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**Paving the Way Forward for Rural Finance  
An International Conference on Best Practices**

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Case Study

## **Agricultural Lending Practices: Non-Financial Services with Financial Products**

### **Moldovan Savings and Credit Associations' Experience**

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All views, interpretations, recommendations, and conclusions expressed in this paper are those of the author (s) and not necessarily those of the supporting or collaborating institutions.

USAID	United State Agency of International Development
DFID	Department for International Development, the United Kingdom
GTZ	Deutsche Gesellschaft fur Technische Zusammenarbeit GmbH
SCAs	Savings and Credit Association of Citizens
MMA	Moldova Microfinance Alliance
RFC	Rural Finance Corporation
NFSCAs	National Federation of Savings and Credit Associations of Citizens
SSB	State Supervisory Body
NGO	Non-Governmental Organization
RDC	Rural Development Center
MoF	Ministry of Finance

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## I. Introduction

Moldova is a small, densely populated country, located in Eastern Europe between Romania and Ukraine, with a total surface of 33.7 thousand km<sup>2</sup> and a population of 4.2 million. Formally, a part of the former Soviet Union, it obtained independence in 1991. Moldova's economy relies on agriculture and agro-processing and thus 76% of the country's territory is represented by agricultural areas.

The country produces a variety of agricultural products including wine, fruits, vegetables and horticultural products. Food and agriculture contributed to about 42 % of GDP and the sector employs about half of the total labor force. Agricultural processing in agro industry is well developed and constitutes 40% of the total industrial production. Privatization of agricultural land was completed in 2000 As a result about 800,000 private farmers became landowners. Most of the new private farms and the newly emerging rural enterprises need additional financial sources. The small-SCAs private farmers with land shares of 1.65 ha are not attractive clients for the local commercial banks, because the credit requests for the working capital in order to process the land are very small, \$ 100-300, and the commercial banks do not accept such small land shares as collateral. Also the new private farmers are in fact the employees of the former collective and state farms, they do not have enough knowledge about the market economy and how to market their products. Relatively small loans are required to enable farmers to buy good quality seeds, fertilizer and machinery services, which in turn would significantly raise the production and the sale of agricultural products.

In 1996 the World Bank carried out a study on access of private farmers and rural entrepreneurs to financial services. The results of the study showed that local commercial banks do not have enough capacity to grant loans to private farmers. The main issues hampering this are as follows:

From the clients side

- Private farmers and rural entrepreneurs' lack of knowledge about how to conduct their own business;
- No experience in dealing with the commercial banks;
- Privatized land plots could not be offered as collateral or sold;
- Large agriculture state enterprises were almost bankrupt, but remained the clients of commercial banks;
- Private farmers and rural entrepreneurs cannot offer loan collateral;
- The newly emerged private farmers tend to mutually help each other to survive in tough conditions, especially those due to pressure from the large state owned cooperatives;
- Farmer's savings were mostly in kind rather than cash money;
- The rural population did not trust the local commercial banks because of a massive loss of savings in 1992.

From the banking side:

- The unwillingness and incapacity of local commercial banks to deal with small clients and small loans;
- Lack skills of local commercial banks in the area of microfinance;
- Large administrative expenses incurred by commercial banks when they are operating in the area of microfinance;
- Local commercial bank's refusal to practice loan security using mutual group liability

instead of traditional collateral.

At the same time in Moldova there is a very old village community tradition of mutual help. A house will be built with support from neighbors, or money will be lent to friends or neighbors without charging any interest or guarantee.

Taking into consideration the traditions of mutual financial help that existed in Moldova before 1940, was one of the main principles for developing rural financial services was supporting the establishment of cooperative microfinance institutions (MFIs).

Due to these conditions, the proposed solution was to create a network called the Cooperative Savings and Credit Associations of Citizens (SCAs) in order to increase private farmers and rural entrepreneurs' access to financial resources.

## **II. Development of the Network Savings and Credit Associations of Citizens**

In 1996 the Government of the Republic of Moldova carried out negotiations with the World Bank to resolve these issues. The scope of negotiations covered the development and implementation of financial services in rural areas through cooperative MFIs. In February 1997 the World Bank Rural Finance Project was launched. In the framework of preparation and implementation of this project the following strategic elements were considered:

- Drafting and approval of SCAS legislation;
- Providing knowledge transfer to SCAs members and management, including the period of the institutional set-up;
- Creating conditions for the establishment of apex organization in the SCAS system and providing assistance to strengthen their capacity in providing services to grass roots level SCAs;
- Developing common standards for SCAs, financial prudential rules, and a unique licensing and supervision system;
- Supporting the establishment of local NGOs that focus on the provision of services, training and technical assistance to SCAs;
- Directing SCAs to become microfinance specialized institutions instead of cooperative institutions providing a large range of universal services;
- Encouraging donor support in knowledge transfer, technical assistance and training of SCAs and discontinuing the undermining of the SCAS system by offering grants or in other ways;
- Enabling SCAs to engage additional credit resources from commercial creditors, but only after legal registration, licensing and training of these SCAs ;
- Promoting large mutual guarantees among private farmers or rural entrepreneurs in case of a lack of collateral;
- Coordinating donor activity to avoid overlapping.

### **Donors and provided assistance**

During 1997-2002 the following donors provided assistance to the establishment of the SCAS system in Moldova:

1. World Bank, provided support in the following areas:
  - Drafted legislation, financial prudential rules, and accounting standards for SCAs;
  - Provided funds at the request of SCAs' for additional credit resources;
  - Established the SCAS apex financial institution – Rural Finance Corporation;
  - Established the licensing and supervision system for the SCAS network;
  - Set-up local NGOs that focused on service and training to SCAs. Also provided assistance for on-going development of these NGOs;
  - Developed accounting software for SCAS.
  
2. USAID, through its contracting agencies offered assistance in the following areas:
  - Trained and established new SCAs, provided by the local NGOs;
  - Implemented instruments that could be used to identify SCAs needs such as self assessment and diagnostic tools;
  - Developed and implemented training programs in financial management, internal audit, accounting and financial reporting;
  - Edited SCAs management manuals;
  - Assisted SCAs leaders.
  
3. DFID, through its contracting agencies, including WOCCU, provided the following assistance:
  - Established and trained new SCAs by local NGOs;
  - Consolidated the capacity of the State Supervisory Body of SCAs activity;
  - Edited SCAs management manuals;
  
4. Soros foundation and GTZ, offered the following assistance:
  - Established and trained new SCAs by local NGOs;
  - Strengthened the capacity of local NGOs in providing services to SCAs.

### **III. SCAs' current network, main institutions and their functions**

#### **Savings and Credit Associations of Citizens**

Definition of the Moldovan Saving and Credit Associations of Citizens

- Saving and Credit Associations of Citizens (SCAs) is a non for profit, non commercial, independent, specialized institution that provides financial services exclusively to its members;
- SCAs main principle is “one member – one vote” irrespective of member contribution to the owner's equity;
- The range of financial services is strictly limited to savings mobilizations from members and lending exclusively to members, as well consulting services related to the provision of financial services;
- SCAs activity is licensed and the State ensures its regulations and supervision.

Services provided by SCAs to their members:

- Short term loans for profit generating activities – up to 1 year;
- Medium term loans – up to 3 years;
- Term deposits of members' savings;
- Mortgage loans for purchasing land plots;
- Consulting services related to the provision of financial services.

SCAs provide loans to its members in strict conformity with the financial prudential rules set by the State Supervisory Body of the activity of SCAs.

**Capitalization of SCAs.** From the very beginning development institutions promoted a strong capitalization of SCAs through provided paid-in membership shares and capitalization of the obtained profit. At the end of 1997 the total owner's equity of SCAs amounted to 65,616 lei from membership shares. At the end of 2002 the total owner's equity of the SCAs' network amounted to more than US\$2 million from membership shares and capitalized profit. Members receive loans, mainly without collateral in order to support a profit generating activity. The collateral is substituted for the most part by the mutual responsibility of SCAs members and by social pressure, from the traditional elements of a Moldovan village.

**Credit repayment.** From the total amount of loans disbursed to SCAs in 1997, 93% of the total credit amount was repaid on time, while 7% of the credit amount was past due for up to two months. In 2002 99.5 % of the total number of loans allocated to SCAs by commercial creditors were reimbursed by the maturity date. Data on SCAS development in the period of 1997-2002 are presented in Table 1.

**Profitability.** In accordance with the Law on SCAs the profit obtained by the Association is exempted from income taxes. The profit sources are represented by the additional margin, as a difference between interest on the loans disbursed to members and the cost of the credit resources, plus profits obtained from investing in the SCAs owner's equity. Other sources of profit are the penalties paid by SCAs members in case of overdue loans. The profits obtained by SCAs are used for covering operational expenditures, creation of reserves (provisions), and capitalization of SCAs. The level of SCAs expenditures during the first year of activity is usually low, because SCAs' management is provided for free by elected board members. A minimum spread of 2% is necessary in order to cover the operational expenditures at the initial stage of SCAs' development. Starting with the second year of activity, the SCAs' operational costs increase as the members of SCAs' chairman, bookkeeper and members of credit committee are remunerated. The SCAs expenditures are made in accordance with the decision of the General Assembly and assure the transparency of their execution.

**Sources of funds and inter links with other financial institutions.** For lending to its members, SCAs accumulate the necessary funds by collecting additional shares, savings of members and attracting credits from financial institutions. The SCA movement in Moldova began in the rural area, where the population is very poor and has no savings. Therefore, until now, the main fund sources for SCAs are the supplemental loans received from the financial institutions, which are re-lent to SCAs members. In 1998 two local commercial banks have started to offer credits to SCAs. In November 1997 SCAs founded a non-banking financial institution, the Rural Finance Corporation (RFC), which is the wholesaler of supplemental loans from different donors to SCAs. In 1998 RFC lent to the SCAs an amount of 2.76

million lei. The loan received by SCAS from banking institutions and RFC is re-lent to its members in accordance with the Prudential Financial Rules only for profit-generating activities of members. . In 2002 local commercial banks and RFC granted credits to the SCAs in total amount of 100 million lei (Exchange Rate 1\$US= 14 MDL).

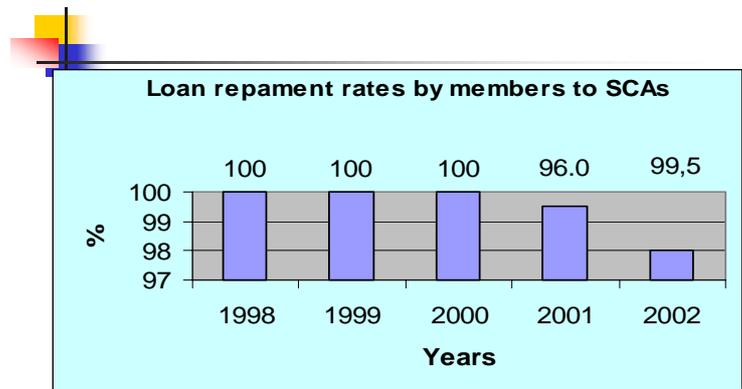
The savings mobilization started last year, but did not develop on a large scale, because: (i) starting with 1991, the population repeatedly lost the savings deposited in the commercial banks, and therefore a general mistrust in the banking system persists; (ii) SCAs are new organizations and the trust in them is continuously built; (iii) a saving's deposit scheme does not exist; (iv) the SCAs received supplemental loans from financial institutions, which allowed SCAs to lend to a significant number of members; (v) savings incentives such as a premium for certain types of savings deposited, bonuses, etc. were not developed or applied.

Development of the SCA network started in December 1996 with establishment of the first SCAs in Opaci village in Tighina County. Currently there are about 475 operating SCAs, consisting of more than 53,000 members. In 2000 SCAs granted about 40,000 loans totaling \$US 9 million. The repayment rate was 99.5%. Members' savings mobilized with SCAs and owner's equity amounted to 2.7 million \$US. SCAs benefited from total credit of 6.3 million \$US provided by two commercial creditors, the Rural Finance Corporation and a local commercial bank, "Moldova-Agroindbank". The evolution of the SCA system during 1996-2002 is presented in Table 1.

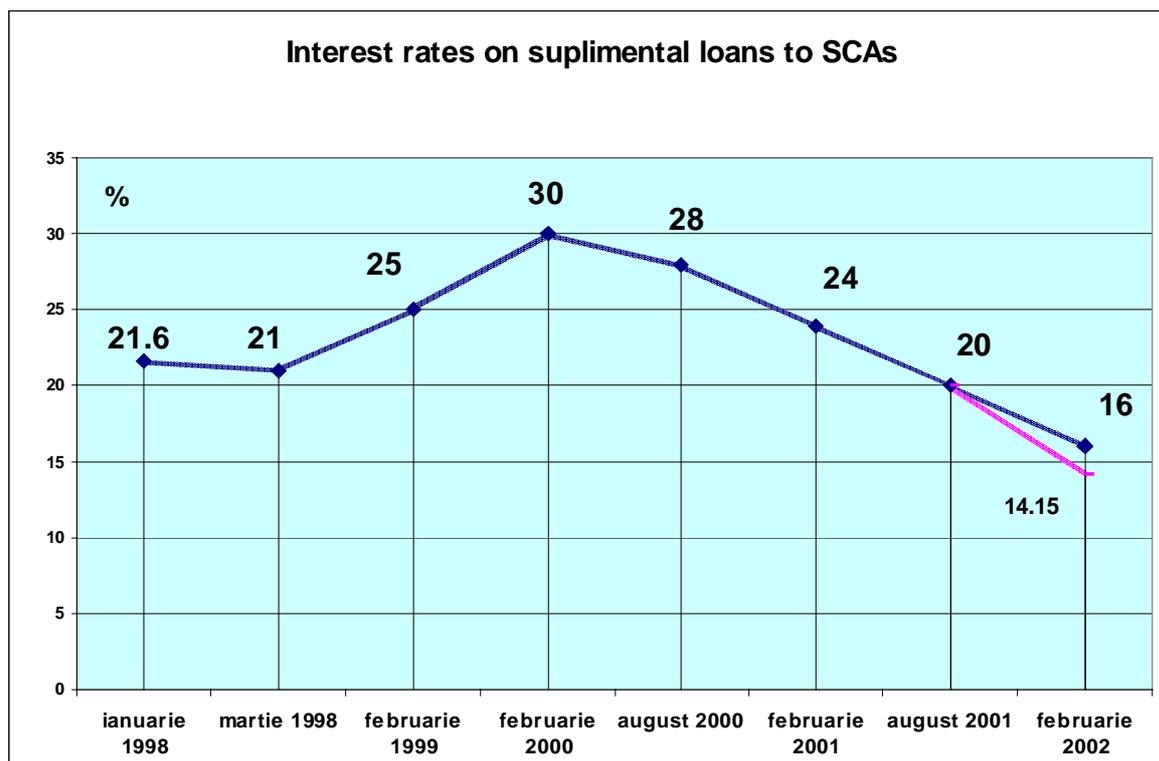
**Figure 1. SCAs Development Trends**

<b>Year</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>
<b>Number of SCAs</b>	<b>12</b>	<b>28</b>	<b>68</b>	<b>230</b>	<b>369</b>	<b>475</b>
<b>Number of members</b>	<b>480</b>	<b>1,400</b>	<b>3,400</b>	<b>12,000</b>	<b>38,000</b>	<b>520,000</b>
<b>Loans outstanding, (in 1,000's \$US)</b>	<b>80</b>	<b>259</b>	<b>889</b>	<b>4,444</b>	<b>6,741</b>	<b>9,100</b>
<b>Past due loans, (in 1,000's \$US)</b>	<b>3</b>	<b>2</b>	<b>6</b>	<b>9</b>	<b>96</b>	<b>156</b>
<b>Savings and Owner's equity, (in 1,000's \$US)</b>	<b>4</b>	<b>26</b>	<b>89</b>	<b>444</b>	<b>1,185</b>	<b>2,100</b>

**Figure 2**



**Figure 3**



#### IV. The National Federation of Savings and Credit Associations of Citizens (NFSCAs)

NFSCAs is SCAs lobby apex organization, established in December 1999. Each SCA is free to decide to join the National Federation of SCAs, which currently includes 380 members out of the existing 475 SCAs.

The functions and services offered by NFSCAs to its members are as follows:

- Lobbying member interests in relations with the Government, Parliament and line state agencies;
- Negotiating with commercial creditors about lending terms for SCAs;
- Informing member SCAs by editing information brochures;
- Training SCAs' management;
- Providing assistance to SCAs in record-keeping and development of financial statements through regional centers;
- Offering legal support in the settlement of disputes that arise between SCAs and their default members;
- Active participation in determining the directions of using government subventions for private farmers.

Currently NFSCAS has nine regional centers that provide such services as assistance in record-keeping, training, and consulting. In 2003 NFSAs is developing and implementing three training courses for SCAs management. These course are:

- SCAs Crediting
- SCAs Internal Control

- SCAs Accounting and Financial Statements

## V. The Rural Finance Corporation

### RFC & its Clients

The Rural Finance Corporation (RFC) was established as a joint stock company in November 1997. Its founding members were the first nine SCAs functioning at that time in Moldova. After five years of operation, RFC works with 220 SCAs, all of which are its shareholders.

As a central finance facility and refinancing institution, RFC provides loans to SCAs, using funds from the World Bank and IFAD credit lines, its own capital, as well as funds provided by other donors and creditors.

Since 2002, RFC provides loans to farmers and rural entrepreneurs directly, in villages where there are no SCAs or in cases when the volume of the business exceeds the limits satisfied by a SCAs. This means that funding is available to other farmer organizations, such as business cooperatives, service and production cooperatives, Limited Liability and Joint Stock Companies, individual enterprises, as well as individual private farmers and rural entrepreneurs.

RFC is competing with commercial banks that intend to lend to the same clients. Thus, since its creation, RFC serves as a quick-starter for the involvement of local commercial banks in lending to SCAs and development of new financial products in rural areas. At the same time RFC is a stable source of funding in case commercial banks abandon this sector.

Evolution of SCAs and RFC during 1998-2002

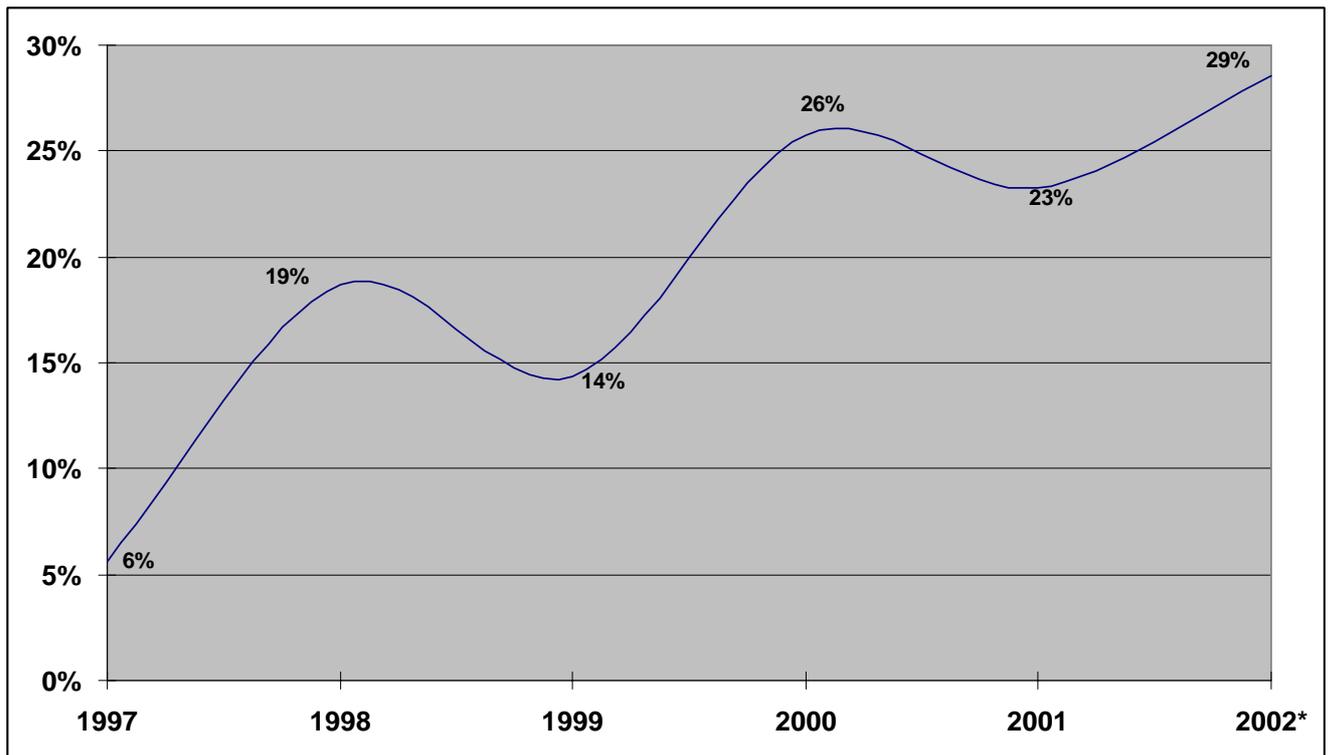
#### SCAs served by RFC & their Membership

Below is a brief presentation of historical data of SCAs evolution during previous five years. Note that the figures include only the SCAs served by RFC.

**Table V-1. SCAs 5-year statistics and projections**

	1998	1999	2000	2001	2002
<b>Number of SCAs</b>	29	103	159	200	220
<b>Membership</b>	1,437	6,500	14,600	22,000	27,000
<b>Owner's Equity</b>	511,584	1,819,592	7,907,543	12,015,487	16,000,000
<b>Loan Received</b>	2,740,000	12,700,000	30,700,000	51,700,000	56,000,000

**Figure 4. SCAs owner's equity /external loans ratio**

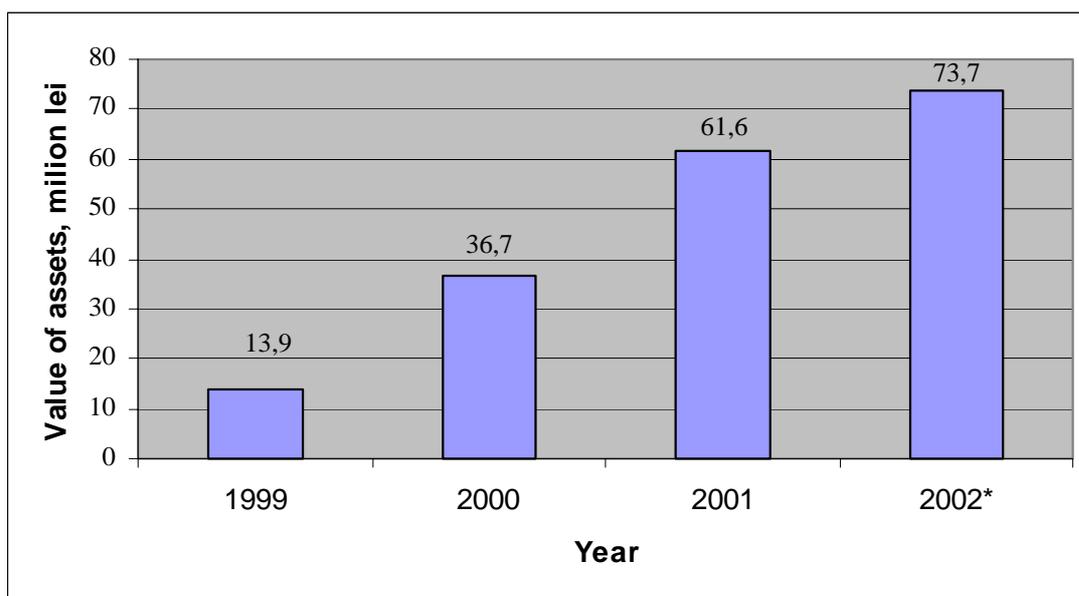


***RFC evolution.*** In line with the progress registered by SCAs, RFC has grown considerably since its start.

During the last year the number of RFC shareholders increased from 176 to 283, as a result of two additional issues of shares (one registered in July 2002 and the other closed in October 2002, to be registered in December 2002). The share capital amounts 469,600 lei as of November 1, 2002. This represents a 100% growth as compared to the beginning of the year. The total share of SCAs in RFC capital achieved 98, 99%, while the share of the Government reduced to 1, 01%.

The charts below show the growth of RFC capital and number of shareholders, growth of total assets, as well as RFC market share in lending to SCAs.

**Figure 5. Evolution of RFC assets, 1998-2002\***



### *Year 2002 Performance*

**Financial Products.** During the year 2002 RFC has offered to its clients the following financial products:

*To SCAs:*

- short term seasonal loans, for working capital (to buy seeds, fuel, hire agricultural services, etc.). The following repayment terms were set: repayment of principal in twelve months or less, balloon payment, interest paid by SCASC members quarterly, payment of interest to RFC in two installments (December 20, 2000 for the accrued part and the rest at maturity). The interest for such loans was at 16% rate, which changed to 15% as of August 1, 2002.
- medium term loans, for the purchase of small equipment, tools, and animal breeding. Repayment terms: up to two years, balloon or installments repayment, interest paid quarterly by members and annually by SCAS to RFC. Interest initially set at 16%, reduced to 15% as of August 1, 2002.

Although projected, long-term mortgage loans (up to forty-eight months, to finance loans for land purchases by SCASC members) were not provided in 2002. Projections were not achieved because funds were not received as agreed from CNFA, under a mortgage lending program that was negotiated earlier. The demand for such loans is extremely high, as the process of land consolidation is going on and farmers may miss opportunities when competing for land purchases with wealthier investors.

*To non-SCASC clients:*

- long term investment loans to individual farmers and small rural entrepreneurs  
loan amount – up to \$US 5,000  
term – up to fifteen years, with a three year grace period  
interest – 15 - 16%,

borrower's contribution- 10-20%

collateral- 130%

- long term investment loans to businesses formed by individual farmers and rural entrepreneurs  
loan amount – up to \$US 30,000  
term – up to fifteen years, up to three years grace period  
interest – 15 - 16%,  
10% borrower's contribution  
130% collateral
- long term investment loans to corporate businesses formed by individual farmers and rural entrepreneurs  
loan amount – up to \$US 250,000  
term – up to fifteen years, up to three years grace period  
interest – 15 - 16%,  
borrower's contribution- 20%  
collateral- 130%

### ***Credit Resources and Loan Portfolio***

RFC credit resources in 2002 included the following:

IDA loan funds, according to the Subsidiary Loan Agreement signed by RFC and MoF in April 1998 in conformity with the Development Credit Agreement between IDA and MoF of January 1998. The RFC was offered a \$4.6 million loan was intended to be "lent on" to the SCAs. The government provided loan funds to the RFC in national currency, bearing the foreign exchange risk (US\$/MDL). The credit line was fully withdrawn by June 30, 2001;

Dutch grant funds of MDL 375,293, granted to the RFC in 1997 to be exclusively used for lending activities;

CNFA credit line of MDL 497,300 (equivalent of USD 40,000) to be exclusively used for financing mortgage loans extended by the SCAs to their members under the pilot mortgage lending project;

IFAD credit line provided by the government to RFC under a Subsidiary Loan Agreement signed on November 30, 2001 in conformity with the Loan Agreement between IFAD and MoF of January 31, 2000. An IFAD credit line of 350,000 SDR was provided to RFC for lending to SCAs in Ungheni judets of Moldova. By November 1, 2002 a total amount of 3.4 million lei (approx. 55% of the credit line) has been withdrawn.

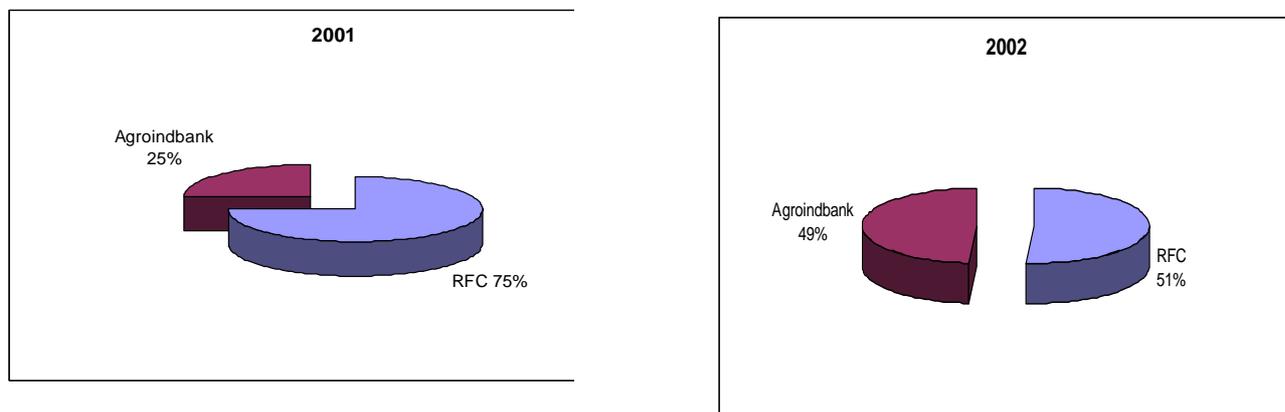
World Bank credit line provided to RFC by the government under the Rural Investment and Services Project (RISP), to be used for lending to individual farmers and rural entrepreneurs and the businesses formed by them. Withdrawals started in the middle of 2002. Under RISP, as of November 1, 2002, RFC provided loans to thirty-two businesses totaling 9.0 million lei.

RFC's own resources from operational income generated during the previous five years of activity.

As of October 31, 2002, 475 officially registered SCAs existed in Moldova. Out of the existing SCAs, 430 received external loans from creditors. RFC has lent to 220 of them.

As of 2002, using all the sources just listed, RFC has disbursed loans totaling 65 million lei, of which 56 million lei (over four million USD) was lent to SCAs.

**Figure 6. RFC market share in lending to SCAs**



RFC provided loans in 2002 at an interest rate of 16% per annum. After a period of inflation, RFC lowered its interest rate to 15% on August 1, 2002. The new rate applied to all short-term loans outstanding at that date, as well as to new contracts.

Figure 6 shows three charts that demonstrate the evolution of interest rates on RFC loans since 1998.

Repayment of loans provided in 2001 and in 2002 is almost 99.2%.

### **Impediments & issues**

In order to recover bad loans from their members and promote repayment discipline, many SCAs have initiated lawsuits against their debtors. Assistance in preparing legal documents and consultations on legal proceedings has been provided to them by RFC. However, the judiciary system in Moldova is very inefficient and time-consuming. Court sessions are oftendefered several times, and although court judgments have always been in favor of SCAs, it is very difficult to get court executives in the field to arrest debtor's property and execute court decisions. Such situations do not contribute to increasing people's responsibility.

Since privatization many of the farmers have enlarged their farms and are renting land and equipment. Still, no investments are reasonable on rented land, and the equipment, in use since Soviet times, is becoming obsolete. Even in cases when farmers have accumulated savings, they need additional co-financing for purchases of land and equipment. There is a huge pressure on RFC on behalf of SCAs to provide more financial products. The pilot mortgage lending project has become very popular among SCAs, and practically all of them want to participate if the project continues. Investment loans are also frequently requested, and as RFC does not providing any credit lines for this purpose, it is often blamed for not

caring about its clients' needs. At the same time, farmers lose opportunities in competing for land with wealthier investors, who have more resources to buy land available for sale in their villages.

It takes at least three years of operation for SCAs to learn all the procedures well and accumulate the financial knowledge to become independent in their decision-making. The first two to three years they count heavily on the training and advice provided to them by the development and lending institutions. RFC cannot refuse to instruct and consult SCAs when requested by them, therefore it is in RFC's interest to train its shareholders despite the fact that it is very costly work. The development institutions only have funding for one year post-creation assistance. Currently, post-creation long-term training is the basic issue.

## **VI. Supervision and intervention mechanisms**

According to the Law on SCAs, the activity of these institutions shall be supervised by a specialized state agency, the State Supervisory Body of SCAs activity (SSB). According to legislation the Moldovan National Bank is empowered to supervise the activities of commercial Banks, the government approved a decision coordinated with the National Bank by which the SSB would be subordinate to the Ministry of Finance rather than the National Bank.

The SCAS activity is regulated and monitored by the SSB. The SSB was founded in September 1998, in accordance with the Law on SCAs, it has a seven person staff and is financed according to the State Budget legislation. As of August 2002, SSB had issued licenses to 350 SCAs and performed a management appraisal at each of them.

Starting with 2002, the licensing function was passed over to the State Licensing Chamber, the unique state agency entitled to issue licenses. Licenses are issued to SCAs for two types of activities:

- Savings mobilization
- Crediting

The main objective of the Service is to supervise whether the SCAs observe the Law, Financial Prudential Rules and collect financial statements from SCAs. Each SCAS must submit its quarterly statements to the SSB. The SSB performs control of the associations' activity in cases of violation of the Law and Financial Prudential Rules, on its own initiative, on request from fiscal and judicial institutions, or on the request of associations and their federation. The staff of SSB is authorized to perform field controls of SCAs. In case essential violations are discovered during the process of field control, the SSB has the right to request an additional audit of the association. Basing on the report of the performed audit the SSB is charged with:

- Prescribing measures for liquidation of Law violations, or
- Submitting an application of administrative sanctions to the Ministry of Finance, or
- Suspending the license of financial activity of the SCAS for a certain period of time, or
- Appointing a provisional Chairman for temporary administration, until the violations are liquidated;
- Canceling the association's license and initiating the SCAs liquidation process.

In January 1999, the SSB began supervising the SCAs activity by performing field controls. The SSB has a computerized system for storing and analyzing the SCAs' financial reports. The software creates a database of the activity of the SCAs' network.

### **Cost and benefits of regulation and supervision**

SSB's annual budget is 230,000 thousand lei (seventeen thousand \$US) which is insufficient, but real in Moldovan conditions. SSB does not have branches because Moldova is a small country. According to the Law on SCAs, the SSB has the power to delegate a part of its monitoring functions to the Federation of SCAs, which is a self-regulatory body. The Federation's regional offices through assistance to SCAs on accounting perform some of the supervising functions, thus making possible some decentralization of the functions of the State Supervision on SCAs, activities.

## **VII. Supporting entities**

Establishment of SCAs in Moldova started with the decision of an initial group to set up an SCA in a village and was supported by implementing a training activities program.

In 1996 a French NGO "FIDES" started training the first twelve SCAs. The Netherlands partially covered the costs of training. To reduce training costs and create local capacities for assistance to SCAs, the support to establish two local development NGOs was granted: Moldovan Microfinance Alliance (MMA) and Rural Development Centre (RDC). These two NGOs received technical assistance from international organizations, specializing in microfinance. MMA and RDC have training programs for SCAs, possess training and development capacities and have regional offices. Actually 450 SCAs out of 475 received training from MMA and RDC. Furthermore, these two development NGOs perform the monitoring of the SCAs' activity and offer services to the SCAs' borrowers, to the State Supervisory Body on the activity of SCAs and National Federation of SCAs. In 2001 the National Federation started training of SCAs.

Development NGOs have few stages of assistance, including quick evaluation of potential of the village in which an SCAS is established. As the capacity of these development NGOs is lower than the demand from initiative groups willing to set-up an SCAS, the selection procedure is applied based on the results of a village evaluation.

### ***Village selection and target group***

The selection of villages and establishment of trust relationships with the target groups inside the villages are the most critical issues at the early stages of the SCAs creation process. They predetermine further success and sustainability of SCAs, at least as much as appropriate training. For this reason development NGOs invest a considerable amount of time in order to implement the first step to sensitive the future borrowers or members of SCAs. Selection criteria in this context are:

- the possibility to initiate income creating activities inside or outside agriculture. The SCAs can include farmers, as well as traders, artisans and civil servants. Situations where people are employees of former collective farms (kolkhozes or sovhozes) and where individual loans do not allow individual or group entrepreneurship must be avoided;
- Strong participation of women: women are clearly a stabilizing factor for the SCAs and associations with strong participation from women are solidly anchored in the village community;
- Good social organization: the approach is built on social relationships between members as basis for loan screening and socially controlled engagements for repayment. For this reason social aspects are very critical issues in village selection;
- Acceptance of democratic principles: former kolhoz chiefs, who make all the decisions, often still dominate villages. The implementation of the basic ideas of the SCAs

proves to be difficult in this kind of village.  
The village and target group selection process is realized in several steps.

### ***Preliminary studies***

In each village in which the SCAs creation process has been started, a rapid appraisal study is implemented. It is based on available documentation and the results of a survey using specially designed questionnaires. The objectives of this first survey are:

- to identify the complex social organization of the village and to define the different groups composing the community such as private farmers and entrepreneurs, farming organizations and collective farms;
- to analyze the economic potential in the fields of primary production, processing, marketing;
- to assess the level of motivation of these groups for the creation of SCAs;
- to identify the preparatory committee for the SCAs, building a link between development NGOs and the target group on the village level;
- to evaluate the economic potential of the village and the demand for credits of the target group.

### ***Spreading information***

Once the preliminary study is made and the village is identified, the administrative authorities are informed about the creation process by the visit of the development NGO and its activities are presented.

Good dissemination of information to all potential members of a future SCAS is essential. A good information campaign allows time to get in touch with an important part of the village community. Based on mutual exchange and dialogue several information meetings are then organized. The objectives are: (i) to explain the basic characteristics of SCAs, underlining the most important principles that take into account: solidarity, democratic organization, self help organization, self management; (ii) to allow the development NGO know the participating groups and to develop a more precise analysis of the initiators of the future SCAs and their background.

At least two preliminary meetings are necessary to insure the quality of the approach.

### ***Training of SCAS initiators and future members***

The training of future SCAs members is organized in several sessions at a village level. The sessions focus on essential knowledge. The following topics are explained in depth:

- The legal and regulatory framework;
- Co-operative and democratic principles of SCAs as a village based organization;
- SCAs statutes and regulations;
- SCAs governance - the general assembly, board of directors, executive body;
- Mutual guarantee's principles;
- Prudential financial and norms risk appraisal;
- The accounting system;
- Selection of borrowers and how loan conditions are decided;
- The interest rates and capitalization ratios.

NGOs also assist SCAs in the legal registration and licensing process.

### ***Ongoing support activities for SCAs***

After legal registration, NGOs provide assistance in:

- installation and monitoring of the accounting system;

- preparation of the credit applications and of the loan screening;
- on-going training and advice.

### **VIII. Supply of financial and non financial services to SCAs by commercial creditors**

One of particularities of microfinance system in Moldova is that small farmers disposed of savings in kind and correspondingly made payments in kind for provided services. Demand for credit was very low and mobilization of savings from SCAs members could bring about the establishment of MFIs operating basically with in-kind payments and lending. Also, a mass loss of the population's savings in 1992 hampered cash savings mobilization in emerging MFIs. Moreover, these institutions didn't have enough experience to manage the savings.

In such conditions it was suggested external financing of SCAs should be provided. In 1998 the World Bank started disbursement of a credit line of 5 million \$US. Starting with 1999 these funds were channelled through RFC and this apex institution became the credit wholesaler for SCAs. On-lent funds were used by SCAs as a source for lending to members in line with mobilized members' savings. Loans are provided by RFC and Moldova-Agroindbank at market rates. In their turn, SCAs apply a credit margin of 2-6% for on-lending to members. This margin represents one of the main income sources for SCAs and is used to cover their administrative costs and establish institutional reserves.

In 1998 after timely and full repayment of loans by the first SCAs, two commercial banks started unsecured lending to them. Moldova-Agroindbank lent out from its own sources and under its own risk. Another commercial bank, Fincombank, funded SCAs using loan guarantee of the Soros Open Society Institute. Eventually it ceased this lending, due to poor loan monitoring and lack of loan guarantee facility from Soros.

In regards to RFC and Moldova-Agroindbank, these financial institutions cooperate closely with NGOs focusing on services and training provision to SCAs. RFC has a cooperation agreement with RDC and Moldova-Agroindbank has an agreement with MMA. By using such a mechanism, SCAs benefit from lending services offered by financial institutions and training, consulting and assistance provided by development NGOs.

For instance Moldova-Agroindbank provides following services to its customer SCAs:

- lending;
- term deposits for SCAs and their members;
- opening and servicing of a bank account;
- money transfers for SCAs and their members.

At the same time, according to the cooperation agreement concluded with Moldova-Agroindbank, MMA grants certain services to bank's customer SCAs:

- preparation of credit application and assistance in negotiations with the bank;
- monitoring outstanding loans to SCAs;
- support in developing of business and marketing plans;
- training of SCAs management;
- assistance in record-keeping and drawing out financial statements;
- support in loan collection.

This cooperation ensures a high level of loan repayment by SCAs members and SCAs themselves.

## **IX. Main indicators of SCAs' Network as of January 1, 2003**

In 2002 482 SCAs were registered, comprised of 52.6 thousand members and operating in about 450 villages. Forty-two thousand loans were made to SCAS members, totaling about 130 million MDL (\$ US 9 million). Mobilized member savings totaled 28 million MDL (\$ US 2 million), of which term deposits were 18 million MDL (1.2 million \$ US). RFC and Moldova-Agroindbank provided additional loans of 105 million MDL (\$ US 7, 3 million) with an annual interest rate of 15 %. Loan repayment rate was 99.2%. Two financial products were offered to SCAs: short-term loans (up to twelve months) and medium-term loans (up to eighteen months). About 70% of loans were provided for agricultural purposes. Such a high concentration of agricultural loans jeopardizes the loan portfolio of SCAs. SCAs offered mainly unsecured loans. Loan security is based on mutual liabilities of SCAS members

In 2002 SCAs' members benefited from the following services:

- Short term loans;
- Medium term loans;
- Term deposits;
- Consulting services related to the crediting and savings mobilization;
- Training to new members;

All SCAs complied with legislation provisions, met accounting requirements and submitted quarterly financial statements to the SSB.

SCAS member access to financial services is far more easy, efficient and less costly due to the following reasons: (i) SCAs location is close to members. They are located in the same village; (ii) the evaluation procedure is faster than in a bank, as the SCAS Board is familiar with all its members; (iii) it is possible to collect information on borrower's creditworthiness since the village community is a free information source; (iv) the village community serves as an efficient instrument in enforcing loan reimbursement through extending social (peer) pressure on the default borrower.

## **X. Results and Impact of SCAs' Network activity**

During a relatively short period numerous private farmers (over 800,000) appeared who were unknown to commercial banks. The SCAs' network was able to resolve the main issue by obtaining credit access for these farmers. Loans made to SCAs' members terminated the practice of kind payments for supply of services and inputs. Lending to farmers is adjusted to their demand and considers the seasonal nature of agriculture. Also, some SCAs offered mortgage loans to their members to purchase land plots between one and ten ha.

### **SCAs Sustainability**

The actual stage of the development of SCAS system has some characteristic features that enable it to stay financially sound regardless of large number of members (110 on average for an SCAS), namely:

- In the first 2-3 years of SCAs activity salaries were paid only to the Chairman and accountant, yet in very moderate proportions – a monthly average of about \$US 30-50;
- Board members are not remunerated, only the costs of their participation in Board meeting are covered;
- SCAs are exempted from income tax payment;
- SCAs are not allowed to pay out dividends;

- Savings mobilized with SCAs are exempted from taxes;
- SCAs management training is effected with donors' support;
- High interest rates allow accumulation of sufficient income to cover administration and ensure SCAs capitalization.

After three to four years of operation SCAs as a rule hire credit officers. By that time about 25-40% of loans are made from SCAs own funds.

Exclusion of the boundary requirement from the Law on SCAs will enable mergers among SCAs and generate the creation of larger SCAs, comprising 600-1,000 members.

Also, there are necessary some amendments to the current legislation to allow acceptance of corporate entities into membership. This will result in SCAs fast capital growth and increased savings mobilization.

## **XI. Challenges and Methods to overcome**

During the six year implementation of the SCAS system the main impediments and issues that weaken the development of the whole system were identified. The following challenges have been identified:

- Limited SCAs knowledge of financial management;
- Limited capacity and competence of some SCAs accounts;
- Lack of external SCAs audit;
- Insufficient internal control in some SCAs;
- Low financial sustainability of small SCAs;
- Excessive reliance of SCAs on external funds;
- Insufficient loan portfolio diversification, mostly short term agricultural loans;
- Abundance of loans secured by mutual guarantee and insufficient promotion of collateral as loans' security;
- Lack of loan guarantee facility;
- Lack of deposit insurance facility;
- Lack of traditional insurance services for SCAs members;
- Limited capacity of local development NGOs on providing services to SCAs;
- Limited capacity of the State Supervisory to ensure adequate supervision of SCAs network in conditions of insufficient budgeting;
- Insufficient donor coordination and collaboration.

A range of methods and activities to overcome these challenges are in progress and other will be developed and/or extended.

### ***Donor activity coordination strategies***

To eliminate weaknesses in SCAS development, a more coordinated and enhanced activity of main stakeholders should be ensured. A special Task Force is working in this direction, which comprises representatives of main SCAs stakeholders. There is an informal coordination of donors allowing avoiding overlapping in assistance to SCAs.

To ensure an enhanced cooperation and improved efficiency of the main stakeholders and donors, a National Strategy on MFIs Sustainable Development will be developed with the active participation of SCAs, stakeholders and donors. Also, there will be an attempt to establish a Non-governmental Microfinance Council that will be in charge of coordinating

strategy implementation and donor activity in assisting MFIs.

### ***Identification of SCAs necessities and training***

In 2002 with assistance of Bizpro Moldova two new instruments were developed that were used to identify SCAs need for training and technical assistance: SCAs Self Assessment and SCAs Diagnostic. As a result training needs were identified and a curriculum of ten training programs were developed for SCAs. Four standard training modules for SCAs had the following content:

- Lending
- Risk assessment
- Internal control
- SCAs' accounting and financial statements

In 2002 with donor support about 1,300 members of SCAs' Boards and 350 members of Internal Control Committee were trained. In March, 423 SCAs accountants attended a training course in record-keeping and financial reporting.

### ***Consolidation of capacities of local SCAs. Development NGOs***

In 2002 local NGOs and the National Federation of SCAs benefited from training in assets and liabilities management, offered by WOCCU in Romania. Also in 2002 a training course in financial accounting in accordance with new accounting standards was implemented. For 2003 a training program for local development NGOs and the National Federation of SCAs is planned, supported by Bizpro-Moldova.

### ***Development of manuals for SCAS management***

In 2002 the Rural Development Centre in cooperation with donors such as DFID, Landell Mills, and USAID, Bizpro edited and published seven manuals for SCAS management. These manuals were handed out to every SCA. In 2003 these donors will support the editing of another six manuals for SCAS management.

### ***Support to SCAS leaders***

In 2003 with assistance of Bizpro-Moldova the needs of three SCAS were indentified. The needs included leaders in training, technical assistance, and consulting. Eventually a complex plan was developed for training these three SCAs in the development of a marketing strategy, a business plans, and the establishment of a management information system. Another seven SCAs will be selected, examined and will receive assistance. These SCAs will serve as a model for other SCAs and will be a source of knowledge and experience exchange.

### ***New services requested by SCAs and their members***

In 2003 the National Federation of SCAs, Rural Finance Corporation and grass root level SCAs will establish a Cooperative Insurance Company with the assistance of Bizpro-Moldova. This company will provide a large range of services for SCAs and their members, including life insurance, real estate insurance, equipment and crop insurance.

In 2003 the SCA National Federation intends to assist SCAs on developing and promoting new financial SCA products in the area of savings mobilization.

### ***The Potential to expand the operation***

Boundary restriction is a serious impediment to the extension of SCA activity as it sets the territorial limits of the operation within one city or village. In the first stage of development this restriction was important in resolving the issue of loan security through the implementation of mutual guarantee and the social (peer) pressure mechanism. However, numerous SCAs have a limited territorial area and cannot extend their services to neighbouring villages. To overcome this limitation a proposal will be made to the government regarding amendments to the Law on SCAs that will eliminate the boundary restriction. This will enable SCAs to operate in an extended area and merge with other SCAs to increase their financial sustainability.

### ***Tracking System of SCAs performance***

According to the current legislation each SCAS is liable to report to the SSB on a quarterly basis. Submitted financial reports contain information about the SCA's financial position, quality of loan portfolio and management performance. All these data are checked, analysed and integrated in a database system. For this purpose the PEARLS-CAMEL rating system was used, because the SCAS system is still very young in Moldova and customers and creditors do not evaluate its rating.

## **XII. Lessons learned**

Lessons learned from MFI development experience can be summarised as follows:

- Adequate microfinance legislation is one of the keys to successful and long term sustainable MFI development;
- The role of the state in MFI development is the approval of adequate legislation, supervision, participation in developing strategies, and no interference in MFIs daily activities;
- Effective accounting and reporting by MFIs and strong supervision of MFI activities are an important for successful development;
- MFI must have professional management for successful development;
- Commercial creditors and MFIs are not only competitors, but also partners;
- Strong and local development NGOs acting as services providers to MFIs is one of the crucial elements for MFIs successful development;
- Weak donor coordination could be a serious obstacle for successful MFIs development
- In a country in transition to a market economy MFIs successful development in rural area is dependent on the transfer knowledge to rural entrepreneurs and farmers.

When implementing microfinance systems in developing countries in transition to a market economy, certain aspects should be considered:

- Usually the privatization process (especially with the reference to the land market) is not completed and creates impediments in the development of private business;
- The rural population is the most vulnerable and does not hold any savings;
- There is a high demand for loans in cash, especially for agricultural purposes and a lack of required collateral;

- Local commercial banks are not willing and do not have enough knowledge and banking technologies to lend small amounts to clients;
- State agencies do not understand their mission and attempt to intervene into MFIs' daily activities;
- High loan costs and interests impede access to borrowing for the poorest layers of the rural population.

In these conditions the following lessons learned could be useful for the development and successful implementation of MFIs development policies:

1. Drafting and adoption of legislation on MFI activity is a main prerequisite for MFI sustainable development;
2. The benefit from a donor's support in training, technical assistance and consulting of MFIs is greater than from the provision of matching grants or sub-interventions;
3. Support to the establishment of local development institutions (NGOs), who focus on service provision to SCAs, helps to reduce donors' costs of establishing MFI network;
4. Assistance in setting-up some apex lobby and financial institutions ensures the protection of MFI interests;
5. Mutual guarantee represents an efficient and useful tool to secure lending to MFIs, especially at the initial stage of their development (the first three to five years);
6. Supplemental loans granted by commercial creditors to MFIs can efficiently reduce the practice of loan provision and repayment in kind in conditions that most rural populations experience;

Commercial banks need not be competitors, but can be partners as well by providing of supplemental lending to MFIs.