INNOVATIONS IN RURAL AND AGRICULTURAL FINANCE IN MOLDOVA

microREPORT #34

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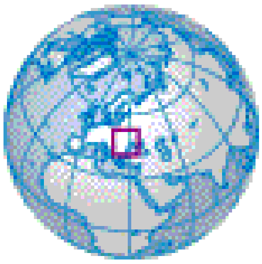
COUNTRY PROFILE



Socio-Economic Highlights

GDP per capita (2004)	US$720
Population (2004 est.)	4.3 million
Population density	125 people/ km^2

Inflation

2000	18.4%
2001	6.3%
2002	4.4%
2003	15.7%
2004	12.5%

Exchange Rates (Moldovan Leu per Dollar)

	Annual Average	Year End
1998	US$1.00 = MDL5.37	US$1.00 = MDL8.32
1999	US$1.00 = MDL10.52	US$1.00 = MDL11.59
2000	US$1.00 = MDL12.43	US$1.00 = MDL12.38
2001	US$1.00 = MDL12.87	US$1.00 = MDL13.09
2002	US$1.00 = MDL13.57	US$1.00 = MDL13.82
2003	US$1.00 = MDL13.94	US$1.00 = MDL13.22
2004	US$1.00 = MDL12.33	US$1.00 = MDL12.46

ABBREVIATIONS AND ACRONYMS

Ag.	Agriculture
AIB	Moldova Agroindbank
CCA	Consulting and Credit in Agriculture
CIS	Community of Independent States
CPI	Consumption Price Index
EC	European Commission
EU	European Union
GDP	Gross Domestic Product
GNI	Gross National Income
HDI	Human Development Index
ICT	Information and Communication Technologies
ILO	International Labor Organization
IMF	International Monetary Fund
IT	Information Technologies
GNI	Gross National Income
LPG	Loan Portfolio Guarantee Program
MAFI	Ministry of Agriculture and Food Industry
MDL	Moldovan Leu
MIS	Management Information System
MSME	Micro, Small, and Medium Enterprise
NBM	National Bank of Moldova
NCEI	National Commission for European Integration
NGO	Non-government Organization
OECD	Organization for Economic Cooperation and Development
PFAP	Private Farmers Assistance Project
PFCP	Private Farmers Commercialization Program
R&D	Research & Development
RFC	Rural Finance Corporation
RISP	Rural Sector Investment Support Project
SCA	Saving and Credit Association
SME	Small and medium enterprises
SSB	State Supervisory Body on SCA activities
SSIB	State Social Insurance Budget
TACIS	Technical Assistance to CIS
UNDP	United Nations Development Program
UNICEF	United Nations Children's Fund
USAID	US Agency for International Development
WB	World Bank
WTO	World Trade Organization

CONTENTS

EXECUTIVE SUMMARY

INTRODUCTION

This case study analyzes the innovations and performance of bank and non-bank financial institutions sustainably expanding access to demand-driven rural and agricultural financial (RAF) services in Moldova during the last five years (December 1999–September 2004). The main objectives of this case study are to explore how RAF programs in Moldova have overcome the challenges of improving access to financial services for rural communities and the agricultural sector and to extract lessons applicable to other less-developed countries. To do this, this case study considers the following questions:

- How did bank and non-bank financial institutions (NBFIs) overcome the obstacles of high poverty, economic over-dependence on agriculture, and inadequate institutional and physical infrastructure to become the national leaders in the provision of demand-driven and sustainable RAF services to tens of thousands of rural clients? In particular, what were the institutional prerequisites, relationships and innovative technologies that facilitated their success?

- What has been the impact of access to USAID's Development Credit Authority (DCA) guarantees on RAF retailing?

- How has the availability of wholesale funds affected RAF retailing?

- What lessons can governments, donors and practitioners in other developing countries learn from the innovations, successes, and shortcomings of the Moldovan experience?

To answer these questions, the case assesses retailing of rural financial services (non-farm and agricultural) by Moldova Agroindbank (Agroindbank), Savings and Credit Associations (SCAs), the Rural Finance Corporation (RFC) and wholesaling of funds by Agroindbank and RFC to the SCAs. The case also considers improvements in the operating environment that have facilitated expansion of RAF services. The paper concludes with highlights of key lessons learned and an evaluation of the transferability of the innovations and results achieved.

CONTEXT AND DEVELOPMENT OF RAF IN MOLDOVA

Moldova is the poorest nation in Europe with a GDP per capita of US$720 (December 2004), with about half the population living in rural areas outside the two main cities. Agriculture is the largest sector of the Moldovan economy, employing near half the labor force, contributing almost 50% of GDP and generating nearly two-thirds of total exports (when also taking into consideration the food, drink, and tobacco industries). Moldova's legal and regulatory framework is steadily improving, but significant issues remain and the judicial system is fairly weak and ineffective.

In this context, the main constraints to RAF market operations are:

- For the ultimate clients – lack of access to RAF, especially medium and long-term agricultural credit suited to seasonal or long-term agricultural activities that could be used to significantly increase the sales and value of farm produce;

- For RAF providers – inadequate capacity to overcome high information and transaction costs in serving dispersed rural enterprises as well as risks linked especially with agricultural production and processing;

- For the government – providing adequate support to RAF market functioning in terms of providing an enabling policy environment, an appropriate legal and regulatory framework, and sufficient institutional and physical infrastructure, while avoiding crowding out of the private sector in RAF service provision; and

- For donors like USAID – striking the optimal balance of Mission programs aimed at developing the agricultural sector and the financial sector and leveraging the work of those programs with the related activities of other donors.

INNOVATIONS IN RAF RETAILING

Several major donor programs, led by those of USAID and the World Bank, have focused on the providing rural and agricultural extension services as well as access to finance since 1998. They have resulted in over a third of Moldova's landholders receiving business development services (BDS) through regional agricultural assistance centers and access to over $45 million in RAF through commercial bank retailers, such as Agroindbank, more than 550 Savings and Credit Associations (SCAs) primarily operating in rural areas, and three microfinance institutions – Rural Finance Corporation (RFC), ProCredit, and MicroInvest. Despite major obstacles, such as widespread poverty, economic over-dependence on agriculture, and inadequate institutional and physical infrastructure, most RAF services are efficiently and profitably provided.

USAID has utilized Development Credit Authority (DCA) loan portfolio guarantees to facilitate financing access to rural sectors in Moldova. The Loan Portfolio Guarantee (LPG) Program in Moldova started in 2000 with a revolving guarantee facility of US$5 million and included three local commercial banks – Agroindbank (US$3 million), Victoriabank (US$1 million) and Fincombank (US$1 million). Building on the early success of the DCA guarantee facility in terms of its high utilization, USAID extended the LPG at the end of 2003 to four new financial institutions in the total amount of US$8 million (of non-revolving funds) to: Mobiasbanca, Moldindconbank, Banca Sociala and RFC. Since initiation of the LPG Program, around 1,000 loans totaling US$15 million have been disbursed (as of December 31, 2004) through these seven local financial institutions. Use of the guarantee facility has encouraged them to pilot new products, expand their definition of what assets are acceptable as collateral, and lend larger loans to a greater number of micro, small, and medium enterprises (MSMEs) in rural areas.

Some of the new financial services being piloted due in part to the LPG Program include a mortgage lending product and a factoring product. In addition, a system of grain warehouse receipts is under development. Each of these products is helping to expand to expand the choices available to RAF clients to help them increase their productivity and better utilize their assets to take advantage of market opportunities.

IMPORTANCE OF ACCESS TO WHOLESALE FUNDS

SCAs have access to wholesale funds mainly through two institutions– Agroindbank and RFC. While Agroindbank lent slightly more to SCAs in 2004 (US$9.4 million to US$7.9 million), RFC wholesaled a larger number of smaller loans to SCAs (449 to 362). Although its focus has been wholesale lending to SCAs, RFC is now equally pursuing the retail lending market. Agroindbank’s primary retail activities have been directed to medium and large-scale farmers, yet it lends to the SCAs to reach (albeit indirectly) smallholder farmers.

Several international donor programs wholesale funds to commercial banks and RFC. Through the USDA Commodity Monetization Program, soybean and wheat were monetized to create a loan fund to lend medium-term credit to farmers and farmer groups through two Moldovan commercial banks. In addition, both the World Bank’s Rural Investment and Services Project (RISP) and IFAD’s Rural Finance and Small Enterprise Development Project provided loans funds to RFC as well as technical assistance.

CONCLUSIONS AND TRANSFERABILITY OF LESSONS LEARNED

Access to financial services is an important component of rural and agricultural development projects. The government and donors have treated agricultural credit as part of RAF market development and as just one important component for rural and agricultural development. USAID/Moldova's similar treatment of RAF as an important and integrated component of rural development has further added to its programs' achievements. For example, many of the Mission's programs have included financial components while emphasizing agricultural development or competitiveness, such as on the Private Farmer Assistance Program, Private Farmer Commercialization Program, Land Privatization Support Program, Agribusiness Development Project and BizPro/Moldova. *Nonetheless, many challenges to scale-up remain. Two of the most important are continued reliance on donor funds and lack of technical assistance needed for the system to continue to grow substantively.* An ongoing focus on markets in which Moldova has competitive advantage and support of RAF as an integral component in promoting rural and agricultural development will also be key to further advances in addressing rural poverty.

Donor coordination is essential to success. Successes in expanding access to demand-driven, sustainable RAF services thus far are due in large part to concentrated donor interest in the agricultural sector and good coordination and cooperation between donors and with the government. USAID has achieved a high degree of synergy between its enterprise growth programs in Moldova, which has contributed to the successful results, especially with regard to those addressing the rural and agricultural sector. USAID should extend its comparative advantage in coordinating programs to promote more cooperation between donors with projects in this sector.

Combine DCA with targeted technical assistance. Use of the DCA has been helpful in promoting commercial bank lending to rural and agricultural enterprises. Early evidence indicates that participating banks are piloting new approaches to rural and agricultural lending (e.g. Agroindbank) such as reducing collateral requirements in some cases or introducing new services in others. To enhance the sustainability of these innovations, technical assistance has also contributed to shifting bank management from the traditional top-down style to a more market-oriented approach which has been crucial to successful RAF operations. Combining the DCA with targeted technical assistance on new product development and implementation has been a key component of USAID's successful expansion of RAF in Moldova.

SCAs have achieved high loan repayment performance because of the close village bonds between members (due in part to Moldova's historical operation of local savings and credit cooperatives) but they face many challenges as well due to their limited outreach. SCAs' high loan repayment performance is largely because of the close village bonds between members (due to traditional communal nature of the villages and lingering Soviet influence). However, weaknesses in the governance of SCAs and cultural barriers (e.g. people do not want everyone else to know about their accumulated savings) contribute to their low savings mobilization and inability to take achieve economies of scale. Governance could be improved through conversion to finance companies and enhancing transparency by adopting a branding strategy for the SCAs. Wholesaled funds from Agroindbank and RFC will continue to be important to the SCA system, especially smaller SCAs.

Finance companies such as RFC, ProCredit and Microinvest are not allowed to mobilize savings and are therefore dependent on commercial bank loans and funding by social investors. For example, RFC's biggest challenge will be to access commercial funds to fuel future growth. This may be accomplished by diversifying their base of social investors to include the likes of Blue Orchard or others or transforming into a bank so that it may legally attract deposits. By attracting additional sources of commercial funds, RFC would be better positioned to expand in rural areas and to improve the range of RAF services offered.

The existence of adequate support services are preconditions to an efficiently functioning RAF system and will induce financial institutions (with ample funding sources) not to shy away from serving the rural and agricultural communities. The necessary financial and non-financial infrastructure includes business development services (BDS) for RAF clients (farm and non-farm rural households as well as urban or per-urban agricultural enterprises) as well as technical assistance and training for RAF providers (banks, cooperatives, finance companies, etc.). The availability of demand-driven and affordable BDS (including business advice, extension, farm management, input supply and marketing services, among others) are crucial not just because they can contribute to increased incomes, but because they build creditworthiness in the eyes of financial institutions. The existence of domestic providers of technical assistance and training services for RAF providers (on accounting, financial management, new product development topics, etc.) is also critical to the growth and development of RAF providers. Many of these services have so far been provided with generous donor support and the long-term sustainability of these efforts is still uncertain. In terms of the institutional infrastructure, equally important is the exchange of information: currently, there are huge gaps in terms of information sharing and standardization of high quality institutions. For example, there is no credit information bureau yet (although development of one is underway) and the risk of over-indebtedness could appear in the medium to long run, if such information exchange facilities are not in operation.

INTRODUCTION

MOLDOVAN RAF ACHIEVEMENTS IN CONTEXT

Moldova is the poorest nation in Europe with a GDP per capita of US$720 (December 2004) and 23 percent of Moldova's 4.3 million people (1.127 million) fall beneath the country's poverty line. Half of the population lives in rural areas outside the two main cities of Chisinau (the capital) and Balti (the next largest population center) where physical infrastructure (especially roads and rails required for transport) and social services (health and education) are weak.[1]

Agriculture is the largest sector of the Moldovan economy, employing near half the labor force, contributing almost 50% of GDP, and generating nearly two-thirds of total exports (when also taking into consideration the food, drink, and tobacco industries). After 1990, the country carried out an ambitious agricultural reform program, privatizing state-owned land and giving title to the new private farmers. However, to be profitable, the new private farmers needed access to new technologies and financing, especially medium and long-term agricultural credit suited to seasonal or long-term agricultural activities that could be used to significantly increase the sales and value of farm produce. Constraints facing RAF providers included inadequate capacity to overcome high information and transaction costs in serving dispersed rural enterprises as well as risks linked especially with agricultural production and processing.

Several major donor programs, led by the World Bank and USAID, have focused on the provision of rural and agricultural extension services as well as access to finance since 1998. They have resulted in over a third of Moldova's landholders receiving business development services (BDS) through regional agricultural assistance centers and access to over $45 million in rural and agricultural finance (RAF) through commercial bank retailers, such as Moldova Agroindbank (AIB), Savings and Credit Associations (SCAs), the Rural Finance Corporation (RFC) and ProCredit. Despite major obstacles, such as widespread poverty, economic over-dependence on agriculture, and

[1] Based on the World Bank's 2004, "Moldova: Country-at-a-Glance" data sheet.

inadequate institutional and physical infrastructure, most RAF services are efficiently and profitably provided.

RESEARCH OBJECTIVES

The main objectives of this case study are to explore how RAF programs in Moldova have overcome the challenges of improving access to financial services for rural communities and the agricultural sector and to extract lessons applicable to other less-developed countries. To do this, this case study considers the following questions:

- How did bank and non-bank financial institutions (NBFIs) overcome the obstacles of high poverty, economic over-dependence on agriculture, and inadequate infrastructure to become the national leaders in the provision of demand-driven and sustainable RAF services to tens of thousands of rural clients? In particular, what were the institutional prerequisites, relationships and innovative technologies that facilitated their success?

- What has been the impact of access to USAID's Development Credit Authority (DCA) guarantees on RAF retailing?

- How has the availability of wholesale funds affected RAF retailing?

- What lessons can governments, donors and practitioners in other developing countries learn from the innovations, successes and shortcomings of the Moldovan experience?

METHODOLOGY

This report includes theoretical considerations drawn from the "financial systems" paradigm[2] and agricultural value chain analysis[3] for analyzing RAF innovations. The main findings and lessons presented here are the product of extensive consultation through individual and group meetings with a wide variety of RAF institutions and stakeholders including government officials, a private bank (AIB), non-bank financial institutions, the National Federations of SCAs, domestic non-governmental organizations (NGOs), donor agencies and their program implementing partners.

Responses to questionnaires eliciting stakeholder views on RAF and their latest institutional and financial data have been incorporated where possible. All institutional and financial data are based on self-reporting

[2] The financial systems paradigm considers financial service niche markets, such as agricultural, rural or micro finance, as part of a country's general financial services market, focuses on the development of sustainable financial institutions, and recognizes that clients are willing to pay the full cost of these services if the services are designed and delivered according to clients' specific needs (Von Pischke 1988; Otero and Rhyne 1994).

[3] Agricultural value chain analysis involves understanding the financial and non-financial actors, institutions and relationships involved in the life cycle of key agricultural products, from production to market.

by the institutions surveyed, unless otherwise noted. Readers should be mindful that this self-reported data is often based on estimates only. This is particularly an issue with some institutions providing RAF services that do not separate them from traditional financial intermediation (an issue with some commercial banks). Lending interest rates are quoted on the basis of simple, declining balances, unless otherwise noted.

ORGANIZATION

Section 2 examines the country context, with particular emphasis on the policy environment, the legal and regulatory framework and support institutions for RAF service provision. It also provides an estimate of the nature and extent of demand for RAF services. Section 3 evaluates major RAF retailers and their innovations in terms of products and services as well as delivery systems. The section also includes analysis of the impact of use of the Development Credit Authority (DCA) on expanding access to RAF services. Section 4 explores what results SCA access to wholesale funds from AIB and RFC has had on expanding access to RAF services. Section 5 shares lessons learned and comments on their transferability to other country contexts.

COUNTRY CONTEXT

Socioeconomic development and macroeconomic and sectoral stability are important considerations in determining suitability of the operating environment to promote development and growth of a RAF services industry. This section highlights relevant socio-economic issues for Moldova, the country's recent macroeconomic performance, and that of the country's agricultural and financial sectors as a basis for establishing the national context for the emergence of a RAF industry.

POLICY ENVIRONMENT

SOCIO-ECONOMIC ISSUES

Moldova remains split between the East and the West. Moldova was the first former member of the Soviet Union to elect a Communist President in 2001. But the Communists lost the high-profile race for mayor of Chisinau, the capital city. Moldova's trade is also divided between Eastern and Western Europe. As of 2004, 51% of exports went to countries that were formerly part of the Soviet Union, mainly Russia and Ukraine (U.S. Department of State 2004). However, Moldova is slowly increasing both exports to and imports from Western Europe, as well as the USA and Canada.

Sound policies have helped stabilize Moldova since the 1998 economic crisis. Moldova's central bank, the National Bank of Moldova (NBM), instituted a policy in 1998 of a free-floating exchange rate, which has helped to stabilize the exchange rate. NBM was also able to consolidate the NBM international reserves from US$136.9 million in 1998 to US$470.3 million in December 2004, which guarantees the stability of the national currency (NBM 2004) Moldova recorded its fifth consecutive year of positive GDP growth in 2004, with year-end real GDP growth of 7.3%. As for any economic activity, steady and positive economic growth and controlled inflation are important conditions for development and expansion of the RAF market in Moldova.
The economy is growing but the heavy burden of foreign debt raises inflation concerns. Moldova is now one of the region's most heavily

indebted countries, with debt per capita of US$397 (World Bank 2004a). Debt servicing represented 32.5 of the budget in 2003. During 2003, Moldova rescheduled an outstanding Eurobond to avoid default. Moldova informed its bi-lateral creditors in 2003 that it would no longer service its debts, although the 2004 budget provides funds for bi-lateral debt service. Despite difficult negotiations, the IMF and World Bank resumed lending to Moldova in July 2002, then suspended lending again in July 2003 (U.S. Department of State 2004). The foreign debt burden is increasing inflationary pressures, which until 2003 had been on a steady decline, decreasingly from 18.4% in 2000 to 6.3% in 2001 to 4.4% in 2002 (NBM 2004). Inflation rose to 15.7% in 2003 and through December 2004, it was averaging 12.5%.

Lack of economic opportunities have forced one-third of the active population, about one million people, to seek work abroad. Unemployment, including underemployment, and persistent poverty continue to plague Moldova. Of the 4.3 million people in Moldova, approximately 23% are living below the poverty line and GDP per capita is only about $720 (World Bank 2004a). This has caused many Moldovans to work in other parts of Eastern Europe, including Russia, Ukraine and Turkey. There are also a significant number of undocumented workers in Western Europe. In 2004, overseas workers remitted about US$332 million back to Moldova (NBM 2004), reaching almost 17% of GDP that year. Perhaps because of the high migration rate, the National Bank of Moldova reported the 2004 unemployment rate to be only 8.1%, with a 12.2% rate in urban areas and fluctuating between 6-8% for the past three years.

FINANCIAL SECTOR

In terms of asset size, geographic coverage and financial intermediation, commercial banks are the leading participants in Moldovan financial markets. This sector is dominated by the 16 privately-owned commercial banks, and in particular by the five largest banks, which account for more than 70% of banking sector assets, over 55% of capital, over 75% of deposits and over 70% of loans issued in 2004. Most of the larger banks originally were Moldovan branches of the specialized banks of the former Soviet Union. All banks are privately owned now (except for the Savings Bank) and performing well over the last four years. The total assets of the banking sector increased by 2.9 times during the period 2000-2004, including the balance of credit extended, which increased by 3.4 times. The weight of net credits in total assets grew from 43.4% in 2000 to 54.4% in 2004. At the same time, loan portfolio quality has improved in recent years and is quite good. Commercial banks' liabilities in the 2000-2004 period increased by 3.3 times, including the deposits attracted, which nearly quadrupled. Commercial banks' net income grew by 45% in the period 2000-2004 and profitability indicators have remained solid: return on assets accounted for 4.4% and return on capital was 19.7% as of December 31, 2004.

The share of the agricultural loans in commercial banks' portfolios is relatively large as compared to banks of other countries. The total amount of commercial credit provided in 2004 to the agricultural and food sector constituted approximately 25.8% ($155 million) of the total commercial credit to the economy ($600 million) (NBM 2004). AIB led the commercial banks by lending over $24 million equivalent (16% of the total) in 2003 (AIB 2004).

Moldova's NBFIs are less developed compared with the banks but among these, credit unions and finance companies are growing at a faster pace. More than 550 SCAs disbursed a combined equivalent of $20.2 million to the agricultural sector in 53,991 loans (averaging $374 each) through July 30, 2004. Two finance companies–RFC and ProCredit–disbursed a combined equivalent of $487,600 through 557 loans (averaging $874 each) to agricultural producers and processors. Provision of RAF by these NBFIs has been brisk, growing in excess of 30% per year on average.

AGRICULTURAL SECTOR

Agriculture is the largest sector of the Moldovan economy, employing nearly half the labor force, contributing almost 50% of GDP, and generating nearly two-thirds of total exports (when also taking into consideration the food, drink, and tobacco industries). In addition, over half the population lives in the rural areas. The dominance of agriculture in Moldova's economy derives from its moderate climate and fertile soils. Important products include fruits, vegetables, tobacco, grapes, sunflower, winter wheat, corn and animal products. The production of such a variety is due to fertile soils and rich labor resources (IMF 2004). Moldova's main comparative advantages in the agricultural sector are rich agricultural resources, an educated workforce, and the production of high value crops, such as fruits and vegetables.

After independence, land was privatized and ownership distributed to eligible citizens. The average family was entitled to plots of between 1.5 and 2.5 hectare (ha). Currently, about 99% of agricultural land is in private ownership. This is one of the achievements of the National Land Program, largely supported by USAID (CNFA 2004a, p. 26). Four categories of farms emerged: (i) small individual farmers; (ii) individual commercial farmers; (iii) farmers in associations with close relatives; and (iv) farmers in groups (from less than 10 farmers to large, joint-stock companies). The small size of many farms precludes the use of agricultural machinery and advanced technology; for that reason, manual labor continues to be used, leading to poor efficiency and profitability. To overcome these constraints, farmers with initiative rent land from people who have retired; they also move from one of the above categories to another to have easier access to inputs and credit or to practice more independently (FAO 2001).

The Commonwealth of Independent States (CIS), mainly Russia, represents the major market for Moldovan agro-food exports (more than 70%). This is due to a number of factors, including: (i) existence of a market niche for Moldovan exports due to high produce quality and uniform standards across CIS; (ii) price competitiveness of Moldovan products due to free trade agreements with CIS countries; and (iii) an overall positive consumer image of Moldovan fruits and vegetables on those markets (CNFA 2004a). However, competition is increasing every year from CIS countries as well as countries in the west.

Moldova faces significant challenges in agricultural exports with western trading partners. The high entry barriers to European Union (EU) agricultural markets, including high custom tariffs, the protectionist agricultural policy and subsidies that discriminate against outside imports of agro-food products, coupled with high import produce requirements will continue to prevent access of Moldovan agricultural exports to western Europe (CNFA 2004a). Moldova also faces significant non-tariff barriers that hamper exports to Eastern European markets, including costly and excessive customs procedures, transit regulations (through Ukraine for products for Russia) and discriminatory excise taxes.

LEGAL AND REGULATORY FRAMEWORK

LEGAL FRAMEWORK

Moldova's legal and regulatory framework is steadily improving, but significant issues remain. An analysis of key commercial laws that directly contribute to creating a favorable investment climate in Moldova, such as secured transactions and bankruptcy laws, shows that even relatively good laws suffer from poor implementation. This implementation gap both undermines the utility of specific laws and diminishes the confidence that foreign investors and traders have in the legal system and in its ability to uphold contractual rights. Corruption also remains a serious problem, partly due to the state's continued heavy involvement in the economy.

Securing business loans with limited or no collateral is difficult in Moldova. In the 2004 financial market, the required collateral security ranges between 140%–180% (NBM 2003). With its strong focus on collateral when assessing the risk related to individual loans, the NBM provides a strong incentive for banks to ask for traditional collateral, such as real estate and cars. Not only are small producers often unable or unwilling to offer such collateral, the transaction costs produced by the provision of such collateral are extraordinarily high in Moldova. The law requires that each agreement be separately notarized to be legally valid, which involves a state fee for notarization. To make a security agreement for a car legally valid, a certificate must be obtained from a state authority, which involves another fee and more time. These procedures make it extremely unattractive for entrepreneurs to initiate a loan request. Since the fixed costs are large, the burden is disproportionate for smaller borrowers (OECD 2003).
There are concerns about new laws regarding collateral and their enforcement. Secured transactions are governed by relatively recent laws (Law on Pledge, November 2001 and Order on The Register of Pledged Movable Assets and Regulations on the Register, June 2002) and the registration system was not computerized until the end of 2002. The registry is now operated by the Ministry of Justice and entries are

made to a notary office. Unfortunately, entries are made both manually and electronically, which leads to discrepancies in the data and general confusion and uncertainty. In addition, the Order is unclear as to who will have access to information and whether the register is open to public inspection. While the 1996 Pledge Law provided that a pledge creditor had the right to foreclose and sell pledged property without recourse from the courts in the event of the debtor's default, in practice, the creditor faced uncertainty as to the validity of the process, as well as obstruction by the debtor, which resulted in lengthy litigation. It is unclear whether the new provisions have remedied these difficulties (EBRD 2003).

Adding to these issues is the fact that the judicial system is fairly weak and ineffective. Moldova's slow and uncertain legal system has caused a crisis of confidence among local entrepreneurs, businesses and foreign investors, thereby hindering economic opportunities and growth.

There are many challenges in setting up and registering a business. Many entrepreneurs claim that starting a business in Moldova is too costly, time consuming and extremely bureaucratic (OECD 2003). The existing Law on Licensing requires that enterprises obtain licenses for certain types of activities and there is a Chamber of Licensing that issues these licenses. According to a World Bank study on the costs of doing business (ARIA 2004), the registration of new companies took on average 28 days and entailed high costs. Perhaps because of this, data from the Microfinance Information Exchange (MIX) in 2003 indicates that some entrepreneurs opt not to register their firms, choosing to operate in the "shadow" economy where things are considered much "simpler."

REGULATION AND SUPERVISION

The licensing options, regulatory framework and supervision for RAF institutions are outlined below. Many of these laws were enacted in the mid 1990s, shortly after Moldova became an independent republic and are still being refined today. In addition, most of the supervisory institutions are quite new and still building their capacity as effective regulators.

The banking regulatory framework applies mainly to commercial banks and is comprised of three main components: 1) Law on NBM (1995), 2) Law on Financial Institutions (1995) and regulatory documents of the NBM (1995-2004). The NBM was established in 1991 with full authority to deal with banking supervisory and regulatory matters. The Law on Financial Institutions applies to banks and other financial institutions, which has caused some confusion in the microfinance sector recently, leading to the adoption of a separate Law on Microfinance Institutions. This law addresses only joint-stock banking issues and does not provide for any forms of cooperative banking (BizPro/Moldova 2003). In 2003, the NBM revised requirements on capital structure for commercial banks, increasing its minimum size to MDL50.0 million (NBM 2003).

On July 22, 2004 a Law on Microfinance Institutions was passed, which applies to non-depositary microfinance institutions (MFIs) other than financial institutions and SCAs. The State Supervisory Body (SSB) is in charge of supervision and monitoring for both MFIs and SCAs. MFIs are defined as joint stock companies or limited liability companies engaged in microfinance as their core business activity. This definition does not apply to financial institutions engaged in deposit taking and non-profit organizations (BizPro/Moldova 2004).

The SSB was founded in September 1998, in accordance with the Law on SCAs and it is financed according to the State Budget legislation. The SSB performs control of SCA activity in cases of violation of the Law on SCAs and Financial Prudential Rules. All SCAs must comply with legislation provisions, meet accounting requirements and submit quarterly financial statements to the SSB. However, SSB supervision is currently weak due to its scarce resources. As the SCAs network is quite large, the World Bank is supporting SSB by providing funds and technical assistance under the Rural Investment and Service Project (RISP).

SCAs are governed by a legal framework, which includes the Law on SCAs (1998), Regulation on SSS (2004),[4] Regulation on Licensing SCA Activities (2004) [5] and financial prudential regulations for SCAs (2004)[6]. Important aspects of this framework are: (i) SCAs can only accept savings deposits from their members; (ii) SCAs are non-commercial organizations with special legal status; and (iii) SCAs must have a license in order to function. Constraints in this law include limited geographical outreach of SCA services, prohibition of savings collections and inability to offer credit to legal entities (BIZPRO/Moldova 2003). New prudential norms have been entered in force since the end of 2004 (regarding capitalization, liquidity, reserves, delinquency, etc.) which strengthened the minimal and quite weak earlier standards adopted in 1998 relative to international standards.[7] These more strict financial prudential rules should help to ensure the continued health of the SCA system.

Being a non-bank financial institution, in the form of a joint stock company (JSC), RFC is not under the incidence of the Law on Financial Institutions and it is not supervised and regulated by NBM. Rather, it reports to the Ministry of Finance and international lenders under the agreements

[4] An update to the 1998 regulation on SSS was adopted through the Decision of the Government nr. 719 from 28.06.2004, Official Monitor from July 9, 2004, nr.108-111, p. II, art. 888.
[5] The 1998 regulation on licensing of SCA activities was also updated by the 2004 order of the Licensing Chamber regarding the conditions of licensing and the lists of additional documents necessary to be attached to the licensing application for some types of activities nr. 77-g, September 10, 2004, Official Monitor from October 29, 2004 nr.193-198;
[6] The new prudential financial rules were also adopted as part of the Decision of the Government nr. 719 from 28.06.2004, Official Monitor from July 9, 2004, nr.108-111, p. II, art. 888.
[7] Such as adherence to the Basel Core Principles for Effective Banking Supervision.

signed with them. Due to its JSC status, RFC is regulated by the Law of Joint Stock Companies, Law on Entrepreneurship and Enterprises, and other general legislation and it is submitted to further supervision by the National Commission for Capital Markets.

FINANCIAL AND NON-FINANCIAL INFRASTRUCTURE TO SUPPORT RAF PROVISION

Since 1998, the World Bank, USAID and other donors have provided technical assistance and training directly to various RAF providers and have assisted in the development of domestic financial and non-financial institutions to support the development and growth of RAF services. These include BDS providers (acting as incubators for new businesses and start-ups), the National Federation of SCAs (NFSCAs), which represents SCAs at the legislative level and offers training and consulting, and the SSB in charge of supervision. Two local development NGOs were established in the late 1990s with the support of international organizations to create capacity for local assistance to SCAs: they are the Moldovan Microfinance Alliance (MMA) and the Rural Development Centre (RDC). These two development institutions have training programs for SCAs, have regional offices, perform some monitoring of SCA activities and offer services to SCA borrowers.

The financial infrastructure for RAF is still fairly underdeveloped. While there are a growing number of service providers for various business development and advisory services, there are huge gaps in terms of information sharing and standardization of high quality institutions.

DOMESTIC PROVIDERS OF TECHNICAL SERVICES FOR RAF PROVIDERS

There remains high demand for technical services by RAF providers, especially SCAs. Training and consulting services have been provided for SCA startup and development in the following areas: strategic and financial planning, loan portfolio management, financial and tax accounting, financial analysis and internal audit. However, most of these training and advisory services have been paid for by donors, with small costs to clients. Demand for these services has remained high while these services have been provided at minimal cost; it remains to be seen if demand will remains high or if effective demand will decline if SCAs start covering more of the true cost of delivering these services in the future.

Both MMA and RDC were established with donor funds and have been providing technical services to SCAs for a number of years, with the losses covered by their donors. Established in 1997, MMA was the first NGO created to develop the microfinance sector in Moldova with a focus on SCAs. Since its inception, it established and supported 235 SCAs, developed training modules, published five manuals on microfinance, developed SCA ratings and new microfinance products.[8] RDC was created in 1999 and has established and registered 220 SCAs, and has

[8] BIZPRO, Microfinance Development Strategy, 2003.

published 12 training manuals for SCAs. It has also supported the startup of 26 new businesses and has created funding documents for 28 new enterprises.

Farm Store Program

In October 1999, CNFA began the process of designing the Farm Store Program, selecting potential partners and developing projects. Since that pilot phase, the Farm Store Program has become a key component of USAID-funded CNFA-Moldova activity, with a network of 85 stores planned by the end of 2003. The farm stores, the majority of which are financially self-sufficient, are actually rural development centers. They typically contain training rooms, local NGOs and Savings and Credit Associations, endeavoring to meet the five major needs of Moldova's private farmers: (i) agricultural inputs; (ii) machinery, machinery services, parts and maintenance; (iii) marketing assistance for agricultural outputs; (iv) training, information and consultations from store agronomists and local NGOs; and (v) access to store credit and small loans from SCAs.

Source: Union of Agricultural Producers' Association of the Republic of Moldova web site, http://www.uap.md/eng/cnfa.php.

The NFSCAs also provides legal assistance and consulting to their SCA members. It was established in December 1998 by 46 SCAs to represent and promote their interests, as well as to lobby government authorities and lenders to help consolidate the SCA network. As of October 2004, membership in the national federation numbered 434 SCAs. Funded primarily with member dues, the NFSCA has effectively assisted with SCA legal issues over the years. For example, mainly due to NFSCA efforts, SCAs are exempt from paying income taxes (from January 2005). The NFSCA also provides accounting assistance and consulting by collecting financial reports for submission to the SSB, providing training workshops at discounted rates to SCA senior management on various topics including financial management, internal audit, and accounting.

PROVIDERS OF BDS FOR AGRICULTURAL AND NON-FARM, RURAL ENTERPRISES

The provision of demand-driven, sustainable BDS services is an essential element in boosting the ability of RAF clients to take advantage of economic opportunities and increasing the effective demand for RAF. A variety of models abound for delivering BDS, from encouraging service provision among value chain actors to the development of business centers. The most successful efforts to increase sustainable BDS provision in rural areas for RAF clients have incorporated elements of both approaches. Donors have helped to develop farm stores (essentially multi-purpose rural development centers) and strengthening of producer associations and regional business centers to provide fee-based BDS services to their members.

Most of the larger business advisory centers and consultancies are based in and around Chisnau and provide services mainly to non-farm urban SMEs on a commercial basis. Examples of organizations that are currently providing services are: the Moldo-American Centre for Private Initiative (MACIP), which seeks to provide management assistance and business advice to entrepreneurs of private enterprises; the Agency for Enterprise Restructuring and Assistance (ARIA), which is a management school and offers business consulting in various SEE countries, including Moldova; and the Moldova Business Centre, which converted into a private company and now charges fees for the provision of business services (OECD 2003). In addition, the National Chamber of Commerce and Industry provides business assistance at the branch level. Country councils are increasingly active in enterprise promotion, some even looking to establish business advisory centers in their territory. There are also a number of training organizations, as well as legal and accounting firms providing services to the non-farm SME sector.

Although most clients in rural areas still have inadequate to no BDS support, two donor-funded programs have been successful in making significant inroads for the *provision of BDS in the countryside.* Several donor programs contributed to increasing the supply of BDS to rural farm and non-farm enterprises. Two of the most important programs have been directed toward increased availability of BDS for Moldova's private farmers:

- As part of the Private Farmers Commercialization Program (PFCP), the Farm Store Program (Box 1) created a total of 85 farm stores from 2000-2004. Essentially rural development centers, the farm stores had an average of 3,900 clients per store and the majority are financially self-sufficient offering a mix of training spaces for local NGOs and SCA services to help meet demand for agricultural inputs, machinery parts and maintenance, access to credit (from SCAs), and increasingly fee-based marketing assistance, training and consultation (from store agronomists and NGOs); and

- As part of the Private Farmers Assistance Program (PFAP), 15 regional Agricultural Producers' Associations (APAs) and regional business centers were strengthened to provide fee-based training in accounting, tax assistance and marketing. Twelve of the 15 are deemed to be financially self-sufficient.

CREDIT BUREAU

No public registry or private credit bureau exists to collect, maintain and disseminate credit information in Moldova; however, one is in the process of development. Preliminary work on the legal environment needed to facilitate establishment of a credit bureau is being undertaken as part of the RISP of the World Bank in coordination with other donor programs, including USAID's BizPro. BizPro/Moldova is facilitating domestic dialogue and indigenous efforts to develop a credit bureau, taking into account regional and international best practices. Establishment of a credit bureau should improve the information vacuum that currently exists regarding current and potential borrowers and should assist efforts by RAF providers to determine borrower creditworthiness. Effective credit bureaus can help improve the quality of loan portfolios and facilitate reduction in the average lending interest rate.

SYSTEM OF GRAIN WAREHOUSE RECEIPTS

A grain warehouse receipts program is also under development. Several international donors have studied the feasibility of such a program in Moldova as a means of financing the working capital needs of the agribusiness sector and improving transparency of commodity product transactions. Under the PFCP, USAID and the European Bank for Reconstruction and Development (EBRD) are currently collaborating to address the remaining legal and regulatory constraints, to deepen and expand existing reforms, and facilitate country-wide implementation of a warehouse receipts system that would develop reliable and secure business relations among all participants in Moldova's grain market.

A system of grain warehouse receipts has the potential to help Moldovan farmers increase productivity and better utilize their land by ensuring access to the short-term credit. The program seeks to increase access to credit by using the farmer's own produce as collateral. Access to receipts from trusted and certified warehouses will also increase the farmers' financial creditworthiness by providing lenders with liquid and guaranteed safe collateral that can easily be marketable in case of loan default. USAID is supporting the design, development, and implementation of the project. EBRD will provide technical assistance and financing to local banks that lend against warehouse receipts, with initial capitalization expected to be US$10 million to US$20 million.

THE NATURE AND EXTENT OF DEMAND FOR RAF SERVICES

The best estimates suggest that about 747,000 persons are engaged in agricultural production or processing, accounting for about half of the labor force. Most are engaged in production of a variety of fruits and vegetables given the rich soil that covers 80% of Moldova. However, widespread poverty exists among agricultural hired labor (56%) and farmers (47%) due to low incomes from agricultural activities. The main source of income for poor households is their agricultural activity. Agricultural income of the poor accounts for 40% of disposable income. Possessing land does not guarantee well-being– 79.2 % of poor rural families have land plots intended for farming activity. The problem lies in the low productivity of agricultural activity, lack of equipment and small sizes of land plots, which predetermine low incomes. The dependence of income on the weather and climate is a specific and additional risk factor for poor rural households (IMF 2004).

Lack of access to financial services, especially safe and liquid savings accounts, seasonal loans, term credit and equipment leases, is one of the main problems for the majority of agricultural enterprises. It is also a problem for agro-processing enterprises, which would like to modernize and restructure. There is widespread local agreement that at least US$1,000 equivalent loan is needed by at least half the population engaged in agriculture, so the minimum total demand could be estimated to be 325,000 loans amounting at least US$325 million. This estimate is subject to great variance, with the number of loans demanded likely to be a more reliable figure than the amount. This exercise is meant only to provide a general sense of the scale of demand. More thorough analysis would need to be done on the basis of rural surveys before more exact and reliable estimates could be derived.

INNOVATIONS IN RAF RETAILING

OVERVIEW OF SUPPLY

The current supply of RAF is estimated to be only 20% of the potential effective demand. By the number of borrowers, there are at most 71,000 rural and agricultural loans outstanding amounting to about US$60 million (equivalent). The RAF provided in Moldova comes from two main sources: commercial banks and NBFIs. The main providers of RAF as of June 2004, include the rural and agricultural lending operations of one commercial bank (AIB), more than 550 SCAs primarily operating in rural areas, three microfinance institutions (RFC, ProCredit [an International Project Consult-affiliated finance company] and MicroInvest [funded mainly by the Soros Foundation]). Table 1 summarizes the rural and agricultural lending portfolios of four of the main retail providers.

TABLE 1: RAF LOANS BY RETAIL INSTITUTION

RAF MAJOR RETAILERS	TOTAL NO. OF RURAL & AG. LOANS	TOTAL AMT. OF RURAL & AG. LOANS (US$ MILLION)	NO. OF AG. LOANS	AMT. OF AG. LOANS (US$ MILLION)	AG. LOANS AS A % OF TOTAL LOANS	AVG. SIZE OF AG. LOAN (US$)
AIB	7,800	34.6	5,500	24.0	41.7%	4,364
SCAs	61,214	22.4	53,991	20.2	88.2%	375
RFC	224	2.5	122	1.4	65.9%	11,475
Procredit	1,426	2.3	333	0.4	15.2%	1,201
Total	70,664	59.5	60,048	44.7		

Notes: Data for AIB is as of July 31, 2004 (the latest statistics available at the time of the study) and include estimates for the number and average size of agricultural loans. Data for AIB's total RAF lending are based on the assumption that 60% of AIB's lending is rural. Data for SCAs is as of June 30, 2004 (the calculated average loan size is $375 equivalent, while SCAs reported average loans size of approximately $250). Data for ProCredit is as of October 31, 2004. Data for RFC is as of June 30, 2004.

The market for RAF is still fairly segmented. About 60% of AIB's total retail lending supports rural borrowers and 42% of their total lending is for mainly larger scale agricultural production and processing.

The bank also wholesales funds to the SCAs (described further in Section IV). The SCAs lend primarily to smaller-scale agricultural producers in rural areas and 100% of their borrowers can be considered either rural or agricultural. RFC lends mainly to SCAs but also, to a more limited extent, directly to micro and small-scale farm and non-farm entrepreneurs in rural areas whose credit needs have outgrown their local SCA. The other two MFIs–Procredit and Microinvest–are serving mainly an urban market (however, 35% of ProCredit's lending is rural and it is finishing a pilot of an agro-lending product based on cashflow lending that holds much promise for scale-up in 2005). Additional details on the RAF services provided by each of the main market player are included below.

MOLDOVA AGROINDBANK

The largest Moldovan commercial bank and RAF retailer is AIB. As of June 30, 2004, it had MDL162.4 million (US$13.4 million) in loans outstanding to support agricultural production and another US$7.0 million equivalent in agricultural processing-related loans. It also had MDL662 million (US$54.6 million) in deposits mobilized outside the main population centers of Chisinau and Balti.

Succeeding the former Bank of Agroprombank of the USSR, Moldova Agroindbank was established in 1991 as a licensed commercial bank. As the leading local bank in terms of market share, AIB has an extended network of 47 branches and 34 representative offices located across the country. It holds approximately 21.6% of all banking assets, 19.9% of total banking share equity, 24.6% of loans granted by all commercial banks and 22.8% of all deposits attracted by commercial banks (as of December 31, 2004).

AIB has a long history of being the leading bank to serve the agricultural sector and has learned through the years how to manage the risks of agricultural lending. About 42% of AIB's total retail lending supports larger-scale agricultural production and processing. Only about 20% of its retail lending can be considered for micro or small-scale agriculture with average loan sizes under MDL180,000 (US$15,000). A large part of companies served by AIB are private companies (87%), the majority of which are involved in industrial and agricultural activity, such as wine, sugar and tobacco. AIB manages the risk of agricultural lending by limiting it to about 45% of its total lending volume, and actively manages credit risk through its Risk Monitoring Department, which reports directly to the bank's President.

It actively collaborates with the donors with regard to support of farmers, wholesaling funds to SCAs and retailing to small, medium and large-scale agribusinesses. AIB's more innovative retail loan products aimed at rural or agricultural clients have been developed in cooperation with one or more donor programs. One example is the mortgage lending product that resulted from the joint USAID and USDA-created Private Farmer Credit Fund (discussed in

Factoring Arrives in Moldova

What is factoring? Factoring is a form of asset-based finance in which the credit extended is based on the value of the borrower's accounts receivable (i.e. the payments owed by the borrower's customers). With factoring, the receivables are purchased by the factor (i.e. financier) rather than used as collateral in a loan, as with traditional asset-based lending.

Attributes of AIB's pilot factoring products. AIB's pilot factoring products will allow a seller (borrower) to receive from AIB 80 percent of the value of an account receivable, and the remaining 20 percent (less interest and service fees) upon receiving payment from the customer.

AIB is offering its factoring product on a recourse basis, in order to address the common problem of factoring: it is often difficult to assess the default risk of underlying accounts. Under recourse factoring, the factor has a claim against its borrower for any account payment deficiency. Thus losses occur only if the underlying accounts default and the borrower cannot make up the deficiency.

As in the typical factoring relationship, AIB bundles financing with collection services. Collection services involve retrieving current accounts and delinquent accounts and minimizing losses associated with the latter through the judicial system. Essentially, SMEs that use factors are outsourcing their credit and collection functions—another important distinction between factoring and traditional commercial lending.

While exact figures concerning number of clients and volume of business were unavailable for publishing, early indications from the pilot program suggest that the factoring product is being well received and having benefits beyond what was originally expected. For example, AIB reports that their factoring work with Metro Cash & Carry - a large German supermarket retail chain – bodes well for future factoring services with other bulk suppliers and retailers.

Sources: Interviews with AIB and World Bank, 2004.

Section IV, B. below) and the two factoring products under development now as part of USAID's BizPro/Moldova Program (Box 2). While AIB's retail lending is profitable, its wholesale operations, which it conducts with its own funds, run at a slight loss (discussed in Section IV, A. below).

SAVINGS AND CREDIT ASSOCIATIONS

By the number of active RAF borrowers, the SCA system is by far the largest rural and agricultural credit provider. At mid-2004, there were 555 SCAs in operation with a total membership of 84,067. The SCAs combined had 61,214 active borrowers, but the total volume of their lending (MDL278 million, or US$22.4 million in outstanding loans) was less than that of AIB because the average loan size lent by SCAs was only MDL4,541 (US$366). The SCAs offer short-term (seasonal) loans with maturities up to one year to provide working capital for profit generating activities and medium-term loans with maturities up to three years (though most are kept to 18 months in duration) to support more capital intensive investments. The vast majority of the lending, however, is short-term with loan sizes ranging from MDL200–MDL50,000 (US$14–US$3,587) in 2003 (Agrex 2004). About 90% of these loans were to support agricultural activities but in order to manage risk of lending primarily to agriculture the SCAs are careful to lend not only to small-scale producers but also to processors and those with agriculture-related activities. Less than 10% of their total lending was for consumption purposes (e.g. to pay for school fees, ceremonies, etc.). The SCAs manage the risk of lending mainly to agriculture by lending to farmers as well as processors and those having agriculture-related activities. In accordance with demand, loan maturities and repayment schedules are adjusted based on the anticipated cash flow of the underlying enterprise and balloon payments are available with both short-term and medium-term loans.

Due to their ability to charge cost-covering interest rates and to maintain good loan portfolio quality, the SCA system as a whole is financially viable. In 2003, their financial self-sufficiency (FSS) ratio was over 130%. All SCAs have a business-oriented approach and they charge cost-covering interest rates of 4-6% over what they pay for funds, which allows accumulation of sufficient income to cover operational costs and ensure capitalization. The interest rate charged on loans varies between 20% - 25% annually depending on the loan size, term, etc. In 2004, the average lending interest rate was 24%.

Loan repayment has been maintained at very high levels compared with international standards. For example, portfolio at risk over 30 days due (PAR30) as of June 30, 2004 was less than 1.7% compared to the 2.8% average for 124 MFIs worldwide reporting to the Microbanking Bulletin (MBB 2004). This has been corroborated by an independent survey of repayment behavior which indicated that in 2003, 96.8% of respondents indicated they paid back their loan on time and in full (Agrex 2004). Agricultural activities and wages were two main sources for loan repayment in 2003. Only one third of respondents stated that farming income was the only source of from which to repay the SCA loan. Other sources of income included salaries and overseas remittances. Collateral requirements are sometimes waived and a variety of assets are accepted as collateral for medium-term loans. Traditional collateral requirements are substituted in part by the mutual responsibility of the SCA member and by social pressure, from the traditional elements of a Moldovan village (long tradition of operation of local savings and credit cooperatives). The acceptance of a variety of collateral and partial substitution of collateral requirements with peer pressure is facilitating access to RAF even by small farmers.

Low costs and tax exemptions contribute to SCA sustainability. The operating principles that SCAs follow according to the stage of their development – length of time operating, number of members, etc. – have some features that enable them to stay financially sound regardless of how small their membership may be (110 members on average for an SCA), namely:

- In the first 2-3 years of a SCA, salaries are paid only to the Chair and accountant; furthermore, they are very moderate with a monthly salary about $US30-$US50;
- Board members are not remunerated; only the costs of their participation in Board meetings are covered (and in the first few year of operation, they may waive remuneration altogether in order to keep costs down);
- SCAs are exempt from income taxes;
- SCAs are not allowed to pay out dividends; and
- Interest earning on savings mobilized by SCAs are exempt from taxes.

Only after 3-4 years of operation do SCAs as a rule hire credit officers. By that time, about 25-40% of loans are made from a SCA's own funds.

Due to the local nature of the operations of most SCAs, the professionalism of SCA management remains an issue. Because of this, RFC supports SCA management in their activities as part of the credit methodology by giving them advice and informal assistance and NFSCA provides SCAs with formal training (in accounting, internal control, etc.) that the new Prudential Regulation for SCAs now obliges SCAs management to take.

Characteristics of SCA membership. Approximately 70% of members are engaged in agriculture. About 20% were employed in education or public administration (Agrex 2004). Three-quarters of those engaged in agriculture have registered peasant farms. The average sales volume for 90% of member businesses was less than MDL20,000

(US$1,435). Only about 10% have corporate businesses suggesting they are involved in larger-scale agricultural production or processing.

More than 90% of SCA members joined their SCA to borrow funds and the average duration of membership is 3.5 years. Members are active in more than borrowing, however; over 90% regularly participate in SCA meetings, and 85% participated in the last election of the SCA Council of Administration, the main body responsible for lending decisions (Agrex 2004).

SCAs depend heavily on AIB and RFC for funds to on-lend. SCAs' sources of funds include membership shares, savings from members and credits from financial institutions. Nevertheless, until now, the main fund sources for SCAs are the loans provided by two commercial creditors (AIB and RFC), which are on-lent to SCAs members. For 2003, the SCAs borrowed a total of MDL80.3 million (US$6.5 million). In addition, while deposit mobilization has not been as successful, as of June 30, 2004 the SCAs had managed to attract 915 deposit accounts with balances of MDL6.9 million (US$560,000) and an average balance of MDL7,552 (US$609). These accounts were mainly term deposits that carried an interest rate of between 18% - 23% depending on the term. Similar to findings in other ex-Soviet states, an independent survey of SCA membership indicated the following reasons for low deposit mobilization by SCAs:

- Low level of confidence – the whole village will know the amount;
- Only members are allowed to make deposits;
- SCAs do not insure deposits;
- Common reluctance of Moldovan population to save in financial institutions; and
- Perception of SCAs as primarily lending institutions created to retail microcredit (Agrex 2004).

Early reports from the NFSCA suggest that in 2005; however, the low deposit mobilization to date by the SCAs may be changing for the better. Reasons for this improvement may be due in part to the recent passage of significant legal and regulatory measures in 2004 aimed at strengthening the SCA system, requiring additional conditions on licensing and reporting, and enforcing more strict prudential financial norms (discussed in section II.B. above).

RURAL FINANCE CORPORATION

Although RFC is predominantly engaged in wholesaling funds to the SCAs, RFC is also ramping up its own retail operations to registered businesses, including individual entrepreneurs and farmers, as well as group businesses formed by farmers and

entrepreneurs in the rural areas. RFC's wholesale lending, which comprises about 80% of its total portfolio, is discussed in Section IV below. Although small by comparison, RFC's retail lending portfolio has grown substantially since 2001 when it initiated retail operations. Since RFC is a joint stock company and not a bank, it cannot accept deposits. Instead, it relies primarily on borrowed funds to support its lending.

RFC was established in 1997 to act as a type of apex institution for on-lending to the SCAs, under an agreement between the World Bank and the Government of Moldova. At the end of 2003, RFC had 298 SCAs as its shareholders and the SCAs now hold 99.6% of voting shares while the remaining shares are held by the government and the staff. RFC's retailing and wholesaling of funds supports its institutional objective to provide RAF access to farmers and rural entrepreneurs. RFC also supports rural development through the provision of technical assistance to the SCAs.

TABLE 2: RFC RETAIL LENDING STATISTICS

	2001	1002	1003
LENDING TO SMALL FARMERS			
No. of loans disbursed (annual)	0	16	40
Amt. of loans disbursed (MDL)	0	702,980	2,625,710
MEDIUM–LARGE AGRICULTURAL LENDING			
No. of loans disbursed (annual)	0	16	28
Amt. of loans disbursed (MDL)	0	5,920,000	7,378,389
BREAKDOWN FOR RURAL, NON-FARM LENDING			
No. of loans disbursed (annual)	1	15	51
Amt. of loans disbursed (MDL)	291,850	5,454,807	9,925,190
TOTAL RETAIL LENDING			
No. of loans disbursed	1	47	119
Amt. of loans disbursed (MDL)	291,850	12,077,787	19,929,289

Since 2001, RFC has made significantly ramped up its retail lending by focusing on a specific, under-served market niche. By the end of 2003, RFC had retailed 119 loans amounting to MDL19.9 million (US$1.6 million). Table 2 summarizes RFC's retail lending history. RFC covers a very specific niche of the financial market, represented by rural clients who had no access to financial markets due to small sizes of businesses and requested loans, the insecure nature of agricultural business, and lack of collateral. Focus has been placed on businesses formed by SCA "graduates," who require different loan products and greater loan amounts than offered by their SCAs. RFC's retail lending is geared mainly (70-80%) toward medium to large farmers and agricultural processors. RFC also lends to business start-ups, although this type of lending comprises no more than 20% of its portfolio. Its average loan size is around US$13,500.

RFC differentiates itself further by keeping loan processing times to a minimum. The average time from application to disbursement is about 10 days for its retail lending. Disbursements are made directly to the client's bank account, if possible, to shorten client waiting time and to minimize risk along with the potential for fraud.

RFC also manages its risk of lending to the agricultural sector in a couple of important ways. The institution targets the split between its retail and wholesale lending at 50-50. In addition, RFC diversifies its retail portfolio by lending not only to agriculture but also to other activities related to agriculture like processing, construction, land improvement, and transportation.

Over the last five years, RFC has maintained high retail loan repayment and their operations have been profitable.[9] Loan repayment has exceeded 98% over the last few years and RFC's PAR30 ratio as of June 2004 was 1.1%. Although about 11% of its retail loan portfolio was unsecured (relying instead on character and cash flow analyses), RFC generally requires collateral but accepts a wide variety of assets. The most common forms of collateral accepted are business equipment (over 40% of the total) and real estate (about 35%). RFC is careful to adjust its lending interest rates on both its wholesaled funds (described further in section IV below) and its retail loans in order to cover their costs. In 2003, its average retail lending interest rate was about 16.3% (annualized rate using a declining balance basis). In 2003, RFC earned a net profit of MDL3.98 million (about $306,154) and achieved a return on equity (ROE) of 29.3% and a return on assets (ROA) of 3.1% according to audited annual financial statements based on international accounting standards. To keep costs down, RFC has established eight regional centers and uses a small fleet of cars to reach their rural clients.

RFC's funding comes primarily from loans from international donors. RFC has based its growth almost completely on long-term borrowed funds from international organizations (received directly or through the Moldovan Ministry of Finance). Long-term loans from the World Bank and IFAD comprise 85% of RFC's funding. Shareholder's equity and retained earnings have grown in recent years and now represent 11.2% of RFC's total assets (as of June 2004).

PROCREDIT

A small but fast-growing retailer of RAF services is ProCredit. As of Oct. 2004, ProCredit had more than 4,900 loans outstanding (about twice that of the year before) and the total amount of outstanding

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[9] The PAR_{30} ratio is for RFC's total lending (wholesale and retail) and the profitability data for RFC's operations reflect both their retail and wholesale operations since breakdowns for each of these indicators by business line was unavailable at the time of data collection.

microcredit amounted to about US$10 million. About 35% of its clients are rural based. Reaching RAF clients is facilitated by using a "mobile office"–a minivan that allows ProCredit to serve agricultural businesses and clients in towns where it does not yet have a permanent office and even in remote villages. The rural share of ProCredit's total lending was 1,426 loans worth about US$2.3 million. Only 3% of ProCredit's loans are for agriculture (by volume), but this is due to the fact that ProCredit only recently finished piloting an agricultural lending product (from late 2003). The pilot loan product features cashflow analysis of the farmer's household, acceptance of alternative forms of collateral (in lieu of traditional reliance on real estate) and interest only monthly payments in order to ensure contact with the clients. ProCredit had 333 outstanding agricultural loans as of October 2004 that amounted to about $350,000 (average loan amount is around $1,000). The successful results of the agro-lending product bode well for scale-up in 2005.

ProCredit Moldova, formerly Micro Enterprise Credit (MEC) in Moldova S.A., was registered in December 1999 as a finance company. Shortly thereafter, it started its micro- and small-lending operations, lending from an international credit line facility. ProCredit's mission is "to service private micro and small enterprises in Moldova, providing banking services under market conditions and, ultimately, to become the leading micro-enterprise banking institution in the country." ProCredit's founders and current shareholders are also the initiators of international programs for promoting the small business sector in developing countries and transition economies. They are Internationale Micro Investitionen AG (IMI), EBRD, the International Finance Corporation (IFC), the Stichting DOEN Foundation and the Western NIS Enterprise Fund (WNISEF). ProCredit's shareholders adhere to a common philosophy that microfinance can and should be provided profitably and efficiently. In keeping with its commercial focus, ProCredit charges cost recovery interest rates of about 22% per year and keeps on-time loan repayment above 99% due to its diversified client base (with a mix of urban, rural non-farm, and agricultural clients). These factors contributed to ProCredit turning a profit in 2003 and increasing its profitability in 2004 despite expanding their RAF service provision in a difficult economic environment.

MICROINVEST

Microinvest has nine field offices and about 70% of its clients are located outside of the capital, Chisinau, but its focus in not yet geared toward agriculture. Since the company is relatively young, its operations are still fairly small. As of September 30, 2004 it had 454 outstanding loans amounting to US$652,378 (equivalent) averaging about US$1,435 (equivalent) each.

Microinvest was established by the Soros Foundation in Moldova and a local NGO, the Moldova Microfinance Alliance (MMA), as a limited liability company in April 2003 to help meet the demand for financial resources (small loans and equity) for micro and small enterprises. Microinvest has taken over the regional staff and branch network of MMA, which during its lifetime, 1997 – 2003 had formed 235 SCAs.

With additional financial assistance and support from the Open Society Institute of the Soros Foundation Network and Novib of Oxfam Netherlands, Microinvest provides microloans for established businesses as well as start-ups (from US$100 to US$1,000 equivalent), group loans, credit guarantees (up to US$20,000 equivalent) and community venture capital (comprising equity or debt up to US$50,000 equivalent). It also offers non-financial assistance, such as business advisory and consulting services.

Three-quarters of Microinvest's lending so far has been directed to individual microentrepreneurs requiring no collateral except for three to nine guarantors (for loans up to US$1,000 equivalent). Loans over US$1,000 (equivalent) require 120 percent collateral, usually in the form of tangible assets. While agricultural lending is not the focus of this fund, 30% of Microinvest's portfolio is used for production, which includes agricultural production. Loan repayment has been good, with portfolio at risk over 30 days (PAR30) at 4.78% as of September 30, 2004. Microinvest charges 24% interest annually on its loans, which should be sufficient to cover its operational and financial costs; nonetheless, it is still heavily donor dependent, with a financial self-sufficiency (FSS) ratio less than 40% due in large part to its early stage of development. It is funded primarily by donated equity funds (US$376,443) and long-term subsidized loans (US$155,940).

IMPACT OF DCA

BACKGROUND ON DCA AND ITS APPLICATION IN MOLDOVA

In 1999, USAID established a credit-financing mechanism – the Development Credit Authority – in an attempt to overcome the general reluctance of traditional commercial banks in many developing countries to lend to MSMEs and increase the flow of financial resources to rural enterprises in particular. DCA is considered one of many different mechanisms to increase liquidity in the financial systems of developing countries and it was designed based on the premise that there are large reserves of dormant private capital in less-developed countries. It was developed to provide USAID Missions and staff with an innovative way to stimulate lending of resources held in the private sector in addition to, or instead of, traditional grant-funded programs. DCA guarantees are always linked to and financially supported by the USAID Mission's strategic objectives. The guarantees are directed toward regional areas or market sectors targeted by Missions for economic development assistance. The guarantee facility was set up in Moldova to mitigate economic volatility and perceived risks associated with MSMEs that hampered their access to credit.

A DCA guarantee covers up to 50 percent of a lender's net loss on the guaranteed portion of the loan. The loans that are extended under a guarantee are only provided to qualified, credit-worthy borrowers on commercial terms in local currency, U.S. Dollars, or Euros. DCA guarantees are flexible and can be tailored to meet the needs of a specific financial partner or project. In Moldova, a qualifying loan is any type of new or net additional local currency credit, including commercial loans, lines of credit, overdrafts, commercial letters of credit, and guarantees or financial leases. A qualifying loan may finance, with certain exceptions, any productive commercial activity. In most cases, the total principal amount of qualifying loan(s) made to any one borrower may not exceed the local currency equivalent of US$5,000 for microenterprise loans or US$150,000 for small business loans. It is often complemented by technical assistance to both lenders and borrowers and this has also been the case in Moldova.

Use of the DCA through the Loan Portfolio Guarantee (LPG) Program in Moldova started in 2000 with a revolving guarantee facility of US$5 million and included three local commercial banks – AIB (US$3 million), Victoriabank (US$1 million) and Fincombank (US$1 million). At the end of 2003, building on the success of this existing guarantee facility, USAID opened an LPG Facility for four new financial institutions in the total amount of US$8 million: Mobiasbanca, Moldindconbank, Banca Sociala and RFC, as can be seen in the Table 3. Unlike the first LPG, the second LPG facility is a term facility (not revolving). Since initiation of the LPG Program, around 1,000 loans totaling US$15 million have been disbursed (as of December 31, 2004) through these seven local financial institutions. Use of the guarantee facility has encouraged them to pilot new products, expand their definition of what assets are acceptable as collateral, and lend larger loans to a greater number of micro, small, and medium enterprises (MSMEs) in rural areas.

TABLE 3: DCA USE IN MOLDOVA, AS OF JUNE 30, 2004

PARTNER INSTITUTION	START YEAR	END YEAR	MAX. AMT. (US$)	CURRENT UTILIZATION (US$)	UTILIZATION % (APPROX.)	CUMULATIVE LOANS	% LOANS TO MSMES
AIB	2000	2005	$3M*	$10.8M	300%	811	25%
AIB 2	2005	2009	$9M	0	N/A	0	-
Victoria Bank	2000	2005	$1M*	$2.2M	200%	82	17%
Victoria Bank 2	2005	2009	$6M	0	N/A	0	-
Fincombank	2000	2005	$1M*	$670,392**	60%	29	24%
Moldinconbank	2003	2008	$2M	$166,400**	6%	6	16%
Banca Sociala	2003	2008	$1M	$114,500**	10%	5	37%
Mobiasbanca	2003	2008	$4M	$173,061**	4%	7	35%
RFC	2003	2008	$1M	0	0	0	100%
TOTAL			**$36M***	**$14.2M**		**940**	

Source: Consulting and Credit in Agriculture (CCA) 2004.

*DCA started in 2000 with a revolving guarantee facility of US$5 million, split between three banks.

**Estimated amount in US$.

DCA IMPACT ON RAF AND MSME DEVELOPMENT

The DCA appears to have led to additionality because it fostered lending by participating institutions to MSMEs that would not have happened otherwise. From the first DCA guarantee in Moldova in June 2000 until June 2004, about 940 loans were disbursed for a total of over $14 million. Approximately 46% of the DCA guaranteed loans were for enterprises located in rural areas (outside Chisinau and Balti, the two largest cities in Moldova). The two main businesses that were beneficiaries of the DCA guarantees were trading companies (50%) and agricultural producers (24%).

In general, the DCA has helped Moldovan micro, small and medium enterprises (MSMEs), particularly in rural areas, access credit from participating commercial banks. According to a recent survey by CCA, an agricultural NGO, 58% of DCA funds went to small companies, 32% to medium sized firms and 7% to micro-enterprises (CCA 2004). In addition, significant portions of partner DCA loan portfolios were in agriculture (29% for AIB).

Combining the DCA with targeted technical assistance on new product development and implementation has been a key component of USAID's successful expansion of RAF in Moldova. Partner institutions are using the DCA to increase their SME loan portfolio (Victoria Bank, for example, increased their SME loans from 9% in 2002 to 17% in 2004). An important accomplishment of the DCA is that it allowed some partners to reduce collateral requirements, such as accepting a 130% loan-to-value ratio instead of the standard 140-180%. In addition, banks used the DCA to accept as collateral goods with lower liquidity and increased risk (in terms of repossession and sale) such as like agricultural stocks and produce. Several institutions (Victoria Bank and FincomBank) noted that DCA helped them to fund start-up companies that they otherwise might not have funded without the loan guarantee. The Moldovan partner institutions also claim that a "considerable" portion of DCA clients are businesses with no credit history or no credit history with their institution (CCA 2004). Overall, there was an increase in SME lending in the three original DCA institutions.

ACCESS TO WHOLESALE FUNDS

SAVINGS AND CREDIT ASSOCIATION ACCESS TO WHOLESALE FUNDS

Two institutions currently wholesale funds to SCAs – AIB and RFC. AIB lent only slightly more to the SCAs in 2004 with total disbursements of MDL113.7 million (US$9.4 million) compared to RFC's MDL95.9 million (US$7.9 million).

RFC does not require collateral before lending to the SCAs but AIB does.[10] For example, AIB requires one or more of the following of SCAs:

- Pledge of a special deposit account;
- Assignment of the right to the bank to collect other receivables due to the borrower in national and foreign currency and apply it toward repayment of loan principal and interest;
- Sureties by individuals/legal entities;
- Assignment of property title pledged to the SCAs by its members arising from the loan agreements entered into by the SCA and its members.

The repayment schedule applied to SCAs differs from one association to the other, but the most common scheme used by both AIB and RFC is the following: the principal is repayable as a balloon payment in one installment in March of the following year, and the interest is paid by

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[10] However, RFC requests that borrowing SCAs require collateral from their members for loans larger than MDL15,000 (US$1,100), although RFC maintains no legal claim to that collateral.

SCAs on a quarterly basis. Some SCAs prepay their borrowed funds to save on interest charges. The terms of SCA borrowing, of course, drive to some extent the type of retail lending that the SCAs are able to do. While it may facilitate the use of these funds for agricultural lending given the repayment flexibility, it may also hamper SCA use of these funds to engage in lending for longer-term, investment activities.

The repayment rate of SCAs to both AIB and RFC is reported to be near 100%. Although it happens that individual members encounter certain problems with credit repayment, the rest of SCA members manage to cover the full loan amount to the lending institution through the association's reserve funds.

MOLDOVA AGROINDBANK

AIB is the largest wholesaler to the SCAs, lending to 300 of them as of November 2004. While AIB's retail activities are directed to medium and large-scale farmers, its wholesale lending to the SCAs is mainly to reach smallholder farmers.

However, they lend their own funds to the SCAs at a slight loss. Total disbursements to SCAs in 2004 were MDL113.7 million (US$9.4 million) and in 2003, AIB disbursed MDL85.5 million (US$6.1 million). The average wholesale loan size was MDL350,000 (US$25,000). AIB charges approximately 20% annual interest on average; however, the officers stated that they would need additional 300-400 basis points (3-4 % annual interest) to cover the costs of wholesaling funds. The main reason why AIB cannot raise its wholesale lending interest rates is because the second biggest wholesaler to the SCAs, RFC, has a lower cost of funds and correspondingly a lower interest rates it must charge to have profitable wholesaling operations. RFC lent to over 400 SCAs in 2003 at approximately the same interest rate as AIB. AIB evidently considers its wholesaling to the SCAs as a loss-leading activity meant to build relationships with the SCAs in preparation for the time when lending interest rates can be raised.

The average annual growth rate in lending to the SCAs is 20%-25%. According to the bank's credit policy, MDL1.5 million (US$123,762) is the maximum loan exposure to one SCA. It is unclear whether or not AIB considers lending to the SCAs as a core line of business in the future. This will likely depend on how long AIB wants to accept this as a loss-leading activity due to their inability to compete with RFC's lower cost of funds. The sustainability of SCA access to the majority of their wholesale funding over the medium term may be dependent on creating a level playing field by discouraging cheap credit lines for RFC.

TABLE 4: RFC LOANS DISBURSED TO SCAs (ANNUALLY)

	2002	2003
Number of short-term loans	344	449
Amount of short-term loans	52,120,000	70,900,000
Number of medium-term loans	21	222
Amount of medium-term loans	3,580,000	25,000,000
Total Number of loans	365	671
Total Amount of loans	55,700,000	95,900,000

RFC

RFC wholesales a larger number of smaller loans to SCAs. In 2003, RFC disbursed 449 short-term working capital loans (with a maximum maturity of 12 months) amounting to MDL70.9 million (US$5.1 million) with an average loan of MDL157,907 (US$11,328). Perhaps due in part to RFC's access to more subsidized capital, they appear better able to engage in longer-term lending to the SCAs. Also during 2003, RFC disbursed 222 medium-term investment loans (carrying a maximum maturity of 36 months) amounting to MDL25 million with an average loan of MDL112,613 (US$8,078). Lending the medium-term loans to the SCAs allows the SCAs, in turn, to engage in more long-term, investment-oriented retail lending.

RFC charges about 18.5% annual interest rate on average due to its low cost of funds. RFC also has a quicker turnaround time from application to disbursement of funds to SCAs – only 3 to 5 days on average. As of June 2004, loans to SCAs represented almost 80% of the RFC total portfolio. Although its focus has been lending to SCAs, RFC is now pursuing a 50-50 split between its wholesale and retail lending. The maximum loan amount to any one SCA is about MDL3.0 million (US$250,000)

DONOR PROGRAMS WHOLESALING FUNDS TO COMMERCIAL BANKS AND RFC

USDA COMMODITY MONETIZATION PROGRAM

In 1998, CNFA monetized two USDA-provided commodities in Moldova: 8,000 metric tons of soybean meal and 5,000 metric tons of wheat. The sales of the commodities generated $549,583 of net available proceeds for lending. The net available proceeds were used to create the Private Farmer Credit Fund (PFCF), which provided medium-term (3-5 year) loans to private farmers and private farmer groups through two Moldovan commercial banks, AIB and Fincombank, and the cooperatively–owned RFC. In most cases, the purchased equipment, livestock or land served as collateral for the loan. Both funding resources and risk were split 50/50 with AIB and Fincombank. In the case of RFC, PFCF supplied 100% of the funding resources while the corporation was responsible for the risk of the subsequent loans made to SCAs and finally to smallholders. In total, 110 loans were disbursed. This intervention was especially important in that some of these loans funded land purchases and represented the first commercial mortgage lending in Moldova and the first privately-financed commercial land loans in the Former Soviet Union (CNFA 2004b).

For example, in 2000 Fincombank approved 10 loan requests for land purchase for a total amount of 0.9 million Moldovan leu. The average loan size in 2000 was about MDL100,000 or $US10,000, while the minimum loan size – MDL50,000 and the max – MDL300,000. The mortgage credits provided were medium-term and the annual interest rate charged was 27%. In addition, Agroindbank approved 12 mortgage loan requests totaling US$130,000. The average loan size was $US 6,500 and the annual interest rate charged was between 29-30%. RFC also disbursed a total of 29 mortgage loans totaling US$37,617. All outstanding loans at the end of 2003 were transferred to RFC, the custodian of the PFCF funds. RFC has expressed interest in engaging again in mortgage lending due to the previously good market response and has only refrained from doing so due to lack of funds.

OTHER DONOR CREDIT LINES

Lending to rural areas has been supported by two international projects: World Bank's RISP and IFAD's Rural Finance and Small Enterprise Development Project, both providing credit lines and client support. Both projects provided loan funds to a number of commercial banks in Moldova, while RISP has been the main source of funding for the RFC loan portfolio invested in rural businesses via a total of about US$10 million in long-term loans carrying a weighted average annual interest rate of 10.5%. IFAD also provided loans to RFC amounting to US$883,126 (equivalent) at an average annual interest rate of 11.8%. Access to these loan funds, coupled with focused technical assistance has helped the participating commercial banks and RFC to better understand the operations and financial needs of rural and agricultural MSMEs, to develop skills in designing products in accordance with demand, and to overcome some of the administrative expenses in pilot testing and increasing their offering of these new loan products.

CONCLUSION

MOLDOVAN RAF ACHIEVEMENTS

The current level of RAF market development, in terms of the variety and number of institutions providing RAF and the amount of credit they disburse, represents substantial progress, especially in light of the challenging conditions the country faced when these RAF services were first introduced. This subsection presents an analysis of the factors that influenced the three main entities (AIB, SCAs and RFC) to engage in rural and agricultural lending, including how DCA may have affected this as a peripheral or fundamental factor. RAF product innovations are also assessed.

INSTITUTIONAL DEVELOPMENT

The emergence of RAF service provision is due to intense government and donor technical assistance and funding support over the last decade. Building on the historical tradition of savings and credit cooperatives before Soviet times, the first World Bank project in 1996 paved the way for subsequent donor projects devoted to RAF development and laid the foundations for the emergence of a rural microfinance system based on the SCAs. In the early years of implementation of the World Bank's Rural Finance Project, SCA creation was supported by two local development institutions funded by donors – MMA and RDC. As the numbers of SCAs grew, an increasing number of SCAs began to be formed independently. Substantial provision of RAF services by the SCAs would not have been possible without the establishment of RFC in 1997 to act as an apex organization for the SCAs. In February 1998, the Parliament of the Republic of Moldova passed the Law on Savings and Credit Associations of Citizens and ratified an agreement between the government and the World Bank providing for US$5 million to be on-lent to the SCAs through the RFC. It was only in the following year that funds also started being wholesaled through AIB. Clearly, these donor interventions had important demonstration effects, without which the private lending would not have occurred. However, it is also noteworthy that continued heavy donor support may hamper at some point the private provision of capital, especially with regard to wholesaling funds to the SCAs.

The early success of the SCAs prompted interest by other entities to offer RAF services, especially at the lower end of the market. These include the IPC-affiliated finance company, ProCredit, in 1999 and the Soros Foundation funded finance company, Microinvest, in 2003. RFC also started retailing to more successful rural clients that have "graduated" from their respective SCAs in 2001.

Donor coordination and cooperation has facilitated program success and contributed overall to RAF development. This success is due in part to the relatively small size of Moldova, the importance of agriculture in the Moldovan economy, and the concentration of donor projects in the sector. USAID in particular has achieved a high degree of complementarity and synergy between its Private Enterprise growth programs in Moldova that has contributed to the successful results in the rural and agricultural sectors. USAID should continue to expand its comparative advantage in coordinating programs in the rural and agricultural sector.

Treating RAF as an integral component of several rural and agricultural development programs rather than treating it as a separate, stand alone initiative has added to USAID's outstanding achievements. For example, many USAID programs have included financial components while focusing on agricultural development or competitiveness, such as the Private Farmer Assistance Program, Private Farmer Commercialization Program, Land Privatization Support Program, Agribusiness Development Project and BizPro/Moldova. Linking expanding access to finance to broader objectives of increasing agricultural competitiveness and rural incomes is an effective way of ensuring that broader development goals are met.

The combination of DCA and technical assistance has promoted RAF lending and new product development. Use of the DCA has been helpful in promoting commercial bank lending to rural and agricultural enterprises. Early evidence indicates that participating banks are piloting new approaches to rural and agricultural lending (e.g. AIB). To enhance the sustainability of these innovations, technical assistance has also contributed to shifting bank management from the traditional top-down style to a more market-oriented approach which has been crucial to successful RAF operations. Combining the DCA with targeted technical assistance on new product development and implementation has been a key component of USAID's successful expansion of RAF in Moldova.

PRODUCT DEVELOPMENT

Loan products for agriculture have been developed and some of the risks mitigated. Agricultural lending exposes the institution and its assets to potential risks since rural activities bear risks related mainly to weather and other external factors. Nevertheless, RAF lenders, such as RFC, are aware of this and are working on improving diversification of their retail loan portfolios as much as possible by lending not only to agriculture but also to other activities related to agriculture (for example, processing, construction, land improvement and transportation). For the same reason, SCAs are also diversifying their own portfolio by lending to different activities related to agriculture. AIB manages the risk of agricultural lending by limiting it to about 45% of its total lending volume, and actively manages credit risk through its Risk Monitoring Department, which reports directly to the bank's President.

Mortgage lending product piloted. About 1.2 million of Moldova's population of 4.3 million people have title to their land. Much of this land is rural, having been privatized as part of National Land Program's liquidation and privatization of collective farms. As such, mortgage lending in rural areas represents a significant untapped market opportunity to expand RAF. The creation and operation of the PCFC introduced the first mortgage lending products in Moldova and the pilot was successful. If RFC is able to access increased commercial funding, it has expressed interest in scaling up its rural mortgage lending. Commercial banks have also expressed interest in expanding on the mortgage lending pilot provided the legal environment is improved to support it.

Factoring products under development. AIB is piloting two factoring products in 2005 with assistance from USAID's BizPro/Moldova. The introduction of factoring products have the potential to assist any enterprise that sells on trade credit terms to other businesses. AIB's bundling of services represents one of factoring's advantages over other types of lending, particularly for rural or agricultural SMEs that may not have the expertise or resources to manage their credit and collection activities. Factoring is also useful for providing financing to high-risk, informationally opaque borrowers, because underwriting is based on the risk of the borrower's accounts—not the risk of the borrower.

System of grain warehouse receipts under development. A system of grain warehouse receipts has the potential to help Moldovan farmers increase productivity and better utilize their land by ensuring access to the short-term credit. A system of warehouse receipts can increase access to credit by using the farmer's own produce as collateral. Such a system also holds the promise of increasing farmers' financial flexibility by providing lenders with liquid and guaranteed safe collateral that can easily be marketable in case of loan default.

IMPORTANCE OF ACCESS TO WHOLESALE FUNDS

SCAs have access to wholesale funds mainly through two institutions– Agroindbank and RFC. While Agroindbank lent slightly more to SCAs in 2004 (US$9.4 million to US$7.9 million), RFC wholesaled a larger number of smaller loans to SCAs (449 to 362). Although its focus has been wholesale lending to SCAs, RFC is now equally pursuing the retail lending market. Agroindbank's primary retail activities have been directed to medium and large-scale farmers, yet it lends to the SCAs to reach (albeit indirectly) smallholder farmers.

Several international donor programs wholesale funds to commercial banks and RFC. Through the USDA Commodity Monetization Program, soybean and wheat were monetized to create a loan fund to lend medium-term credit to farmers and farmer groups through two Moldovan commercial banks. In addition, both the World Bank's Rural Investment and Services Project (RISP) and IFAD's Rural Finance and Small Enterprise Development Project provided loans funds to RFC as well as technical assistance.

AREAS FOR IMPROVEMENT

This subsection specifies how the current state of RAF market development stops short of the "ideal." While significant achievements have been made by several donor programs led by USAID and the World Bank in terms of expanding access to BDS and financial services for RAF clients, many challenges to scale-up remain. Two of the most important are continued reliance on donor funds and lack of technical assistance needed for the system to continue to grow substantively. For example, RAF providers have not mobilized a large volume of rural savings and there is limited medium to long term lending. In addition, several support institutions need to be established or improved for the sustainable and efficient functioning of a RAF system.

Strengthening SCAs Through Branding

The NFSCAs could rate performance of SCAs and provide stickers or certificates of financial health to increase transparency of performance, build trust, and improve their ability to attract deposits and other sources of commercial funds. Cooperative branding was an innovation introduced successfully by the USAID's Credit Union Empowerment and Strengthening (CUES) Program in the Philippines. The brand name used there is Finance Organizations Achieving Certified Credit Union Standards, or FOCCUS. A coop that is FOCCUS-certified means it has achieved certain international prudential financial ratios geared toward providing members the best financial service. The key international prudential standards adopted by FOCCUS are shown in Annex 4. Similar movement-wide branding strategies are implemented in the U.S., Poland, Australia, Central and Latin America. These strategies help to improve the profile of cooperatives as an industry, thereby increasing trust in the system – crucial for mobilizing large amounts of savings.

Source: AIB 2004.

SCAs have achieved high loan repayment performance because of the close village bonds between members (due in part to Moldova's historical operation of local savings and credit cooperatives) but they face many challenges as well due to their limited outreach. Weaknesses in the governance of SCAs and cultural barriers contribute to their low savings mobilization and inability to take advantage of economies of scale. Emphasis should be on improving governance through conversion to finance companies and improving transparency by adopting a branding strategy for the SCAs (Box 3). Wholesaled funds from AIB and RFC will continue to be important to the SCA system, especially smaller SCAs. Consolidation of the SCA system is also desirable so that fewer SCAs reach a larger number of clients to benefit from economies of scale.

Finance companies, such as RFC, ProCredit and Microinvest, are not allowed to mobilize savings. This denies them a reliable and affordable source of capital and makes them dependent on commercial bank loans and funding by social investors. RFC's biggest challenge will be to access commercial funds to fuel future growth. This may be accomplished by diversifying their base of social investors to include the likes of Blue Orchard or others, or transforming into a bank so that it may legally attract deposits. By attracting additional sources of commercial funds, RFC would be better positioned to expand in rural areas and to improve the range of RAF services offered.

The existence of adequate support services are preconditions to an efficiently functioning RAF system and will attract financial institutions (with ample funding sources) to the rural and agricultural markets. The necessary financial and non-financial infrastructure includes business development services (BDS) for RAF clients (farm and non-farm rural households as well as urban or per-urban agricultural enterprises) as well as technical assistance and training for RAF providers (banks, cooperatives, finance companies, etc.). The availability of demand-driven and affordable BDS (including business advice, extension, farm management, input supply and marketing services, among others) are crucial not just because they can contribute to increased incomes, but because they build creditworthiness in the eyes of financial institutions. The existence of domestic providers of technical assistance and training services for RAF providers (on accounting, financial management, new product development topics, etc.) is also critical to the growth and development of RAF providers. Many of these services have so far been provided with generous donor support and the long-term sustainability of these efforts is still uncertain. In terms of the institutional infrastructure, equally important is the exchange of information: currently, there are huge gaps in terms of information sharing and standardization of high quality institutions. For example, there is no credit information bureau yet (although development of one is underway) and the risk of over-indebtedness could appear in the medium to long run, if such information exchange facilities are not in operation.

ANNEX 1: SCOPE OF WORK

Chemonics International Inc.

AMAP Knowledge Generation Task Order #1

Rural and Agricultural Finance

Draft Scope of Work for a Case Study on Innovations In Rural and Agricultural Finance in Moldova

OVERVIEW AND OBJECTIVES

Introduction

Socio-economic Context. Moldova is a small country of 4.5 million people on a land area slightly larger than Maryland, USA. Moldova has a favorable climate and good farmland but has no major mineral deposits so the economy depends heavily on agriculture. About 40% of the 1.4 million labor force is employed in agriculture, featuring fruits, vegetables, wine and tobacco, which provides 21% of GDP. As part of ambitious reform efforts begun in 2001, Moldova introduced a convertible currency, freed prices, stopped issuing preferential credits to state enterprises, backed steady land privatization, removed export controls and freed interest rates. After an economic downturn in 1998, the economy returned to positive growth – 2.1% in 2000, 6.1% in 2001, 7.2% in 2002, and 6.3% in 2003. However, Moldova remains the poorest nation in Europe and most of the poor reside in rural areas.

Access to Rural and Agricultural Finance. While there is generally liquidity in the banking sector, banks are still hesitant to loan to agricultural enterprises. Virtually all of the rural and agricultural (RAF) services in Moldova are provided by the Moldova-Agroindbank SA

(AIB) and the Rural Finance Corporation (RFC), which both retail services and provide wholesale funds to primary savings and credit associations (SCAs) for on-lending to members. Access to RAF services through these two donor-assisted institutions is helping tens of thousands of Moldovans to help themselves out of poverty and facilitate job growth through the expansion of non-agricultural, rural businesses and medium-to-large-scale agro-enterprises, including producers and processors.

INTRODUCTION TO AGROIND

Succeeding the former Bank of Agroprombank of the USSR, AgroInd was established in 1991 as a licensed commercial bank. As the leading local bank in terms of market share, AgroInd has an extended network of 44 branches and 32 representative offices located across the country. AgroInd holds approximately 21.2% of all banking assets, 20.1% of total banking share equity, 22.8% of loans granted by all commercial banks and 21.8% of all deposits attracted by commercial banks. AgroInd provides services to more than 132,000 clients and approximately 89% of them are individuals. A large part of companies serviced by AgroInd are private companies (87%), the majority of which are involved in industrial and agricultural activity, such as wine, sugar and tobacco. AgroInd offers a wide range of financial services specialized for companies, institutional and private investors. These services are integrated with other banking operations and represent a unique advantage to benefit from tailored banking services. AgroInd actively collaborates with the local microfinance network, MicroFinance Alliance, the SOROS Foundation and CNFA-Moldova with regard to support of farmers, wholesaling funds to SCAs and retailing to small, medium, and large-scale agribusinesses.

INTRODUCTION TO THE RFC

RFC is a non bank financial institution licensed as a joint stock company, initially formed under the Rural Finance Project of the World Bank and Government of Moldova to serve as a central finance facility for rural savings and credit associations. Created in 1997 by primary SCAs in Moldova, at the end of 2003 RFC had 298 associations as its shareholders. In 2002, RFC began retailing rural finance services to registered businesses, including individual entrepreneurs and farmers, as well as group businesses formed by farmers and entrepreneurs in the rural areas. Special focus has been placed on start-up businesses, and businesses formed by SCA "graduates," who now required different loan products and loan sizes than offered by their SCAs. RFC's retailing and wholesaling of funds supports its institutional objective to provide access to farmers and rural entrepreneurs to rural financial services.

In only six years, RFC has facilitated the provision of over 100,000 loans to more than 35,000 clients, in a cumulative volume of over MDL300 million (about US$24 million), covering a very specific niche of the financial market, represented by clients who had no access to financial market due to small sizes of businesses and requested loans, insecure character of agricultural business and lack of collateral. Over the last five years, RFC's operations have been profitable. In 2003, RFC earned a net profit of MDL3.98 million (about $306,154) and achieved a ROE of 29.3% and a ROA of 3.1% according to audited annual financial statements based on international accounting standards.

OBJECTIVES

How did these two organizations overcome the obstacles of high poverty and dependence on agriculture to become the national leaders in the provision of demand-driven and sustainable RAF services to tens of thousands of rural clients? What were the institutional prerequisites, relationships and innovative technologies that facilitated their success? How did access to the Development Credit Authority (DCA) facilitate their retailing and wholesaling activities? What lessons can governments, donors and practitioners in other developing countries learn from the innovations, successes and failures of these two experiences?

The main objective of this case study will be to identify and assess innovations both in terms of products and relationships that have led to the expansion of RAF finance outreach (primarily credit, with some discussion of expanded rural savings services) to agricultural and non-agricultural enterprises and households in Moldova. The primary focus of the case will be on AgroInd Bank to capture and assess all their innovations in RAF (both retail to medium and large-scale farmers and wholesale to SCAs). Secondary focus will be on RFC's retail and wholesale activities. Both expanded access to credit and savings services will be addressed. In addition, the case will address how certain key relationships have played a role in the expanded provision of RAF (e.g. ownership of RFC by SCAs). The case will also assess what the impacts have been in terms of both institutions having access to capital through the DCA and other commercial funding sources. In addition to the case study, one RAF technical note will be produced on innovations in RAF in Moldova. The objectives of this publication is to raise awareness of innovations that have led to increased outreach and how lessons from the experiences of AgroInd and RFC can be applied elsewhere to expand the frontier of RAF products and services in a meaningful and sustainable way.

TEAM

Stephanie Charitonenko, RAF Research Director For AMAP-FS KG

This initiative will be led by Stephanie Charitonenko, with support from the AMAP-FS Knowledge Generation Director, Anita Campion. As a Level I Research Specialist, Ms. Charitonenko is a rural and microfinance expert with more than 12 years of experience working in every major region in the world (e.g. Armenia, Bangladesh, Bolivia, Indonesia, Japan, Jordan, Kenya, Mexico, Nepal, Nigeria, Pakistan, Philippines, South Korea, Sri Lanka, Thailand, Vietnam, and West Bank/Gaza). She is a seasoned financial analyst with three years of commercial banking experience (working with senior management at NationsBank, now Bank of America) as well as seven years cumulative consulting experience for the World Bank with several departments: Private Sector Development, Agriculture and Natural Resources, Asia Technical and Human Resources and Africa Rural Development. She co-authored the World Bank's strategy on rural finance in 2002 which was an update to its 1997 Vision to Action Strategy Paper. She also contributed to the 1997 World Bank monograph, Rural Finance: Issues, Design and Best Practice. Ms. Charitonenko has a Masters degree in Agricultural Economics and a Bachelors degree in Finance and Japanese studies.

Anna Bantug, AMAP-FS Knowledge Generation Project Administrator
As the Level III Research Specialist, Anna Bantug, has conducted billable RAF research and is assisting in the evaluation of the USAID Implementation Grant Program. Ms. Bantug has an MBA from Nanyang Technological University in Singapore, with a specialization in International Business. As a researcher with CGAP on the Microfinance Rating and Assessment Fund project, Ms. Bantug managed and tracked rating fund disbursements to MFIs, presented microfinance applications, and regularly maintained the rating fund website.

ACTIVITIES

The team will conduct the following activities in three phases, as follows.

Phase 1 – Preparation for Field Research (5 Days LOE)

Weeks 1-2:

1. Ms. Charitonenko will compile and review all relevant literature. She will work with Chemonics' AMAP Knowledge Generation Director, Anita Campion, as well as USAID to refine the outline (see the attached draft as Annex 1) and clarify any remaining issues to be addressed as part of the field research (3 days).

2. Ms. Charitonenko will gather secondary data (most recent financial and institutional details) to support the research on AgroInd and RFC by communicating with contacts at DAI and the respective institutions. Ms. Charitonenko will also aim to set up meetings by email with key donors and project staff in Moldova in advance of her going to the field (2 days).

Phase 2 – Fieldwork: Data Collection and Analysis (15 Days LOE)

Weeks 3-7:

3. Ms. Charitonenko will travel to Moldova to meet relevant stakeholders, conduct interviews and gather primary data. While she is in the field, Ms. Charitonenko will start data analysis and drafting of the case study. Before leaving Moldova, she will circulate a draft of the case study for AMAP KG team members to review and provide comments (15 days)

Phase 3 – Finalization of the Case Study and Drafting of RAF Technical Notes (21 Days LOE)

Weeks 8-12:

4. Upon receiving initial feedback on the draft case study, Ms. Charitonenko will complete her writing of the case study. The case study will highlight innovations and lessons learned from the experiences of AgroInd and RFC in terms of how they expanded their retailing of sustainable agricultural credit and wholesaling to other financial service providers in a particularly challenging environment (poorest country in Europe). It will also identify key questions and issues that remain and merit additional research and/or pilot testing. The draft case study will be no longer than 30 pages and will be reviewed by the RAF Research Director and Knowledge Generation Director before being sent to USAID for review. Based on USAID's feedback, Ms. Charitonenko will make adjustments and final edits. Once USAID approves the content, Ms. Anna Bantug will format the document according to USAID's specifications in preparation for publication, under Component 3, Knowledge Management. She will then submit the publication for posting on USAID's external website and distribute hard copies of the publication based on dissemination guidance provided by USAID (17 days).

5. Ms. Bantug will draft a RAF technical note that will be reviewed by the RAF Research Director and the AMAP Knowledge Generation Director before being sent to USAID for review. Based on USAID's feedback, Ms. Bantug will make adjustments and final edits. Once USAID approves the content, Ms. Anna Bantug will format the document according to USAID's specifications in preparation for publication. She will then submit the publication for posting on USAID's external website and distribute hard copies and soft copies of the publication based on dissemination guidance to provided by USAID (4 days).

DELIVERABLES

The deliverables to be produced for USAID include the following:

1. Case study of RAF innovations in Moldova with a focus on AgroInd Bank and the RFC.

2. At least two RAF technical notes (official name for the series still TBD) that highlight findings from that case study that are of wide interest to the field, including government, donors and practitioners.

TIMEFRAME

Work will begin within one month of approval (we anticipate this SOW to be approved by the end of October and fieldwork to be conducted around Nov. 15 – 30, 2004) and will be completed within three months thereafter. The LOE usage during this period is expressed in the table below.

TABLE 5: LOE SUMMARY TABLE

NAME	FUNCTIONAL LABOR CODE/CATEGORY	LOE (DAYS)
Phase 1:		5
Stephanie Charitonenko	Research Specialist, Level 1	5
Phase 2:		15
Stephanie Charitonenko	Research Specialist, Level 1	15
Phase 3:		21
Stephanie Charitonenko	Research Specialist, Level 1	17
Anna Bantug	Research Specialist, Level 3	4
Total		**41**

ANNEX 2: LIST OF PERSONS INTERVIEWED

1. BizPro: Denis Gallagher – Country Director; Mariana Botezatu – Department Manager, Financial Services Department; Iurie Postica – Consultant; Eugenia Stancu – Advisor, Financial Services Development Department

2. USAID/Moldova: Sergiu Botezatu – Project Manager; Corneliu Rusnac – Project Management Specialist

3. National Federation of Savings and Credit Associations: Nicolae Olaru – Chairman of the Board; Svetlana Platon – Executive Director

4. Procredit: Philipp Pott – General Manager

5. Rural Finance Corporation (RFC): Ion Gangura – President

6. Private Farmers Assistance Project (PFAP): Gerald Knutson – Director General

7. Microinvest/Moldovan Microfinance Alliance (MMA): Artur Munteanu – CEO

8. Moldova Agroindbank: Ana Gheorghiu – Retail Banking Head; Ala Polustanova – Chief of Development and Administration, Retail Product Department

9. Republic of Moldova, World Bank Consolidated Agricultural Projects Management Unit (CAPMU): Igor Gorashov – General Director; Liviu Gumovschi – RISP Project Manager

10. Private Farmers Commercialization Project (PFCP) and Agribusiness Development Project (ADP): Rod Beason – Country Director, Citizens Network for Foreign Affairs (CNFA)

ANNEX 3: REFERENCES

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BizPro/Moldova. 2004. SME Messenger, September 2004.

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2004b. Financing Small and Medium-size Enterprises with Factoring: Global Growth and Its Potential in Eastern Europe. Marie H. R. Bakker, Leora Klapper and Gregory F. Udell. May 2004.

ANNEX 4: KEY INTERNATIONAL PRUDENTIAL STANDARDS OF THE FOCCUS BRAND

Ratio	Silver	Gold	Platinum
LLP >12 months	100%	100%	100%
LLP 1–12 months	100%	100%	100%
Solvency	—	> or = 110%	> or = 110%
Net loans	> or = 60%	70–80%	70–80%
Savings deposits	> or = 50%	60–80%	70–80%
Net institutional credits	> or = 4%	> or = 8%	> or = 10%
Total delinquency	< or = 15%	< or = 10%	< or = 5%
Nonearning assets	Decreasing	< or = 10%	< or = 7%
Member shares	—	> or = inflation	> or = inflation
Operating expenses	< or = 12%	< or = 10%	< or = 10%
Liquidity	> or = 15%	> or = 15%	> or = 15%
Membership	> or = 5%	> or = 5%	> or = 5%
Total assets	> or = inflation	> or = inflation	> or = inflation

LLP = loan loss provision.

Source: Llanto and Fukui 2003, p. 8 as quoted in Charitonenko et. al. 2004, p. 69. Available: http://www.asiandevbank.org/Documents/Reports/Commercialization_Microfinance/South_SE_Asia/

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