks are the following:

- Many of the companies keep double accounting of the income.(underground and formal bookkeeping), striving to avoid taxes. Banks don't have enough stimuli to operate more intensive with SMEs. The riskiest and almost deprived from getting loans are startups or young enterprises with no credit history.
- SMEs environment is more uncertain and competitiveness is harsher, rates of return are high, but the risks are also high.
- Pledged collaterals and high interest rates make SMEs to refrain from contracting bank credits. National Bank of Moldova lowered its base rate from 19,5 percent to 9,5 on October 1st. This is thanks to the fact that inflation slowed while economic activity remained weak and external risks high.

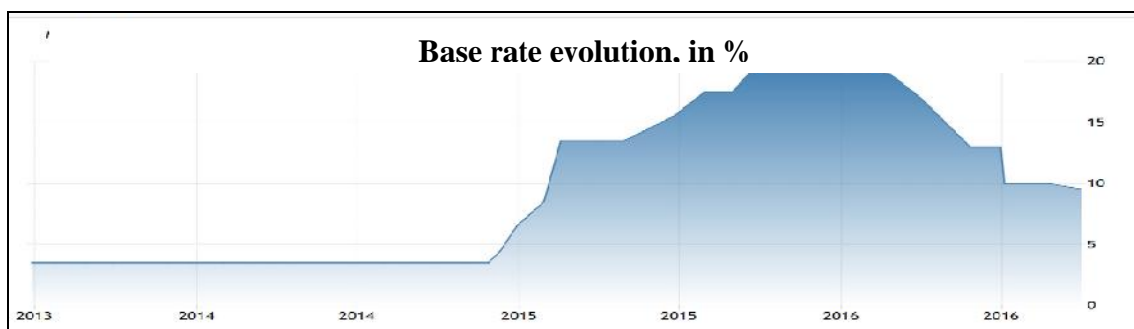


Fig. 3. Base rate in Republic of Moldova

Source: Trading Economics (<http://www.tradingeconomics.com/>)

The highest registered rate was 21%, during the crisis between 2008 and 2009. The lowest interest rate amounted 3,5%. This rate was kept between 2013 and the first semester of 2014. At the end of 2014 and beginning of 2015 the rate popped up sharply, causing troubles to those who contracted loans. The weighted average interest rates on new loans given to entities in national currency, starting from 2013 varied between 6,2% and 22,17%, depending on term.

Credits in foreign currency weren't so affected. In the previous year due to banking crisis, many of the rates were recalculated, so that at the beginning of the year 2015 many of the SMEs were forced to close their credits and tighten their activity. This is one of the causes of the decline in credit portfolio in the banking system. Money from banks was replaced with resources from microfinance institutions or pawn services. This is typical for crisis periods. If we compare the base rate to the weighted average interest rates from commercial banks, we observe an unusual gap. The difference between the base rate and the commercial banks interest rate starting with 2014 is approximately between 3-5%. Base rate exceeds interest rates. This is explained by the fact that deposits are contracted at a lower rate than the base rate, so commercial banks could afford to reduce the percentage for crediting at that moment.

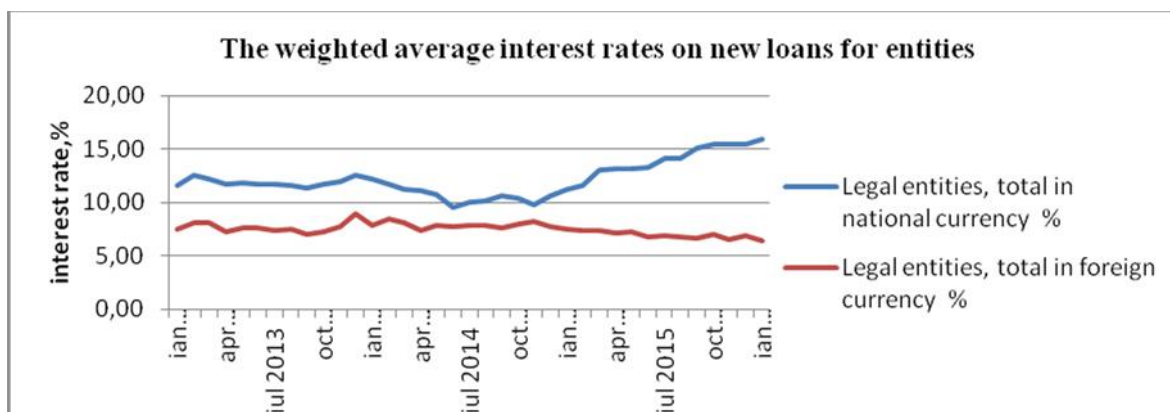


Fig. 4. Weighted average interest rate in banking system

Source: drafted by the author, relying on data from National Bank of Moldova

3. Other funding choices for SMEs efficient growth

Even if it is slow, the growth of domestic nonbank financial market has shown steady progress. This means that alternative crediting products became more attractive. There are arrayed three available possibilities for funding on the domestic market. Nonbank financial sources has the main representatives: (1) microfinance institutions and saving and loan agencies, (2) leasing companies and (3) government programs.

Microfinance is the first and main substitute for bank loans. Philosophy and policies regarding microfinance loans suppose release of credits including those customers who cannot present a classical insurance and therefore cannot be clients of the banks. Even if the interest rates are high, the urgent need of financial resources in SMEs makes entrepreneurs acquire loans even with very expensive price.

Microfinance sector is particularly sought in times of crisis. This is proven by data in the figure below, in the year 2008. From the graph observed that indicator loan portfolio of microfinance entities in relation to GDP recorded a slight rising trend for the year 2014, similar to previous crisis period.

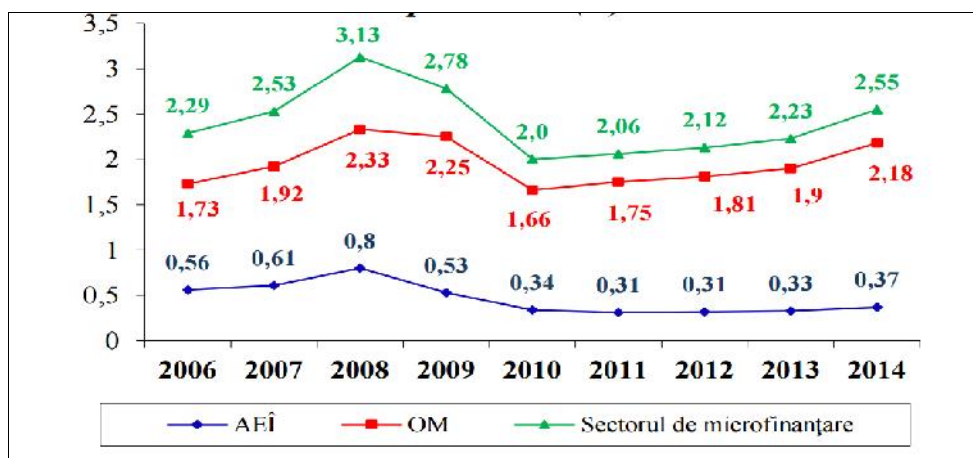


Fig. 5. The loans portfolio of microfinance entities relative to GDP (%)

Source: Anual Report 2014 of NCFM

Microfinancing activities develop in a very fast pace. This can be extracted from the fact that the number of the enterprises in this field raised with approximately 16 units or 19% during 2014, reaching the number of 112 organizations in the 3rd quarter of 2015. The number of loan contracts also raised, the majority of them are for consumption, construction, and other purposes (according to accounting classification). Pursuant to the data provided by the Credit History Bureau (Î.M. „Biroul De Credit” S.R.L), their database grew by 4 %, the number of people with positive credit history also grew with about 29%. This growth is be due to severe conditions in banking system. Some legal entities migrate from banking system to microfinancial organizations. SMEs prefer fast, easy to obtain credits, even if the interest rates are higher. The rate of financing at microfinance institutions was around at 22% before 2015. In the last year it rose to 26% till 32%.

In the Saving And Loan Agencies field, it is also registered an evolution of the mean value of the loan per the beneficiary member in the period 2010-2014. This is an evidence of the continuous demand of loans offered by Saving And Loan Agencies, which are mainly used in countryside, approximately 90% are used in agriculture. The financing rate in Saving And Loan Agencies varies from 17,9 to 26%. But as the resources are put and withdrawn by the members of the agencies, its utility is high and third parties are not affected by the risks..

The **second alternative for bank loans is leasing**. In Republic of Moldova leasing is not sufficiently developed. Overall, the leasing portfolio structure refers more to the purchase of cars. In our country leasing is considered a luxury product. This lending tool is one of the financial instruments available and quick access to internal and external financial resources, especially for the financing of equipment, advanced technology, supplies of agricultural assets in larger amounts.

But, under a liberal regulatory framework, which does not classify this operations as one exclusive leasing activity, theoretically any company can provide these services, as the bassets in the balance sheet are not separated. Therefore, for a better management, it is recommended to introduce licensing for this type of activity. According to the State Registration Chamber, in Moldova there are over 100 companies, covering activities said "Renting of machinery and equipment". The number of companies which provide leasing services decreased from 21 companies in 2013 to 18 companies in 2014. According to the date from the National Bureau of Statistics, 93.2% of the total fixed assets represent leased vehicles, their value amounting up to 997.7 mil. lei, including 831.6 million awarded for cars. Full structure of fixed assets leased in 2014 is as follows: means of transport- 93.2%, machinery and equipment 2.5% 3.0% special buildings and other fixed assets-1.3%.

Table 2. Leased fixed assets, structured by beneficiaries

| | Structura, % | | | | | | |
|-------------------------------|--------------|-------|-------|-------|-------|-------|-------|
| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
| Total, % | 100,0 | 100,0 | 100,0 | 100,0 | 100,0 | 100,0 | 100,0 |
| from which: | | | | | | | |
| Enterprises and organizations | 49,9 | 53,3 | 53,8 | 48,5 | 57,3 | 56,7 | 58,7 |
| Financial institutions | 0,6 | 0,2 | 0,0 | 0,4 | 0,0 | 0,1 | 0,2 |
| Individuals | 49,5 | 46,5 | 46,2 | 51,0 | 42,7 | 43,2 | 41,1 |

Source: drafted by the author, relying on data from National Bureau of Statistics

According to NBS statistics, the share of leased fixed assets with the maturity in 3 years accounted for 59.7% of the total. The share of leased fixed assets with the maturity of 3 to 5 years constitutes 38.2% and those over 5 years - 2.1% of the total value of fixed assets leased.

Leasing, compared to a classic credit, is more convenient because it not forcing SMEs to own property and to provide evidence of pledge. In some programs are offered quite favorable financing conditions as: 8-9% interest, longer period of funding in Euro, flexibility in establishing the payment schedule. The only issue for leasing is that, the credit is contracted in a foreign currency, i.e. leasing consumption cannot flourish during crisis, as the depreciation of national currency affects the beneficiaries.

The thirds method is government intervention in SMEs financial development. Despite the fact that our country passes through a harsh economic period, public authorities still showed interest in supporting SMEs.

In order to generate economic growth and create new jobs, small and medium enterprises sector needs long-term and affordable financing. Because commercial loans are not available, the Government took the following measures. To enhance private sector development, Moldovan government mobilizes money from its development partners on preferential terms. This mostly takes the form of credit schemes, grants or subsidies.

Preferential interest rates for these financing opportunities are lower or, in grants and subsidies, do not exist. Also, the repayment period of the loans is several times higher than in commercial loans, many of them having and grace periods. In this way, public authorities try to provide for entrepreneurs a source of affordable and long-term financing.

In addition, there are different programs and policies, for example: Pare1+1- with the goal to attract remittances into the economy; National Program for Economic Empowerment of Youth, special fund for Loans Guarantee and consultancy from foreign experts. These programs above are considered a very good opportunity for small and medium enterprises.

But still, in order to be possible to use these programs, entities need a high qualification or potential to bring higher added value. This is possible for medium enterprises, or enterprises which activate in the group. For example, Horizon 2020 or COSME have the condition for applicants (entities) to work in a larger group and even in several different countries. Some programs require a more sophisticated, hampering access to finance. Innovative financing schemes can be found both in the national and regional programs. Through these programs it is possible to obtain loans or grants from the state for creation of new businesses and subsidizing certain types of activity, considered important for the economy. There are also platforms that help SMEs to build a better entrepreneurial profile, to be more credible for creditors and more competitive on the market.

Still, national authorities still need to rethink some parts. In order to stimulate SMEs it is necessary to promote awareness of small business development and to keep track of enterprises growth stage and to educate/guide entrepreneurs in financial decision making. The government must maintain political sphere, banking system in good functionality and to avoid disrupting natural development path on the small and medium enterprises. In addition, it would be necessary to improve legislation regarding the pace of contracting a credit by reducing bureaucracy, establishing preferential terms in crediting.

In conclusion it can be stated that on the domestic market there are possibilities to diversify financial resources by contracting loans by alternative methods listed above. Credits from microfinancial sphere is the main substitute for bank loans. Currently it represents the second biggest lending activity. But in order to flourish, leasing activity legal framework needs to be improved, as for now there is no specific bookkeeping method and this field is still new for the country's enterprises. Government intervention is efficient for groups of enterprises and companies with high international competitiveness.

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