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Assessment of the Impact of USAID's Ten Years of Assistance in Micro-lending, Rural Credit, Mortgage, and Equity Investment

Romania's Unique Financial Mechanisms Assisted by USAID

August 2007

This publication was produced for review by the United States Agency for International Development. It was prepared by Banyan Global in collaboration with DAI.

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This report has been prepared by a team of experts consisting of: Lisa Tarantino, Team Leader; Lauren Mitten, Microfinance Expert; Aneta Nascu, Romanian Financial Sector Expert, and Maria Doiciu, Microfinance Expert.

Photographs in this report are of firms financed with USAID assistance. CHF-Express Finance provided the photographs in the case study of a CHF-Express Finance borrower. The photograph of DOMO Retail is from the DOMO Retail website. Banyan Global assessment team members took all other photos.

ABBREVIATIONS

ANSVM	Romanian Association of Securities Dealers
BAF	Balkan Accession Fund
BCA	Balkan Capital Advisors
BR	Banca Romaneasca
BVB	Bucharest Stock Exchange
CAP	Common Agricultural Policy
CAPA	Credit Assistance and Business Training (translation of Romanian Acronym)
CEED	Center for Entrepreneurship and Executive Development
DCA	Development Credit Authority
EBRD	European Bank for Reconstruction and Development
EC	European Commission
EDS	Enterprise Development and Strengthening Program
EU	European Union
FDI	foreign direct investment
GDP	gross domestic product
GE	General Electric Company
GOR	Government of Romania
GVA	gross value added
ICT	information, communication, and technology
IFC	International Finance Corporation
IFI	international finance institution
IMF	International Monetary Fund
MDB	Multilateral Development Bank
MEBO	Management Employee Buyouts
MFI	microfinance institution
MIS	management information system
MLP	Micro Loan Program (of the Romanian-American Enterprise Fund)

MSME	micro, small, and medium-sized enterprise
NBFI	non-banking financial institution
NGO	nongovernmental organization
NIS	Newly Independent States
NSC	National Securities Commission
OJCA	county extension consultants
OMRO	Opportunity Microcredit Romania
PHARE	Poland and Hungary Assistance for the Reconstruction of their Economies
RAEF	Romanian-American Enterprise Fund
RALFI	Romanian American Leasing and Financing
RASDAQ	Romanian Association of Securities Dealers Automated Quotation System
RFLD	Rural Finance Leader Development program
RON	new Romanian Lei
SAPARD	Special Accession Program for Agriculture and Rural Development
SAS	Shorebank Advisory Services
SEAF	Small Enterprise Assistance Funds
SLP	Small Loan Program (of the Romanian-American Enterprise Fund)
SME	small and medium-sized enterprise
TBRF	Trans-Balkan Romania Fund
UNDP	United Nations Development Program
USDA	United States Department of Agriculture
USAID	United States Agency for International Development
USG	United States Government

EXECUTIVE SUMMARY

For the past 10 years, the United States Agency for International Development (USAID) has supported the development of the financial sector of Romania, and thereby the growth of the overall private sector, with a variety of financial mechanisms. As USAID prepares to end its activities in Romania in 2008, this assessment aims to evaluate the impact these USAID-supported projects and institutions have had on firms and subsectors, the financial sector, as well as on the broader business environment. The assessment examines the effectiveness of the mechanisms and institutions involved as well as their prospects for sustainability beyond USAID's presence and assistance. This report documents any remaining gaps or obstacles for firms seeking access to finance and the development of the financial market, and will distill key "lessons learned" from USAID's experience in Romania for the benefit of USAID, the Government of Romania (GOR), and other donors.

The assessment found that, in most cases, the programs and institutions supported by USAID have been uniquely successful and effective in reaching their stated goals. In many cases, institutional performance surpassed initial goals to have longer-lasting and broader impact on the development of the financial sector than expected, and will have an impact on firm-level growth even after USAID funding ends. USAID used mechanisms such as investment funds, a guarantee facility, microfinance institutions, small loan programs, and a business support project to fuel the development of the micro, small, and medium-sized enterprise (SME) sectors, rural enterprises, and large newly created and privatized firms, as well as the creation and development of the mortgage finance market.[1] Some of these mechanisms, such as the Small Enterprise Assistance Funds-Trans Balkan Romania Fund (SEAF-TBRF), were not unique in their structure in the region at that time; thus, their success in relation to others is particularly striking. Due to the success factors outlined below, these initiatives have positively affected the development of the financial sector of Romania and have translated into immediate and long-term benefits for private enterprises and the economy.

ASSESSMENT METHODS

The assessment team used an analysis framework to examine four levels of impact: 1) the firms/subsectors accessing financial services, 2) the institutions providing products and services, 3) the overall financial sector, and 4) the broader enabling environment in Romania. At each level of analysis, the team utilized a series of research tools, including focus groups, questionnaires, key informant interviews, public documents, internal reports and assessments, and other data made available by USAID, its partners, and other stakeholders in Romania.

THE PRIVATE SECTOR THEN AND NOW

The private sector and financial markets in Romania have undergone dramatic changes over the past decade. In 1996, the financial sector was dominated by troubled state-owned banks with limited private participation. Consumer and mortgage finance was unavailable, and SME loan and investment finance was scarce. In 2007, the financial sector is booming, dominated by large foreign-owned banks

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[1] Note that for the purposes of this report SME will refer to microenterprises and small and medium-sized businesses.

that have brought expertise, technology, and lower-cost funds that have helped drive down interest rates as the sector becomes more competitive. Consumer finance and mortgage finance are now available and SMEs have a number of financing options, including banks and microfinance institutions (MFIs) and, in some regions, mortgage finance companies, leasing companies, or consumer finance companies. Investment finance is increasingly available from private funds and the more active stock exchange.

The growth in the financial sector has been coupled with tremendous growth in the private sector. In 1996, the private sector generated less than 50 percent of the country's gross domestic product (GDP). SMEs numbered fewer than 200,000 in a country of 22 million.[2] Most large firms were still state-controlled. In rural areas, farms and agribusinesses were suffering from the shock of the reorganization of the sector after the 1989 revolution. By 2006, the private sector generated 75 percent of Romania's GDP. In 2007, it is estimated that SMEs alone will account for the lion's share of GDP. The total number of SMEs has increased to more than 500,000 in 2006, and comprised more than 99 percent of all Romanian enterprises. More than 70 percent of all employed workers are in the private sector, as is nearly 55 percent of capital. Foreign direct investment (FDI) in the country has increased, reaching a peak of $7.2 billion in 2006 alone. The sectors showing particular growth are the information, communication, and technology (ICT) and service industries, including the financial sector, commerce, and the construction and real estate markets.

KEY FINDINGS

USAID programming played an important role in driving this growth and contributing to the Romania success story. The assessment of USAID financial and private sector programs revealed a number of key findings.

USAID-funded programs that supported access to financing drove firm and sector growth at the SME level. At the firm and sector levels, growth in numbers of employees, assets, and sales was identified among firms assisted by USAID. Trends confirmed industry-level findings that credit is an engine of growth, particularly among SMEs. Approximately 87 percent of SMEs surveyed reported that their sales had increased since they received their first USAID-supported financing. Nearly 90 percent stated that their assets had increased; the most frequently cited increases were among the service sector. Seventy percent of firms that knew their market share claimed that it had increased since receiving financing. The commerce and services sectors had the highest levels of growth among the SMEs.

Foreign direct investment facilitated by USAID resulted in the growth of larger firms. Larger firms that were recipients of FDI stated that the "non-financial" asset of having a US-funded investor on their boards of directors resulted in real financial dividends. US-funded investors often took an active role in the strategic direction of the firm, assisted in the establishment of Western management structures and administrative procedures, and facilitated the search for other investors. Many of the surveyed firms claimed that FDI and marketing opportunities, which resulted in firm growth, were the direct result of either SEAF-TBRF or Romanian-American Enterprise Fund (RAEF) influence.

[2] Assessment team estimates based on historical trends and data from subsequent years.

Among the firms that benefited from USAID assistance, those with the highest growth rates were SMEs funded by SEAF-TBRF. Firms with the highest growth rates, particularly in terms of revenues and employment growth, were the SMEs financed by SEAF-TBRF. This finding is supported by other industry studies that indicate that the highest growth rates with financing are achieved by small firms.

RAEF played a special role in the development of the financial sector. RAEF played a key role in the transformation of one bank and the privatization of the agriculture bank, contributing to the stabilization of the sector and attracting FDI into the market. The RAEF investment in Domenia Credit served to initiate reforms, allowing for the creation of the retail mortgage market.[3] Domenia Credit's business success was supported by grant funding for operational assistance from USAID and a loan from Raiffeisen Bank, which benefited from a USAID Development Credit Authority (DCA) guarantee. RAEF lending through its Small Loan Program and Micro Loan Program contributed to the growth of the sectors and implementation of best practices, which raised the standard for Romanian microfinance industry performance.

Most USAID-funded programs will leave behind at least one sustainable finance or business development institution. These institutions should continue to prosper beyond USAID assistance. Examples include:

USAID-Funded Programs	Legacy Finance and Business Support Institutions
RAEF	Balkan Accession Fund (BAF), Enterprise Capital, the Energy Efficiency Fund, Banca Romaneasca, GE Money (Domenia Credit, Ralfi, Motoractive,) and Raiffeisen Bank (Banca Agricola.)
RAEF Micro Loan Program (MLP)	The RAEF Foundation, CAPA/World Vision (CAPA), and Opportunity Microcredit Romania (OMRO)
Enterprise Development and Strengthening Program (CHF International)	Express Finance
SEAF-TBRF and the Rural Finance and Leader Development (RFLD) program	Center for Entrepreneurship and Executive Development (CEED)

The Romanian economy and the policy reforms that enabled its growth both benefited from and contributed to the success of USAID programs. USAID programs had a catalytic effect on aspects of the Romanian economy. Economic growth itself enabled the success of some USAID-supported activities. USAID's role in the privatization of the agriculture bank contributed to stabilizing the banking sector. USAID backing for legislation and regulatory norms supporting the operations and supervision of non-bank financial institutions (NBFIs) enabled the growth of the consumer finance, leasing, microfinance, and mortgage finance industries. Legislation is now in place, following USAID advocacy, that provides the foundation for the future development of the secondary mortgage market. The MFIs supported with USAID funding are strong models for the industry.

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[3] Development Credit Authority guarantees are supported by the US Government and implemented by USAID missions with the support of the USAID/Washington Office of Development to provide partial loss guarantees on loans to predefined qualified borrowers. They are used to mitigate perceived risk for commercial lenders, thereby encouraging lending to priority sectors for development.

USAID programs have introduced Western business practices and industry best practices, particularly to financial institutions and larger firms. These practices have contributed to the efficient functioning of the institutions and their ability to draw foreign investment. By showing by example that SME lending and equity investments in Romanian businesses can be done profitably and at acceptable levels of risk, these programs and institutions have led the way for more inflows of capital and knowledge to build on Romanian initiative and entrepreneurship.

THE ENABLING ENVIRONMENT

A number of key developments improved the enabling environment for private sector firm growth between 1996 and 2006 and contributed to the success of USAID initiatives. The RASDAQ and Bucharest Stock Exchange were founded and later merged while becoming a viable mechanism for exchange for investors. A number of macroeconomic developments after 2000 contributed to Romania's success, including tax reforms, the lifting of currency restrictions, declining inflation and interest rates, a reduction in unemployment, and increasing GDP growth. Legislative reforms in the banking and commercial sectors, some of which benefited from USAID support, served to rationalize activities and raise investors' confidence. USAID promoted the establishment of laws enabling MFIs and mortgage finance companies to function and grow, which are important to the development of the NBFI sector. Some rural communities have been changed by the establishment of communication channels and support networks for municipal leaders, business consultants, and rural entrepreneurs—a direct result of USAID assistance.

SUCCESS FACTORS AND LESSONS LEARNED

In Romania, USAID's strategy of using diverse mechanisms to develop the financial sector comprehensively, thereby benefiting the overall private sector, differentiates it from other donors and from USAID strategy employed in other countries. The success factors of USAID's approach, which helped build sustainable legacy institutions and produced a broader ripple effect on the economy, include:

- Increasing the potential for positive impact by investing donor funds and efforts across sectors.
- Using diverse financial instruments to help meet the needs of consumers and produce broader effects in the sector.
- Taking a long-term approach to sector development.
- Employing a commercial approach to ensure sustainability.
- Adapting lessons learned from the region as an effective way to achieve development goals.
- Coordinating with other donors and government to accomplish ground-breaking activities and wide-ranging impact.
- Encouraging knowledge-sharing among local and international professionals to create a change in business culture.
- Successfully promoting the adoption or reform of legislation or regulations to contribute to the wider development of the private sector. USAID's ability to work with the GOR unilaterally and/or with other donors or multilateral development banks (MDBs) to improve the enabling environment

for finance institutions primarily, and secondarily for private businesses directly, had a wide and sustainable impact on the development of the private sector and the economy more broadly.

Lessons learned from USAID-funded activities begin with the finding that flexibility is essential to meeting financing needs as an economy changes. In addition, promoting a commercial approach, such that local partners and institutions may profit from donor-led activities, leads to greater sustainability of initiatives. Equity investments in an emerging economy benefit from a hands-on approach. Technical assistance for training financial institutions can be effective to promote new services and products and, in this area, it is important to prove results in the form of profits to partner institutions. USAID-supported institutions demonstrated that barriers to expansion must be addressed head-on, in cooperation with government and other donors. Legal structures and the ability to enforce contracts are important to the success of FDI and the development of an equity market. Experience in Romania shows that a commercial institution can serve as an effective instrument for greater industry reforms. Government engagement throughout is vital and can have lasting effects. Finally, the assessment confirms wider industry findings that finance is an engine for growth for SMEs and financial institutions.

REMAINING GAPS AND CHALLENGES

The assessment team found a number of remaining gaps in and challenges to the development of the overall private sector and the financial sector in particular.

- Private enterprises and consumers still have unmet demand for credit.
- The stock, bond, and securities markets are in the early stages of development; this is particularly true of the mortgage finance market, and no secondary mortgage finance is yet available.
- In rural areas, the redistribution of land into fragments to original owners after the communist period resulted in a current average agricultural landholding of only 3.27 hectares (ha), which inhibits development.[4] In addition, the wholesale agriculture market is underdeveloped.
- Greater liberalization is needed in the energy sector to maximize potential investment.
- Both the financial sector and private enterprises have a human resource constraint—institutions and businesses find it difficult to identify and retain well-trained individuals at affordable wages.
- Foreign-owned banks, with low costs of capital, are moving down-market to lend to SMEs and compete with MFIs.
- SMEs cite government bureaucracy as a continuing impediment to growth.
- Finally, European Union (EU) accession will pose particular challenges to the SME sector; these enterprises will face new competition and potentially costly standards requirements.

[4] As of 2005, including small subsistence and semi-subsistence farms as well as larger landholdings that encompass more than 50 percent of the overall utilized agricultural land, according to the “Romania National Rural Development Programme 2007–2013.”

Another gap, which could also be considered an opportunity for the financial sector, is the development of the secondary market for mortgages. Legislation and the required institutions are in place, but the market is as yet inactive.

Some of the above gaps and challenges are products of the free market, yet most could be addressed by policy makers and, potentially, donors.

BACKGROUND

On January 1, 2007, Romania acceded to the European Union (EU), a major milestone made possible by political and economic changes over the past decade, which have transformed the former Soviet bloc country into a vibrant market economy. During this time, the United States Government (USG), committed to revitalizing the Romanian private sector, has implemented programs to reform and strengthen the financial sector and mobilize capital for broad-based economic growth. As the United States Agency for International Development (USAID) prepares to close in 2008, this assessment was designed to evaluate the growth of the financial sector in Romania, understand USAID's role in this progress, and identify lessons that can provide a model for USAID, government and other donor programming, building on the hard-won efforts of the last decade in Romania.

In 1996, when the first USAID-funded mechanism to support the private sector initiated activities, private sector firms generated less than 50 percent of the country's gross domestic product (GDP.) The overall economy was experiencing economic stagnation and shrinkage in the mid-to-late 1990s, only a few short years after emerging from the yoke of a communist dictatorship. Small and micro businesses numbered approximately 200,000 in a country of nearly 22 million. Most large firms were still state-controlled, with all of the problems inherent in such firms at that time in the region. In rural areas, farms and agribusinesses were still suffering from the shock of the reorganization of the sector after the 1989 revolution. Consumer and investment finance were nearly unavailable and SMEs had few credit options. In this context, USAID made a strategic decision to support the expansion of private enterprises in order to help the GOR address market imperfections, as the country took its first steps towards a free market economy and a politically stable democracy. Lack of access to affordable and appropriately structured finance was identified as a key constraint to the private sector, thus programming was initiated to meet some immediate financing needs and support the wider, sustainable development of the financial sector to meet those needs in the longer run.

USAID PROGRAMS

USAID supported the growth of private firms, the development of the financial sector, and the improvement of the enabling business environment by funding activities in the following areas.

INVESTMENT FINANCE

The Romanian-American Enterprise Fund was established in 1994 by the US Congress to assist Romania in its transition to a free market economy by providing financing for SMEs, greenfield and newly privatized companies. RAEF received grants in the amounts of $50 million for funding for investment and loans, as well as an additional $11 million for funding technical assistance. Governed by an independent private sector board of directors, RAEF was designed to pursue both development and commercial objectives. The Fund was one of the first to offer direct equity investment in newly privatized, greenfield, and other growth oriented private enterprises in Romania. The RAEF Major Transaction Program (MTP) funded projects that require over $200,000 with debt, equity or a combination of financing. RAEF in early years focused on greenfield and recently privatized firms, as well as investments that leveraged US or other foreign investment. In later years, RAEF had more of a focus on financial services and established private firms. RAEF participated in the privatization of the agricultural bank, and purchased and transformed another private bank. Other RAEF investments included market leaders in consumer finance and automobile leasing. See the section “Romanian-American Enterprise Fund” below for details on this institution and its investment finance activities.

Small Enterprise Assistance Fund Trans-Balkan Romania Fund (SEAF-TBRF) was established in December 2000 with $8.5 million in seed capital to provide equity and loans to SMEs with growth potential. The seed capital came from its shareholder, the SEAF Trans-Balkan Small Equity Fund, LLC. SEAF, a not-for-profit corporation with USAID and IFI funding, establishes and oversees the management of commercially sustainable, for-profit private equity funds in emerging markets. Unlike RAEF, this fund did not receive separate grant funding for technical assistance, and rather cooperated with programs to provide this support to companies. Any technical assistance accessed for investee firms was financed either by the firm or by another donor. SEAF-TBRF also differs from RAEF in that it only took minority shares in firms. SEAF-TBRF is a profitable fund that has made nine investments and brought returns to investors while serving to grow SMEs. The fund is now almost completely divested, and expects returns higher than industry standards when it closes its books in 2009. See the section below “Small Enterprise Assistance Funds-Trans Balkan Romania Fund” for details.

MICROFINANCE AND SMALL BUSINESS LOANS

USAID funded microfinance and small business lending activities through the RAEF Micro Loan Program (MLP) and Small Loan Program (SLP) as well as through **CHF Romania**, now Express Finance, as part of the **Enterprise Development and Strengthening Program (EDS)** of 2003.

RAEF established its micro and small loan programs in 1996. These programs over the years provided funding for SME loans through MFIs including CAPA-World Vision (CAPA), CHF, and Opportunity Microcredit Romania (OMRO), as well as through the banks Banca Transilvania and Banca Romaneasca. Since inception, over $50 million has been lent to Romanian SMEs through the MLP program, which was created to provide up to $15,000 in financing to small businesses. Currently, there are more than 2,000 active clients and an outstanding portfolio of approximately $14.5 million. The RAEF MLP has been operational via MFIs in Romania:

- This program has loaned to CHF Romania for lending to micro and small businesses. This relationship ended in 2003.
- OMRO currently borrows from RAEF MLP and on-lends these funds to SMEs.
- The larger portion of the RAEF MLP portfolio is lent via an agent relationship with CAPA, wherein RAEF is the lender and CAPA receives fees for origination and servicing.

RAEF SLP, which was initially designed to fund loans from $20,000 to $150,000, had a brief agreement with Banca Transilvania to initiate a small business loan program, wherein RAEF was the lender and the bank received service fees. RAEF had a similar agreement with Banca Romaneasca (BR). After the termination of the relationship with Banca Transilvania, RAEF purchased controlling interest in Banca Romaneasca, and the loan program began to grow rapidly. Bank employees and management were introduced to cash flow lending techniques, the attractiveness of the SME market, and Western bank management techniques. In 2005, the SLP was closed, although SME lending continues to be done by BR.

CHF Romania, affiliated with the US-based non-profit CHF International, in 1996 and 1999 received $1.15 million from USAID to provide microfinance services. In 2003 and 2005 USAID provided $0.5 million for lending to flood victims and $1.2 million to cover investments and expenses for CHF to establish a sustainable microfinance institution, later renamed **Express Finance**.[5] Today, CHF-Express Finance extends individual microfinance loans up to approximately $37,000, and has a presence in 25 counties. Express Finance is a registered NBFI, regulated by the National Bank of Romania. As of the end of 2006, CHF-Express Finance had an outstanding portfolio of $10.8 million. See the section below entitled "CHF–Express Finance" for more information on this program.

RURAL CREDIT

The Rural Finance and Leader Development program was funded by USAID and jointly implemented by USDA and Iowa State University. The RFLD program operated from 2003 to 2007 with a $970,000 budget to build business consulting-capacity and facilitate access to finance in several rural areas. The RFLD program built the capacity of business and government leaders to work together to ease a number of burdensome business regulations with training and other initiatives, and developed the capacity of 68 business consultants in 4 regions to provide services to rural business, helping them to access and manage finance and grow their rural businesses. In addition, the program assisted rural enterprises to access over $50 million in bank and donor funding for commercial activities. See "Rural Finance and Leader Development Program" below for more details.

MORTGAGE MARKET DEVELOPMENT

RAEF created the first mortgage finance company in Romania, **Domenia Credit**, with a grant for technical assistance and operational expenses from USAID, an initial investment from RAEF, and a USAID-backed Development Credit Authority (DCA) partial guarantee of a loan from a commercial bank. Technical assistance established innovative lending techniques that not only contributed to business success but set industry standards. The commercial bank loan backed by the DCA guarantee fuelled portfolio growth and contributed to the company's ability to attract additional loans and equity. USAID provided technical assistance to develop the necessary legal framework for the company's operation by forming the Mortgage Task Force with other donors and private sector stakeholders. See "Mortgage Market Development" below for more details.

ENABLING ENVIRONMENT

The **USAID Enterprise Development and Strengthening (EDS) program and the Capital Markets Reform Project** promoted legislative and policy reform for microfinance, consumer finance, and exchange activities. The EDS program (2003–2006) had a component focused on easing of regulations and barriers to private enterprise activities especially in rural, ICT, and tourism markets and the program accomplished much in that area. In addition, EDS supported the Microfinance Coalition, which served as a vehicle for industry lobbying for MFI and NBFI legislation. The Capital Markets Reform Project (2004–2007) provided support to the government to develop the RASDAQ exchange. RAEF was another vehicle for promoting legislative and regulatory reform. With RAEF

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[5] The transition of assets and activities from CHF Romania to Express Finance was ongoing during the course of the assessment. Express Finance is still widely known as CHF. Thus, for the purposes of this report the name CHF-Express Finance is used to refer to the MFI component of CHF Romania activities in Romania and the subsequent NBFI Express Finance.

and EDS support, laws enabling the creation and regulation of non-bank financial institutions were passed as were legislative measures and norms supporting retail mortgage lending and the creation of a secondary mortgage market.

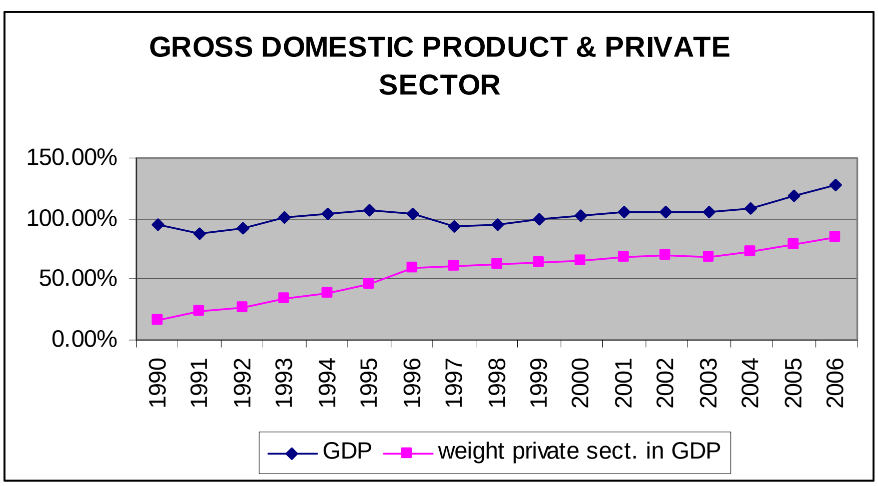
OVERVIEW OF THE ROMANIAN PRIVATE SECTOR– THEN AND NOW

Between 1994 and 2007, Romania's economy went through a dramatic transition. From a highly centralized economy characterized by old and inefficient technology in state-owned companies, a weak banking sector, an underdeveloped agricultural sector, lack of internal financial capital, and low ability to access international financial markets, it transformed into an EU member free market economy based on private domestic and foreign capital, with access to international financial markets.

There were a number of imbalances in Romania throughout the early years of transition, including a slow pace of reform, persistent lack of financial discipline, the lack of real competition among economic agents, the maintenance of some monopolies, as well as certain structural and circumstantial factors that contributed to high rates of inflation. Government efforts to reassure investor confidence, tax reforms that served to increase spending and promote investment, and currency liberalization all worked to promote economic growth. By 2005, the country witnessed a 9.5 percent annual growth in gross domestic product (GDP) and a 7.7 percent increase in 2006. However, GDP per capita in Romania in 2005-2006 was only 33 percent of the average for the EU, indicating that gaps and challenges still remain on the path to economic growth and prosperity.

In Figure 1, the GDP is set against the 1990 level which is 100 percent. From 1996 to 2006 GDP has risen over 25 percent. The private sector contribution to the economy has grown from slightly over 50 percent in 1996 to 75 percent in 2006.

FIGURE 1: GROSS DOMESTIC PRODUCT AND THE PRIVATE SECTOR



Source: National Institute of Statistics and NBR

THE ROMANIAN FINANCIAL SECTOR: A LANDSCAPE TRANSFORMED FROM 1994 TO 2007

THE FINANCIAL SECTOR AT THE OUTSET OF USG ASSISTANCE

In 1994, when the US government began to assist Romania's reform of the financial sector, Romania was experiencing a great deal of economic and political challenges. It had a weak and unstable financial market, affected by a deep recession, with constraints on accessing international financial markets and extremely high inflation rates of over 200 percent per annum. In addition, the state-dominated banking sector was struggling to integrate in the new free market environment.

> "The unfriendly economic environment, the poor quality of bank managers and shareholders and cumbersome legal procedures [in the 1990s] led to an increase in tensions, the poor quality of credit portfolios representing the major difficulty of the banking sector."
>
> *–National Bank of Romania–Financial Stability Report–2006*

In 1990, Romania had no external debt, yet in a few years of free market transactions, the current account deficit increased dramatically, and by 1999, Romania was close to payment default.

In this difficult macroeconomic environment, USAID's early presence directly and indirectly affected the development of the financial market by bringing technical assistance and expertise through various instruments and programs which:

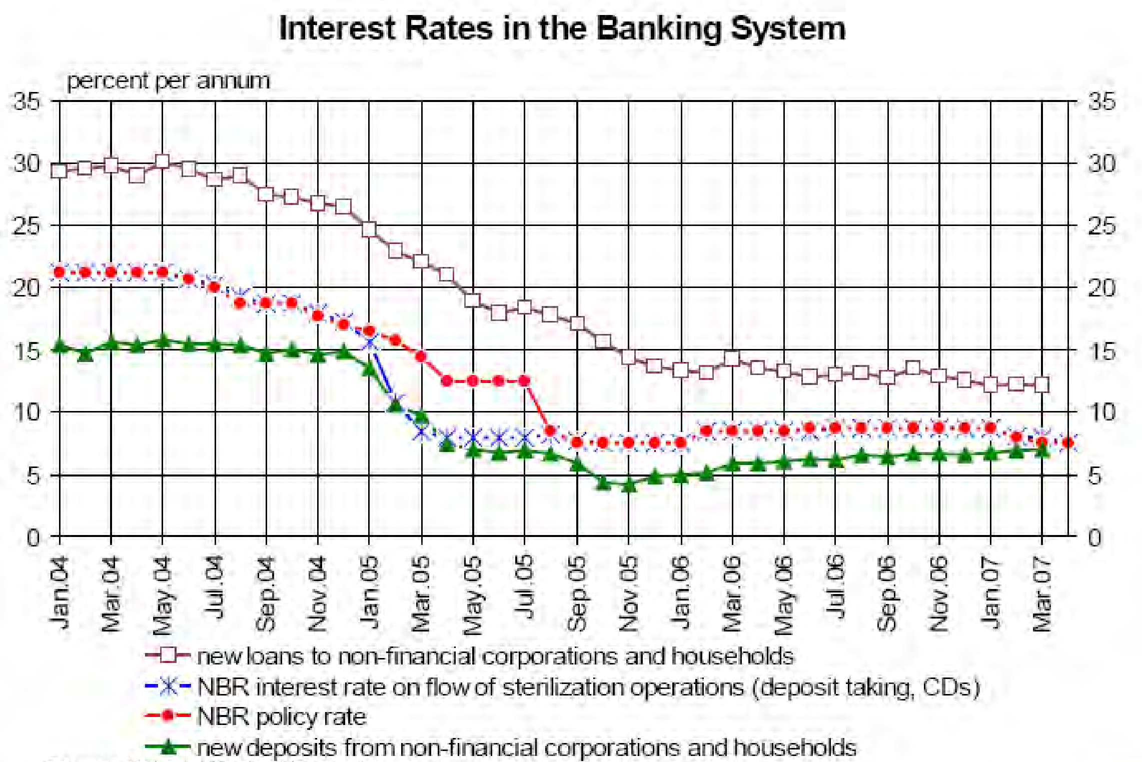
- stimulated the emergence of new financial subsectors (micro-lending, mortgage, consumer credit, over the counter market);
- assisted and contributed to the banks' privatization process;
- supported selected banks to strengthen their market position;
- provided equity funds and technical assistance to support development of the domestic private sector with a focus on SMEs; and
- provided technical assistance for rural areas.

MACROECONOMIC FACTORS INFLUENCING THE EVOLUTION OF THE FINANCIAL SECTOR

During the early years of transition, interest rates increased a great deal and had a drastic and negative impact on the economy. The lack of liquidity in the banking sector generated high interest rate volatility, which had a negative impact on business and household customers and eroded the banks' capital.

Throughout the past 10 years, the GOR acted to reduce the inflation rate, establish a realistic and stable foreign exchange rate, discontinue state subsidies, and improve relationships with leading international financial institutions. In 2000, the rate of inflation began to decline steadily, dropping from 46 percent in that year to 6.6 percent in 2006. The years 2005 to 2007 have shown a trend of declining interest rates and interest margins as the sector becomes more stable, sophisticated and competitive, encouraging investment and benefiting consumers.

FIGURE 2: INTEREST RATES IN THE BANKING SYSTEM



Source: National Bank of Romania

In the first years of transition, when local currency reached its lowest level of standard purchasing power, US currency dominated the financial market. In 2000, this trend began to reverse, with the Lei becoming more stable because of the GOR's prudent economic reforms and generally increasing political and economic stability. In 2005, the government introduced the new Romanian Lei (RON), which served to stabilize the currency value.

PRIVATIZATION, STABILIZATION, AND GROWTH OF THE BANKING SECTOR

The Restructuring of the Romanian Banking System

In early 1990, the National Bank of Romania (NBR) began the first restructuring process of the Romanian banking sector. First, it changed its own structure, retaining the role of a Central Bank and transferring its commercial activities to the state bank, Banca Comerciala Romana (BCR). The three existing state banks that had historically specialized in domestic banking transactions for single economic sectors were converted to universal banks.

> "[USAID was a] very well prepared and educated 'teacher' and a very good 'trainer' for the Romanian financial market."
>
> *–Mr. Florin Georgescu, First Deputy Governor, National Bank of Romania, August 2007*

In this environment, the first equity investment fund in Romania—RAEF—was founded. RAEF's presence in the market was timely, providing a measure of investor confidence in the future of

Romanian economic development and leading by example in its investments in the sector. RAEF introduced the first lending methodology based on cash flow analysis to the banking sector through its Small Loan Program in 1996.

After a series of bank failures in the late 1990s, prudential and monetary policy measures were taken by the NBR to stimulate credit growth and foster lending in domestic currency. New banking regulations were adopted to oversee bank lending processes and to mitigate risks. In 1998, Romania started the privatization process of banks in an effort to strengthen and increase the efficiency of the banking sector.

In 2001 the NBR prioritized further restructuring of the banking system to prevent systemic risk, with an immediate impact on the soundness of the banking sector.

RAEF was one of the first investors to recapitalize and privatize a major state-owned bank, Banca Agricola, the agriculture bank. Before privatization, this bank was in poor condition, and international financial institutions at that time were lobbying for its demise, although the GOR feared the closure would destabilize the sector. RAEF played a critical role in brokering the privatization and sale to Raiffeisen Bank, a strategic investor with the capital and know-how to turn the bank around.(See text box, right.)

RAEF's actions in participating in the privatization and facilitating a foreign investor's purchase of the bank spared the Romanian banking system from a second large liquidation of a state-owned bank.

RAEF's purchase of another bank, Banca Romaneasca, introduced modern bank management techniques based on corporate governance through technical assistance. This contributing more broadly to the modernization of the banking sector with demonstration effects, stabilization and development. BR was subsequently sold to a strategic investor, the National Bank of Greece.

> "The new government of Romania in 2001 facilitated an easy privatization, in order to reassure potential investors in the country."
>
> *–Mr. James Stewart, Vice President Raiffeisen Bank, S.A.*
>
> **Yet, the challenges of restructuring privatized banks are many…**
>
> For **Banca Agricola**, purchased by RAEF from the GOR, then sold to Raiffeisen Bank, the first year after privatization required huge structural and strategic changes in the bank in order to avoid failure. In 1999, before privatization, the bank was characterized by an overinflated staff of 11,000, bad debts, low capital, and huge losses.
>
> After taking over the bank, Raiffeisen management embarked on massive efforts to restructure the bank. In the first 12 months the new management replaced some top managers, reduced staff, hired 1,500 new employees to fit the new strategic needs of the institution, and relocated branches by closing 50 and opening 40 in more commercially attractive locations. When Raiffeisen Bank took over Banca Agricola, the bank had 250 branches. Now there are 350 with 100 new branches slated to open in 2007 alone.
>
> The first year of restructuring laid the foundations for growth. Assets at the time of purchase were $350 million-today they are EUR 4.7 billion ($6.4 billion). From 2003 to 2004 the bank's net profit grew from EUR 4.3 million to EUR 28.3 million. Today, Raiffeisen Bank is ranked third in the country in terms of market share and has been named by Global Finance "The Best Bank in Romania."

The Banking System Today

The Romanian financial system is benefiting from a strong economy and the ongoing privatization of the banking system, as part of the EU accession process. Capitalization is strong, and problem loans are manageable. As Table 1 shows, over the past eight years there has been a substantial shift from government to private ownership. Today Austrian, French and Greek banking interests dominate the sector.

TABLE 1: ROMANIA BANKING SYSTEM & STRUCTURAL INDICATORS

	1999	2000	2001	2002	2003	2004	2005	2006
Number of credit institutions*	41	41	41	39	39	40	40	39
Number of banks with majority private capital	37	37	38	36	36	38	38	37
Number of banks with majority capital, of which:	26	29	32	32	29	30	30	33
Foreign bank branches	7	8	8	8	8	7	6	7
Number of banks per 100,000 inhabitants	0.18	0.18	0.18	0.18	0.18	0.18	0.19	0.18
Assets of bank with majority private capital/Total assets (%)	53.2	53.9	58.2	59.6	62.5	93.1	94.0	94.5
Assets of bank with majority foreign capital/Total assets (%)	47.5	50.9	55.2	56.4	58.2	62.1	62.2	88.6
Assets of top five banks/Total assets (%)	66.7	65.5	66.1	62.8	63.9	59.2	58.8	60.3

**Including Creditcoop*

Sourse: NBR - Financial Stability Report - 2007

Establishment and Role of Non-Bank Financial Institutions

In 2001, RAEF launched the first non-bank financial institution dedicated solely to providing mortgage financing for individual home ownership, now called Domenia Credit. In addition, RAEF established the first consumer credit company, the Romanian-American Leasing and Financing company (RALFI, trading as Estima Finance) out of an early investment and invested in Motoractive, an automobile leasing company. All became market leaders whose product offerings increased competitiveness and growth in their sectors. GE Money recently purchased Domenia Credit, Ralfi and Motoractive, making available adequate funding to fuel the company's growth.

In 2005, the GOR initiated a legal framework for financial activities performed by institutions other than banks. The purpose of this legislation, the first of which was the 2005 Microfinance Institutions Law, was to help ensure that the demand for finance of the fast growing private sector, particularly small businesses, could be met by rationalizing prudential rules applied by the banking sector that made loans to small businesses prohibitively expensive. In 2006, the GOR passed the Non-Bank Financial Institutions Law, which brought a number of financial companies under the NBR's supervision. The law affects a number of institutions including consumer finance companies, leasing companies, MFIs, mortgage finance companies, and factoring companies. Table 2 shows the breakdown of the 3,756 NBFIs in Romania as of July 2007.

TABLE 2: FINANCIAL INSTITUTIONS (JULY 2007)

Type of Financial Institution	Number
1. Banks	30
2. Guarantee funds	5
3. NBFIS:	
Leasing companies	278
Credit cooperatives	128
Credit Unions	3,306
Micro Finance Companies	28
Other NBFIs involved in lending (such as mortgage financing, factoring)	16

Source: NBR

Although NBFIs are still relatively smaller players in the Romanian financial sector, they are an important source of finance to SMEs and consumers. In addition to their direct financing role, their presence and niche product offerings serve to improve industry standards for the benefit of customers. For instance, Domenia Credit's quick loan approval process has set the bar for others to follow.

According to the most recent survey conducted by the National Council of Small and Medium Sized Private Enterprises in Romania, SMEs are using a mix of financing sources for their activities: their own resources, loans from the banks, and funding from leasing companies. Depending on the age of the SME, 24–45 percent of firms receive financing from leasing companies, up to 4 percent from other NBFIs such as MFIs, and more than 2 percent from factoring companies. Companies that have been operating from 10–15 years have the highest percentage of external financing, including loans from NBFIs. Bank financing, however, remains the most popular source of external financing with over 40 percent citing a bank as a source of funding.

The MFIs supported with USAID funding, CHF–Express Finance, CAPA and OMRO are the three largest in the country. Between the three of them, over $25 million of USAID funding has been put to use to support lending to small businesses, and they have branch networks covering all regions of the country. CAPA is the largest MFI in the country according to portfolio size. CHF-Express Finance recently won an industry award for the use of Yahoo! Messenger in lending activities and OMRO was the first Romanian MFI to receive a credit line from the European Bank for Reconstruction and Development (EBRD) to implement an EU-funded Romanian microcredit scheme. This is a milestone for the industry. CHF–Express Finance later also signed on to this credit line and as of the writing of this report, CAPA is negotiating for such funding.

INVESTMENT FINANCE

Privatization Process and Capital Market Development

Development of domestic and foreign capital investment in Romania went through two main stages in the early years. From 1990 to 1994, Romania experienced the development of trade and the services sector due to the establishment of many new small and medium size enterprises; and from 1995 to 1997, private domestic and foreign capital emerged to serve the industrial sectors, specifically the processing industry.

The first step of the privatization process in Romania consisted of the conversion of 6,280 state-owned companies into commercial companies. As part of the second step of the privatization process, in August 1992, shares in state-owned companies were distributed to 15.5 million Romanian citizens.

In the 1990s, investors viewed both security exchanges–RASDAQ and BVB-with wariness, due to high costs, low trade volumes, and a still untested reliability. Trading on the RASDAQ remained relatively low through the end of 1999 and volumes did not increase enough to provide a viable exit strategy to equity investors until the mid-2000s. BVB and RASDAQ shareholders approved a merger of the two exchanges in December 2005 but RASDAQ continues to operate as a separate market within the BVB until its restructuring is completed.

Foreign Investment

In addition to its impact on the financial sector, the flow of foreign direct investment (FDI) has a significant impact on the overall Romanian economy. The volume of FDI has increased year by year, slowly following macroeconomic trends and market stabilization. FDI in Romania in 2006 was $12 billion, and the International Monetary Fund projects FDI to be between $12 and $13.5 billion in 2007. This is up from less than $1 billion in 2000, and places Romania at the top of all Southeastern European countries in terms of FDI. In addition, around $4 billion in remittances enters the economy each year from overseas workers.

PRIVATE SECTOR FIRMS: SLOW BEGINNINGS TO STRONG, STABLE GROWTH

Private sector firms accounted slightly more than 50 percent of GDP in 1996. In 1997, more than 1,400 enterprises were privatized and by the next year, the private sector contribution to GDP formation rose to 58 percent. By 2006, the private sector contributed 75 percent to GDP and more than 70 percent of all employment was in the private sector.

PRIVATIZED AND NEWLY CREATED LARGE FIRMS

When USAID began activities in Romania, the private sector was in its infancy, with large state owned firms beginning to be privatized as the country moved away from a command economy system. This process began with a multi-staged privatization process that continues to this day. The first step of the mass privatization process in Romania consisted of the conversion of 6,280 state-owned companies into commercial companies, and the creation of a number of institutions to support the privatization process. As part of the second step of process in August 1992 tradable Certificates of Ownership were distributed to 15.5 million Romanian citizens. Beginning in 1994, around 1,500 companies were sold to associations of employees and management for Certificates of Ownership and/or cash. In March 1995, 113 Initial Public Offerings (IPOs) were launched. The first listed stocks on the BVB came from among those companies. Other companies were sold directly to strategic investors.

> **Policolor:** Privatization and international expansion of a paint producer
>
> In 1997 RAEF participated in the privatization of Policolor, a paint production and retail firm. As an active member of the board of directors, RAEF proceeded to bring in new ideas in the areas of management and marketing. RAEF assisted with raising external funding for Policolor's purchase of a Bulgarian firm, the first such international transaction for a Romanian firm. Today, Policolor has a greatly expanded market share, with products that meet ISO 9000 and European environmental safety guidelines. (See the case study of Policolor in the annexes.)

Capital markets activity increased in 1997, an increasing number of companies traded on both the BVB (about 80 on the first and second tiers) and RASDAQ (over 5,000). In the late 1990s government attempts to accelerate privatization yielded disappointing results, yet several companies were listed on the Bucharest Stock Exchange that were able to attain investors' interest.

A number of privatizations occurred in the energy sector in 2004, which was an important turning point for the sector and the GOR as it increased investor confidence in the country further.

Newly created firms, known as greenfield investments to equity investors, carried their own special challenges. The greatest risks lie in misjudging the market and untested management. In the early years of activity, RAEF pursued greenfield investments as a function of its mission to grow the private sector and the small size of the market of existing firms at the time. These investments in some cases proved challenging and had mixed results. RAEF pursued a hands-on approach to its role as owner and member of the board of directors to help shepherd these new firms.

MICROENTERPRISES AND SMALL AND MEDIUM-SIZED ENTERPRISES

From 1996, when USAID funded implementers began providing micro loans, to today, the number of SMEs in Romania has more than doubled. The total number of SMEs registered in Romania represents over 99 percent of enterprises in the country. Within the last few years, SMEs have made a substantial contribution to total employment and have consolidated their role in the economy in terms of average turnover per enterprise. In 2003, SMEs contributed slightly more than 40 percent to GDP. In 2004, SMEs accounted for more than 10 percent of total exports. It is estimated that by 2007, SMEs, representing over 99 percent of all Romanian enterprises, will account for 70 percent of GDP. These firms contribute 70 percent to total employment in the country.

TABLE 3: SME DEFINITION

Enterprise Category	Number of Employees	Turnover	Or	Total Assets
Medium-Sized	< 250	≤ EUR 50 million		≤ EUR 43 million
Small	<50	≤ EUR 10 million		≤ EUR 10 million
Microenterprises	<10	≤ EUR 2 million		≤ EUR 2 million

Source: European Commission, 2003.[6]

Romanian SMEs have on average 5.9 employees and annual turnover of EUR 161,000. The data below for the period from 2000 to 2006 illustrates the continuous growth of the SME sector. Most SMEs (89 percent) are microenterprises.

TABLE 4. ACTIVE PRIVATE SMES, BY SIZE[7]

Enterprise Size	1999	2000	2001	2002	2003	2004	2005	2006 estimate
Micro	294,597	279,893	280,448	285,207	313,485	358,242	N/A	N/A
Small	25,987	29,417	31,249	32,010	34,883	36,080	N/A	N/A
Medium	6,102	6,864	7,455	7,989	8,342	8,674	N/A	N/A
Total	326,686	316,174	319,152	325,206	356,710	402,996	450,091	512,000

Sources: Ministry of Public Finance and National Institute of Statistics of Romania, SME European Observatory

In 2004, the SME sector showed a large jump in total numbers of firms. The most impressive increase was in the construction sector (23.2 percent), which grew at a much faster rate than the average annual growth rate of approximately 13 percent. This was a year of high economic growth for the country at large.

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6 Note that turnover and balance sheet totals were lower in the 1996–2003 definition employed by the EC.

7 2005 and 2006 disaggregated data were unavailable at the time of this assessment.

TABLE 5: ACTIVE PRIVATE SMES, BY SECTOR OF ACTIVITY[8]

Activity sector	1999	2000	2001	2002	2003	2004	2005	2006
Agriculture	10,055	9,494	8,929	10,011	10,430	11,390	N/A	N/A
Industry	39,457	40,252	41,609	45,586	50,117	54,657	N/A	N/A
Construction	10,956	11,705	13,990	16,312	20,378	25,115	N/A	N/A
Services	266,218	254,723	254,625	253,297	275,785	311,834	N/A	N/A
Total	326,686	316,174	319,152	325,206	356,710	402,996	450,091	512,000

Sources: Ministry of Public Finance and National Institute of Statistics, SME European Observatory.

A crosscheck on size and sector of activity reveals that SMEs belonging to the industry sector are larger than those involved in other activities. The greatest share of medium enterprises (those enterprises that employ 50 to 250 employees) as a percentage of the total is in the industrial sector at 7.8 percent. Microenterprises are the dominant type of enterprises in all sectors, ranging from 73 percent in the industrial sector to 92.5 percent all SMEs in the services sector.

THE AGRICULTURAL SECTOR

Eighty-seven percent of Romania's 238,000 sq. km territory is considered rural. About half of the total population of 22 million, and over 70 percent of the low-income population, lives in rural areas.

Romania's agricultural sector is comprised of informal and formal activities. The estimated 4 million subsistence farmers own 60 percent of farmland but produce mostly for their own consumption on an informal basis. The formal agricultural sector consists of the larger farms, which produce for domestic and export markets. Starting in 1997, all state owned farms were privatized.

In the early 1990s, agricultural production fell sharply, followed by a slow recovery over the next 10 years. According to the World Bank, total production dropped 20 percent between 1989 and 1998, though gross value added in the sector has only dropped 1 percent. One reason for the low productivity of farming is the agricultural reforms that initiated in 1991, which returned land nationalized under the communists to its former owners or their heirs. A limit was put on the amount of land that could be returned, in the interests of social equality. The result is that Romania now has the most fragmented agricultural land in Eastern Europe.

In 1999, agriculture employed 42 percent of Romania's workforce, which generated 16 percent of GDP. By 2006, roughly a third of Romanians worked in the formal agriculture sector, which contributed only 10 percent contribution to GDP. Improving this ratio is one of the biggest challenges facing Romania as it tries to raise living standards after entering in the European Union.

The main characteristics of the Romanian agriculture sector today are:

- The sector is still dominated by small individual farms, of which 82 percent are subsistence type farms on less than 5 hectares. The average size of these holdings is 2.15 hectares, while the average national agriculture area used by an agriculture holding is 3.27 ha.
- The corporate farms account for about 29 percent of agricultural land and have an average size of 263 hectares.

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[8] 2005 and 2006 disaggregated data were unavailable at the time of this assessment.

- 50 percent of land owners are more than 60 years old, of whom 40 percent are pensioners
- There is an underdeveloped wholesale market, with most producers selling locally due to lack of distribution channels.

The above characteristics create large opportunities and challenges for future development as Romania tries to meet the local and EU market demand of consumers. Increasingly, the Romanian agricultural sector will be pushed to respond to the need for high quality, standardized supply to satisfy the increasing rise in networks of hypermarkets, supermarkets, and stores.

THE ENABLING ENVIRONMENT: LEGISLATIVE AND POLICY REFORMS AND BUSINESS SUPPORT NETWORKS

KEY REFORMS AND LEGISLATIVE DEVELOPMENTS

A number of key developments positively affected the enabling environment for private sector firm growth in the years 1996 to 2006. These legislative changes and policy reforms created a more favorable environment for financing the private sector and private sector growth more broadly. Banking and commercial sector reforms rationalized activities and eased investors' confidence, serving to encourage domestic and foreign investment and economic growth. A selection of key legislative and policy developments follows.

Banking Reforms

The NBR adopted new banking laws, including the Banking Act, the National Bank of Romania Act, and the Bank Insolvency Act, which substantially strengthened the central bank's capacity to take action in the area of banking supervision. In 2003, the NBR fully harmonized the Law on Banking Activity with EU directives.

Non-Bank Financial Institutions, Mortgage, and MFI Legislation and Regulation

Laws enabling MFIs, mortgage finance companies and other NBFIs to function and grow were important to the development of the financial sector. International assistance programs have supported the introduction of the legal and regulatory framework for non-bank financial services since 1995, when the first law for leasing was approved. USAID played a central role in the establishment of many of these laws and regulations.

Microfinance institutions. Until 2005, MFIs registered as NGOs worked within an undefined regulatory framework. Romania had no law on microfinance or a definition of microfinance institution. A USAID-supported network of 14 organizations, called the Microfinance Coalition, effectively lobbied for a law regarding microfinance institutions, the Microfinance Companies law (Law number 240/15), issued in June 2005. This law established the framework permitting MFIs to offer loans.

Government Ordinance 28, issued in January 2006, provides for the regulation of all NBFIs legally registered under specific laws, such as the Leasing Law, Mortgage Law, and Microfinance Companies Law. The NBR was appointed under this law as the supervisory authority. This law was passed with USAID taking a lead role in the Mortgage Task Force with other donors and the Microfinance Coalition. Secondary legislation is still under development: several norms, particularly in the mortgage finance area, have already been issued.

By registering with the NBR, NBFIs' financial activity is now recognized as part of the financial sector. The regulatory framework supports the development and commercialization of the sector and is fairly liberal. For instance, no limitations are set on geographical expansion or foreign investment. It ensures transparency of the transactions, and mitigates risks for both clients and NBFIs.

These regulatory changes have put in place some prerequisites for the microfinance market to grow:

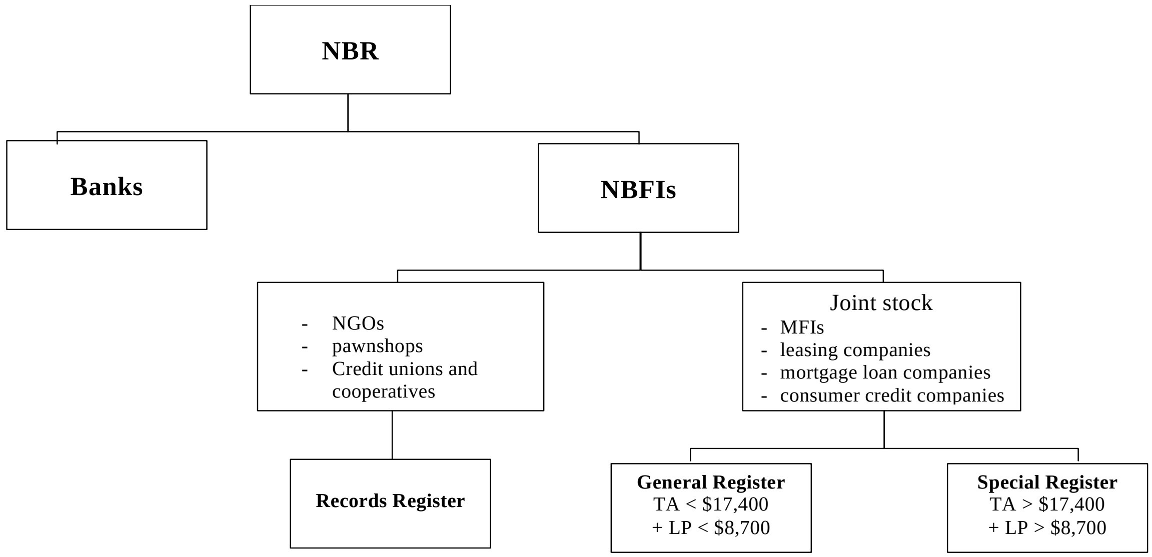
- **Higher credibility:** With the new law, commercial banks can now recognize the credit history of the applicant who had previously borrowed from an MFI. Therefore the SMEs may have greater access to larger loans from banks as they develop.
- **Risk mitigation for clients applying for credit:** The law imposes a minimum capital minimum capital of EUR 200,000 for NBFIs, which obliges smaller MFIs to drop out of the market. The law also requires an independent audit and transparency in fees and interest charged.
- **More competitive microfinance loans for business owners:** The law benefited microfinance borrowers and made MFIs more competitive, by making interest on microfinance loans tax-deductible. Before the law, MFI loan interest payments made by businesses were tax deductible in amounts equaling up to rate of the central bank's interbank lending rate. Yet bank loan interest rate payments of any amount were fully tax deductible.
- **Investor assurances:** Regulation could have the affect of reassuring commercial and/or international investors and lenders of the stability of MFI-NBFIs, thus leading to greater access to financing and subsequent institutional and sectoral growth.

In 2006, the microfinance sector reached a critical point in its evolution with the NBFI legislation. In addition to the first eight MFIs established between 1992 and 2000 with international donor support, another 20 new microfinance companies established themselves under the 2006 legal framework and are in the process of registration and licensing. The MFIs supported by United Nations Development Program (UNDP) closed their operations, as they found difficulties in meeting the new capital and reporting requirements. Larger MFIs, however, met the challenges of the new requirements. Figure 3 demonstrates the groupings of NBFIs under NBR regulation.

Retail mortgage lending and the secondary mortgage market. USAID played a lead role promoting passage of the Mortgage Law issued in 2000, which enabled lenders to provide financing against residential collateral. At that time, there were very few mortgage services available in Romania. No specialized mortgage finance companies existed. Bank services were characterized by high collateral requirements and bureaucratic procedures and generally entailed loans of fairly short duration (less than 10 years). Under USAID initiative, in close collaboration with the GOR Agency for Housing and in coordination with donors through the Mortgage Task Force, legislation enabling the development of the retail mortgage market was passed. These reforms included easing a restrictive mortgage law and rationalizing real estate registrations and foreclosure procedures.

In 2002, due to efforts of the Romanian government and the USAID-backed Mortgage Task Force, including representatives of USAID, RAEF, EBRD, and other donors, the Emergency Ordinance on mortgage loan companies was passed, paving the way for the establishment of mortgage finance institutions. The RAEF-funded and USAID-supported mortgage company, Domenia Credit, established in 2003, served as a vehicle to spearhead industry reforms.

FIGURE 3: NATIONAL BANK OF ROMANIA REPORTING RELATIONSHIPS



KEY:
TA = Total Assets
LP = Loan Portfolio
US Dollar equivalents of Lei amounts shown (1USD = 2.87 RON)

A secondary mortgage market legislative package, promoted by USAID, was approved and published in March 2006, making Romania one of only seven countries in the region equipped with the foundation needed to develop the secondary market. The norms related to these laws were developed with technical assistance from other donors on the Mortgage Task Force. Today, there are five mortgage finance companies in Romania, and Domenia Credit remains a market leader.

Capital market and insurance sector reforms. During 1996 to 2007, the RASDAQ and Bucharest Stock Exchange (BVB) were founded and developed to become viable mechanisms for exchange for investors. RASDAQ was developed with US support including the Financial Markets Reform project, and was based on the model of NASDAQ. The Romanian Association of Securities Dealers (ANSVM) and the National Securities Commission acting on behalf of the broker-dealer community with the support of USAID, led efforts aimed at developing a market to link buyers and sellers from all over Romania.

The National Securities Clearing, Settlement, and Depository Company (NSCSD), established in August 1996, according to Securities Law No. 52/1994, was created to promote a clearing, settlement, and depository system for securities, and to complete the legal framework and institutional system for capital market transactions. In the insurance sector, in 1995, the GOR issued Law 136, which defined the Guaranty Fund for Insurance and Re-Insurance. In 2000, the Insurance Supervisory Commission was founded to supervise insurance and insurance companies.

Tax reform. The Corporate Income Tax was created in 1991, laying the foundation for a number of future tax reforms instituted in the years from 1994 to 2005 designed to increase compliance. The corporate income tax rate dropped from 38 percent in 1994 to 16 percent of profit in 2005. For small businesses, with less than EUR 100,000 (approximately $143,000) turnover, the rate is only 3 percent, charged on gross income. Also in 2005, Romania switched to a flat tax on income and profit, which is one of the lowest rates in the region. Tax exemptions for ICT firms served to invigorate the sector. This particular reform received lobbying support from the USAID-funded EDS Program. While some tax incentives had existed for the tourism industry, some are being rolled back. For example as of January 2007, there will be no profit tax or property land tax for small mountain rural tourism units.

Currency reform. Currency restrictions were lifted in the 1990s. Reforms that served to stabilize the value of the lei were implemented in the mid 2000s, with a new currency, the new Romanian Lei (RON) introduced in 2005. These reforms were essential to increase foreign investor confidence.

Reductions in bureaucracy, accounting and commercial legislation reforms. A number of reforms served to make the environment in Romania friendlier to private business and to SMEs, in particular. Business registration procedures were streamlined, particularly for those in the tourism sector, a sector prioritized by USAID's EDS Program. Permit requirements were rationalized, which served to increase the numbers of new businesses, encourage some existing businesses to enter the formal sector, and promote business and sectoral growth. Accounting and tax reporting rules for professionals were streamlined. The USAID funded RFLD program introduced a new accounting system for agricultural producers, which eased financial management and reporting burdens for those business owners.

DEVELOPMENT OF BUSINESS SUPPORT NETWORKS

Business Networks

At local levels, some rural communities have been changed by the establishment of communication channels and support networks for municipal leaders, business consultants, and rural entrepreneurs. The USAID-supported RFLD Program was particularly effective in establishing channels of communication and cooperation among Chambers of Commerce, business associations, and local and national government leaders and agencies. These relationships have changed in a fundamental way, forming a foundation for future regional development as EU initiatives begin to take shape and the GOR pursues further decentralization. In addition, a number of national tourism associations promoted by the USAID EDS Program serve to support the industry.

Laying foundations for rural development in the EU reality

The RFLD program introduced local registries to facilitate cooperation among agriculture producers to sell goods into the wholesale market.

Romania could build on these foundations, as did other countries that have benefited from EU integration, such as Ireland, which relied on local networks and business support to maximize dividends from EU funding.

Networks for Bank and Non-Bank Financial Institutions

The banks of Romania do have an association, although it does not perform all of the roles and functions such an institution could for the benefit of members. The Microfinance Coalition, at one point boasting 26 members, disbanded after the end of the USAID EDS Program. Members gather now on an informal basis to discuss topics of common concern. The industry is currently discussing whether a national association is necessary or whether membership in a European microfinance association is sufficient for MFIs.

REMAINING CHALLENGES AND GAPS

ACCESS TO FINANCE

While the banking and NBFI sectors have come a long way in terms of meeting demand for microfinance and SME finance, it is estimated that the market demand is still not saturated, particularly for SMEs and rural enterprises.

The unmet demand for microfinance in Romania is significant.[9] It is estimated that 194,400 creditworthy microenterprises are willing to borrow. As of 2006 the total number of borrowers served by MFIs in Romania was approximately 45,000, thus there is an unmet demand of approximately 150,000 enterprises. The volume of loans this would represent, if current MFI loan value averages were to be assumed, is EUR 903 million or $1.27 billion, in addition to current portfolios.[10] Based on industry trends, it could be expected that only 53 percent or 104,000 microenterprises of the original "pool" of clients would remain in the program as "regular, repeat" clients of the industry.

These borrowers are widely disbursed throughout the country. The potential demand for financing per region is presented in Table 6.

TABLE 6: SME DEMAND BY REGION AND URBAN AND RURAL LOCATION

	Total pool[11]	Repeat client number	Rural Loans	Average Rural Loan (EUR)	Urban Loans	Average Urban Loan (EUR)	Total Demand (EUR m)	Percentage of total demand
North East	22,417	11,657	2,564	2250	9,092	3,750	39.9	11.2%
South East	25,572	13,298	2,925	2250	10,372	3,750	45.4	12.7%
South	22,080	11,481	2,526	2250	8,955	3,750	39.3	11%
South West	16,925	8,801	1,936	3000	6,865	3,750	31.5	8.4%
West	18,147	9,436	2,076	3000	7,360	4,500	39.3	9%
North West	28,119	14,622	3,217	3000	11,405	4,500	60.9	14%
Centre	24,688	12,838	2,824	3000	10,013	4,500	53.5	12.3%
Bucharest–Ilfov	42,853	22,283	0	0	22,283	3,750	83.6	21.3%
Total	200,800	104,416	22,972		81,444		393.6	100%

Source: Assessment team calculations using Perrett methodology, 2003.

9 In 2006 there were over 500,000 SMEs, of these, 90% or 450,000 are microenterprises. The assessment team used assumptions of demand and creditworthiness based on the Graham Perrett method of assessment (2003).

10 EU estimates a lesser total demand of approximately $986 million in 2007. Source: Benchmarking Microfinance in Romania 2005-2006, European Union, ANIMMC, Ministry of European Integration.

11 Amount in that region which demand credit and are creditworthy, based on most recent figures for regional distribution of microenterprises (National Institute for Statistics, 2004).

These are conservative estimates, as demand could increase in the next few years as businesses grow and their credit needs increase, as evidenced by trends in the portfolios of MFIs with repeat clients.

Investment finance for SMEs is still difficult to come by in Romania. Yet, with the exception of a small percentage of medium-sized firms, most small businesses do not demand or require equity infusions.

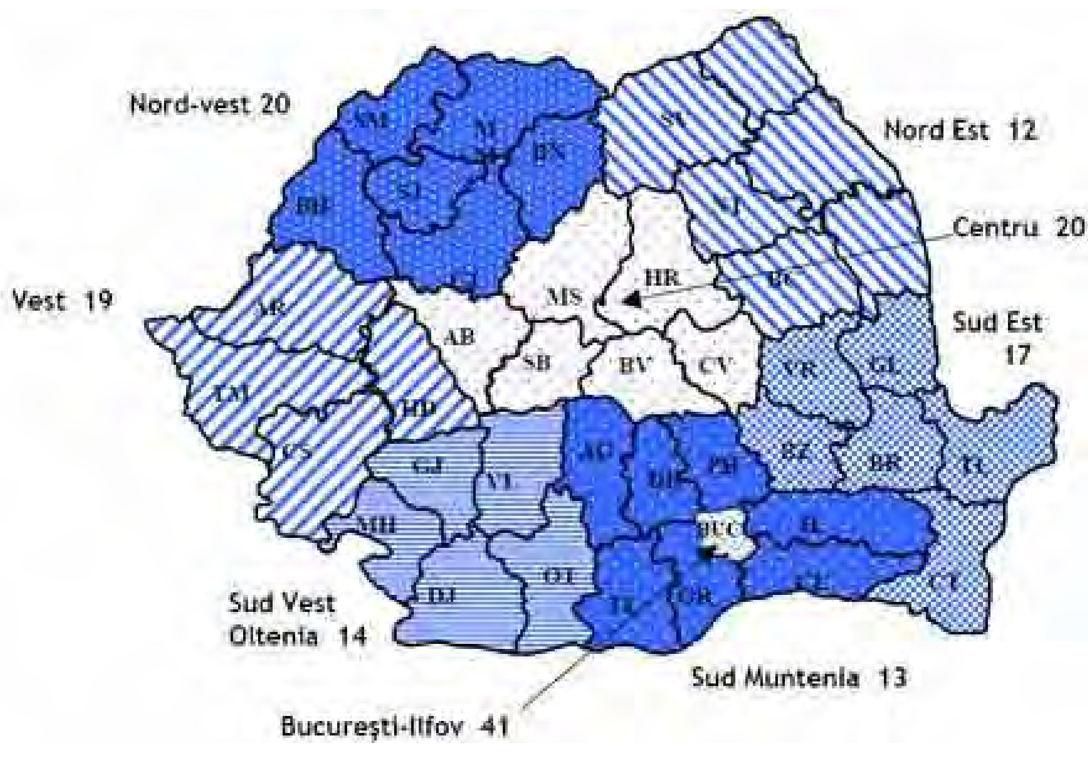
CONSUMER CREDIT AND MORTGAGE FINANCE

While consumer credit has tripled in the past two years, there is still a great deal of unmet demand, including for housing mortgages. In 2006, there were approximately 500,000 real estate transactions in Romania, yet only about 30,000 new mortgages, thus there is a gap in the financing of these transactions.

SME SECTOR

There is still room for growth in the SME sector, as there are large discrepancies among various development regions in the number of SMEs per thousand of local residents. At the lower end, there are 15 SMEs per 1,000 local residents in the North-Eastern region and at the upper end there are 41 SMEs per 1,000 local residents for the Bucharest-Ilfov region. The national average is 23 SMEs per 1,000 local residents. This compares to the EU average of 52 SMEs per 1,000 local residents.

FIGURE 4: SME DENSITY: NUMBER OF SMES/1,000 INHABITANTS, 2004[12]



[12] White Charter of Romanian SMEs – 2006 National Council of SME

Despite having experienced improvements in financial performance, SME respondents to the assessment survey cite a long list of challenges to increased and continued improvements. Legislative conditions and labor availability and cost were cited by a quarter of respondents. Other significant challenges mentioned were high interest rates and low market prices. Shortage of raw materials and the availability of other resources were also mentioned.

RURAL MARKET STRUCTURE

While only contributing ten percent to total GDP, the agricultural sector employs a third of all Romanians, not including those Romanians operating the more than four million subsistence farms in the country. The agricultural sector continues to be inefficient and uncompetitive due to its structural challenges. Land is divided into small plots, which are difficult to manage profitably and pose challenges to developers in rural areas. The wholesale market for agricultural products is underdeveloped with low levels of capital resources and thus does not adequately serve the needs of private producers.

While some rural areas benefited from the capacity building efforts of the USAID-funded Rural Finance and Leader Development Program, that complemented the EU Special pre-Accession Program for Agriculture and Rural Development (SAPARD) funding, this program's impact on the rural credit market was confined by its limited geographic outreach, as it only covered 21 of the country's 42 districts. This type of assistance is still needed in vast areas of rural Romania, specifically:

1. community building and capacity building in problem solving and business support;
2. local leader capacity building in public management and accessing funds; and
3. business support capacity building to develop business consultants capable of helping rural businesses attract and manage funding, particularly EU structural funds.

EU ACCESSION

Accession to the EU will bring both opportunities and challenges to the Romanian private sector, particularly SMEs. While the expected economic growth will benefit most, many will face costly challenges to meet standards as well as increased competition particularly from producers and retailers. Already, labor prices are increasing, which small businesses see as a major obstacle to business growth.

ENABLING BUSINESS ENVIRONMENT

While much progress has been made in recent years at the legislative level in reducing bureaucracy for small businesses, bureaucracy is still a common complaint among business owners. In focus groups, business owners also claim to need assistance in marketing and marketing training.

The growth and rationalization of the energy sector is inhibited by barriers to investment related to price controls and stalled plans for restructuring and greater privatization of the sector.

MICROFINANCE INSTITUTIONS

While SME finance has increased dramatically over the past five years and consumer borrowing has tripled in the past two years alone, there is still unmet demand in both sectors, which the financial sector is struggling to meet.

One of the key challenges that Romanian MFIs are currently facing is the difficulty in increasing their funding base in order to serve the high client demand base in the market, due in part to their already high debt levels compared to relatively low levels of equity. The debt to equity ratio CHF– Express Finance is roughly 5.4 to 1, for CAPA it is 8.4 to 1, and for OMRO 2.4 to one. The high debt to equity ratio of these MFIs poses a challenge to attracting new funds. All of these institutions have non-USAID funding sources, in addition to USAID funds.

MFIs seeking equity investment find the risk management requirements of investors challenging to meet. Investment funds are available to a certain extent, particularly from international funds. Romanian MFIs are not familiar with negotiating with equity investors and are challenged in meeting the reporting and internal controls requirements of these institutions.

Another challenge facing MFIs is the increasing competition from the banking sector. In addition to ProCredit, which is a bank that markets itself as a bank for small businesses, other banks, such as Banca Transilvania, are increasingly moving down-market with products modeled after best practices in microfinance. With a lower cost of capital and a larger range of services, banks are beginning to pose competition to MFIs. This is forcing some MFIs to rethink their marketing strategy and role in the market.

BANKS

The banking sector is experiencing a period of rapid growth, and is challenged by the rising cost of labor and real estate. Wages are increasing significantly for jobs in the sector. A recent increase in the pension tax may also increase this cost by motivating workers to ask for higher wages in the face of higher taxes they must shoulder. While there is a good-sized pool of well-trained professionals in the country, the rapid growth of the sector is straining the supply and posing a challenge for bank managers.

Another challenge faced by banks in Romania is the high costs of foreign borrowing, with a 40 percent reserve requirement imposed by the NBR for such loans. Foreign banks may be at an advantage in this situation as their offshore affiliates may borrow on their behalf.

Banks in Romania are not supported by a strong and active bankers' association, which could otherwise serve to assist in solving these challenges.

One gap in the financial sector is that of a centralized, user-friendly credit bureau. At the present there are three different databases, one available only to a subset of banks and none freely available to MFIs. The data captured only encompasses negative (default, fraud) information on individuals as opposed to positive credit history, which may benefit borrowers seeking repeat loans or commercial credit. Both banks and NBFIs would benefit from a centralized system available to all financial institutions.

THE MORTGAGE MARKET

A remaining gap in the mortgage market is the lack of secondary market development. This could also been interpreted as a ‚market opportunity. Romania is one of only seven countries in the region that has the required legislation for the issuance and trading of mortgage-backed securities and covered bonds. Yet the market is inactive for a number of reasons:

- Currently there is adequate liquidity in the sector. Banks, particularly foreign-owned banks, have adequate resources to hold mortgages on their balance sheets for the near term. This is a short- term situation, however, and lenders may need refinancing inflows within a few years.
- The mortgage market is still in the mid-stages of development. The volumes of mortgages may not yet be sufficient to support a secondary market.
- The costs of trading is high in Romania, and given that cost, bankers' confidence in the NSC may not yet be sufficient to take the risk of being the first to place such assets on the market.
- There is neither an efficient municipal and other government bond market nor an efficient corporate bond market, which would be the usual precursors to a private mortgage bond market.
- Last, supporting valuation institutions need to be further developed and mortgage products more standardized to facilitate this market development.

ASSESSMENT METHODS

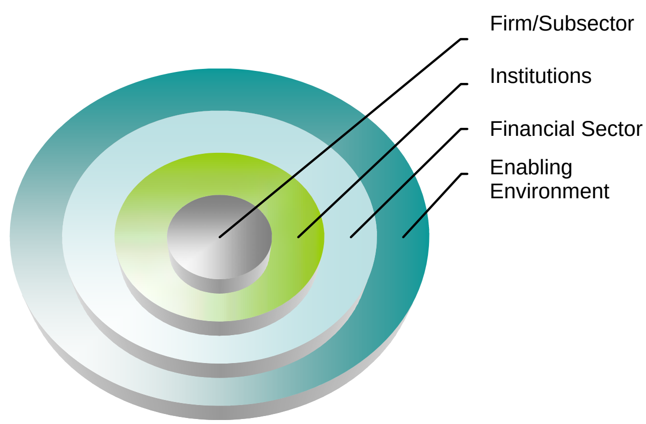
RESEARCH OBJECTIVES

In order to meet the goals of the assessment, the project team attempted to answer the following key research questions:

- How have firms and sub sectors been affected by financial and non-financial services provided by USAID and its partners?
- What is the viability and effectiveness of the various financial institutions, programs and mechanisms supported by USAID?
- What has been the broader impact of USAID's support on the financial sector?
- What aspects of the enabling environment have been improved due to USAID's programs and what are remaining weaknesses?

ANALYSIS FRAMEWORK

The assessment team used an analysis framework to answer these questions by examining four levels of impact: 1) the firms/subsectors accessing financial services, 2) the institutions providing products and services, 3) the overall financial sector, and 4) the broader enabling environment in Romania.



METHODS

At each level of analysis, the team utilized a series of research tools, including focus groups, questionnaires, key informant interviews, public documents, internal reports and assessments, and other data made available by USAID partners and stakeholders in Romania. Annex 1 has a complete list of all documents reviewed.

Focus groups were held with both end borrowers of SME financing as well as with key stakeholders, such as business consultants, government representatives, and private sector leaders. Individual interviews were held with three of the six companies in the SEAF-TBRF portfolio, eight of the thirty-seven companies, which were financed by RAEF since inception, as well as government, donor and private sector stakeholders. Annex 2 has a list of contacts made during the course of the assessment.

The team also conducted a survey of 63 firms that benefited from finance or assistance from CHF-Express Finance, the RAEF Micro Loan Program, and the RFLD program. This survey was not designed to be statistically significant, rather the findings were triangulated with data and findings from portfolio reports, focus group meetings, and individual interviews to confirm general trends. Respondents were randomly selected according to USAID program affiliation, business sector, and geographic location stratification. Interviews were conducted primarily over the telephone based on a pre-tested questionnaire, and a few of the interviews were conducted in person. Data was analyzed using an SPSS-based analysis tool.[13]

Of the investments made by the RAEF Major Transaction Program and SEAF-TBRF, the assessment team interviewed management or owner representatives who were present at the time the investment was made through the exit. The team chose companies to get a selection of different industries. In the case of RAEF MTP companies, there was an effort to examine investments that appeared to have had a significant impact on the financial services sector or business environment, beyond the impact on the company itself. "Average performers" were also sought.

Case studies of several companies that benefited from USAID financing are in the attachments.

In addition to the institutional impact and effectiveness analysis of RAEF, SEAF-TBRF, RFLD and CHF-Express Finance contained in the body of this report, broader institutional assessments of CHF-Express Finance and CEED are attached.

[13] SPSS is the maker and brand name of a type of predictive analytic research software.

USAID PROGRAMS – 1996 TO 2007

ASSESSMENT FINDINGS: THE IMPACT ON FIRMS

One of the main objectives of this assessment was to determine the impact that USG programs have had on assisted firms and sub sectors. The team divided the firms to be assessed into two groups:

1. microenterprises and small businesses that benefited from CHF-Express Finance funding, Romanian-American Enterprise Fund (RAEF) Micro Loan Program (MLP) finance, and Rural Finance and Leader Development Program (RFLD) assistance; and
2. the largest firms supported by RAEF Major Transaction Program (RAEF) and SEAF-TBRF investments.

The findings related to these two groups are presented separately below. The findings are primarily from the client survey, as well as information gathered in interviews, focus groups, and portfolio information.

RESPONDENT PROFILE–MICRO, SMALL AND RURAL ENTERPRISES

The respondent profile **CHF-Express Finance, RAEF MLP,** and **RFLD** beneficiaries can be described in terms of program affiliation, region, location, gender, business characteristics, and firm size. Sixty-three valid surveys were collected from respondents.

- Approximately 35 percent of the respondents received support from CHF-Express Finance, 38 percent from the RAEF MLP, and 27 percent from RFLD. Note that all respondents from RAEF MLP are borrowers of CAPA. More than 95 percent of the MLP portfolio is lent through CAPA at the time of the assessment and RAEF MLP has a direct lending relationship to these borrowers, as opposed to the loan to OMRO wherein OMRO is the retail lender. In interviewing beneficiaries of the RFLD program, only rural non-consultant businesses were selected to participate in this client survey.
- The majority of respondents are from the West (49.2 percent) and the South West (32.8 percent). A small percentage of respondents are from the North East (6.6 percent), Bucharest (6.6 percent), and the Southeast (4.9 percent).
- Furthermore, 77 percent of respondents are from urban areas, whereas 23 percent are from rural areas.
- Seventy-seven percent of respondents were male and 23 percent were female.
- Most respondents (73 percent) operate limited liability enterprises and 11 percent are sole proprietorships. Interviewees work in the agriculture (3.5 percent), commerce (30 percent), services (40 percent), and production sectors (20 percent).

- Over one forth of respondents are active business association members; 6.3 percent are inactive members; and 63.5 percent are not members. This correlates with focus group findings wherein even those who are members of business associations are not active and do not value participation in such groups.

FINANCING SOURCES AND USES OF FUNDS

According to the survey, **CHF-Express Finance, RAEF MLP,** and **RFLD** beneficiaries use retained earnings (58.7 percent), bank loans (52.4 percent), entrepreneur's own funds (50.8 percent), and loans from microfinance institutions (44.4 percent) as primary sources of business finance. Government programs and family and/or friends are the least significant sources, at 6.3 percent and 4.8 percent respectively. Other sources mentioned are leasing (20.6 percent) and supplier credit (11.1 percent).

The team explored interviewees' reasons for not borrowing prior to becoming a client of a USG assisted program to learn more about what had inhibited client borrowing. Sixty-seven percent of respondents stated that their main reason for not borrowing is that they did not need to do so. Another large percentage (26 percent) of respondents had not borrowed in the past because they thought either that they would be rejected or found other lenders' application requirements too difficult to meet. Nine percent did not know where to go in the past. Given the over 97 percent repayment rates of the RAEF MLP and CHF-Express Finance it is clear that these are good borrowers with the ability to repay, who have now been given the opportunity to grow their businesses as a result of increased access to finance.

Respondents use loan funds mostly for equipment purchases (44 percent), working capital (35 percent), and business refurbishment (14 percent). Other uses of loan funds include technology purchases and property purchase, both at nearly 10 percent. Less significant uses include consumption (5 percent) and investment (3 percent).

FIRM PERCEPTIONS

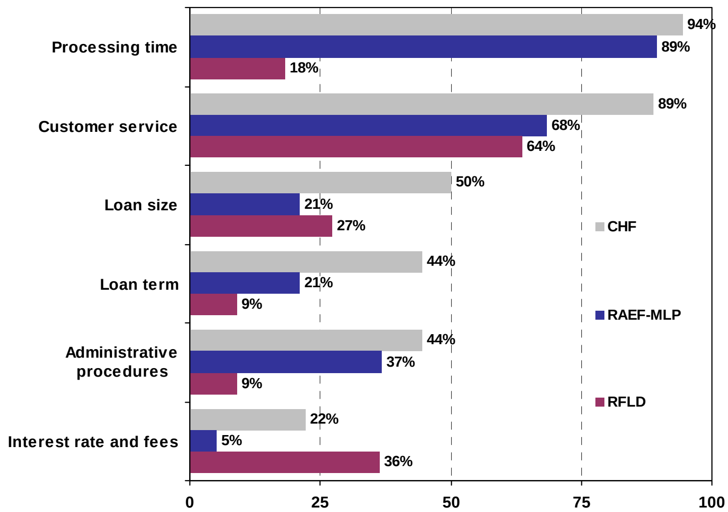
Most **CHF-Express Finance, RAEF MLP,** and **RFLD** beneficiaries (86.7 percent) describe their experience with the financial institution or program as positive. Only 1.7 percent describes it as negative, and 11.7 percent as neutral. Of those that described their experience as negative most cited high interest rates and fees, and others mentioned inappropriate loan terms and sizes, and cumbersome administrative procedures.

According to respondents, the best features of the CHF-Express Finance, RAEF MLP and RFLD programs are: customer service and processing time. More than a quarter cited an appreciation for loan size, administrative procedures or loan term. Less important was interest rates and fees. This finding was confirmed in focus groups and personal interviews, wherein borrowers placed particular value on their relationship with the institution beyond the financing terms offered.

When asked for suggested program improvements, respondents frequently asked for lower interest rates (63.5 percent), longer-term loans (50.8 percent), and larger loan amounts (50.8 percent). Other suggestions included networking opportunities and alternative collateral. Respondents were given additional choices, including faster service, increased numbers of branches, deposit-taking services, and business advice and training, which were rarely selected.

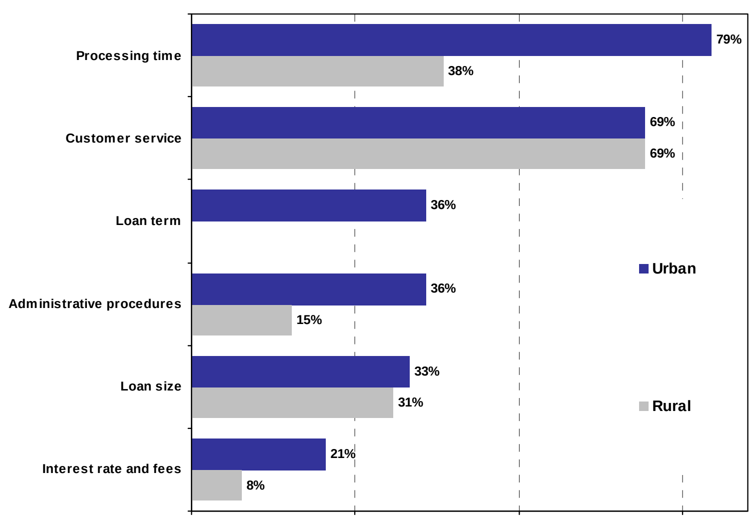
Client perceptions vis-à-vis the features of each USG-supported MFIs and programs are highlighted in the chart below and are discussed in more detail in the sections on each program later in the report.

FIGURE 5: CLIENT PERCEPTIONS OF THE BEST FEATURES OF USAID MICROFINANCE AND RURAL DEVELOPMENT PROGRAMS[14]



The figure below shows significant differences in perceptions among rural and urban clients in some areas. Namely, rural borrowers are less happy with the processing time, administrative procedures and loan terms than those in urban areas are.

FIGURE 6: RURAL AND URBAN CLIENT PERCEPTIONS OF THE BEST FEATURES OF USAID PROGRAMS[14]



[14] Multiple answers were allowed for this question.

FIRM IMPACT

Firm level impact on **CHF-Express Finance, RAEF MLP,** and **RFLD** beneficiaries can be examined on various levels, such as increased financial performance (measured by increased assets, increased revenue, and improved market share) and increased numbers of employees.

Revenues

Figure 7 illustrates revenue changes by sector. Since receiving financing, the vast majority report an increase in revenue of which 69 percent reported a great increase. Entrepreneurs active in commerce reported the greatest improvements in revenue, with 90 percent claiming an increase, of which 81 percent had a great increase in revenue.

FIGURE 7: REVENUE CHANGES BY SECTOR FOR MICROFINANCE AND RFLD BENEFICIARIES

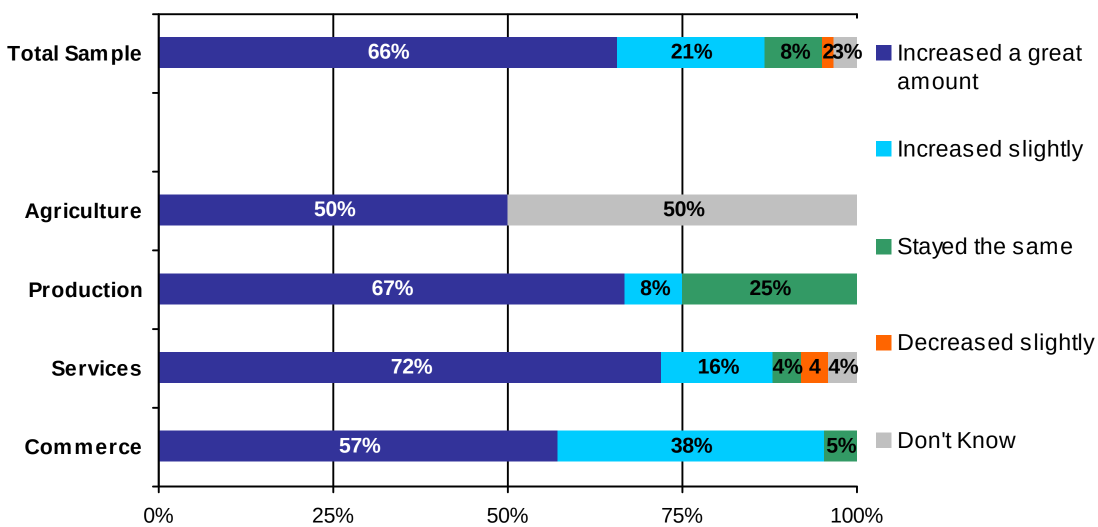
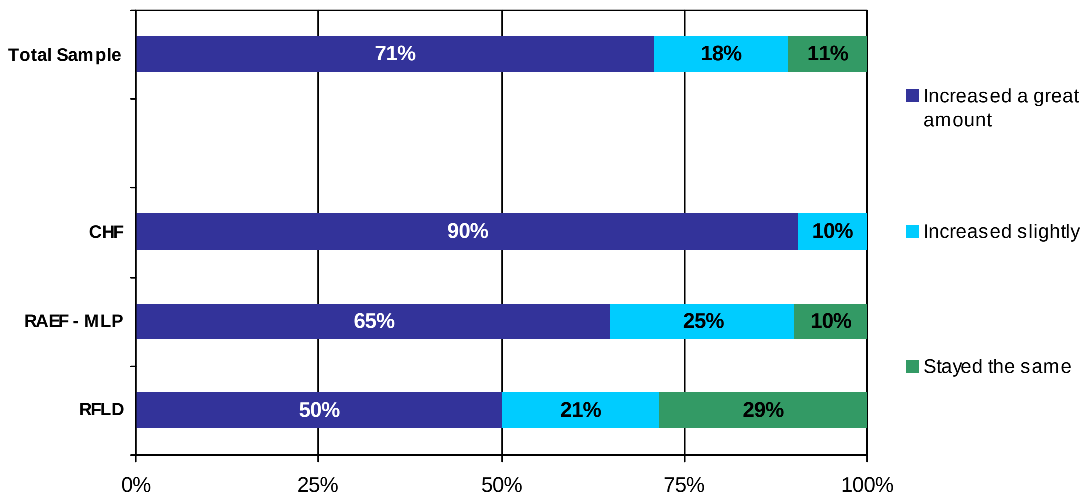


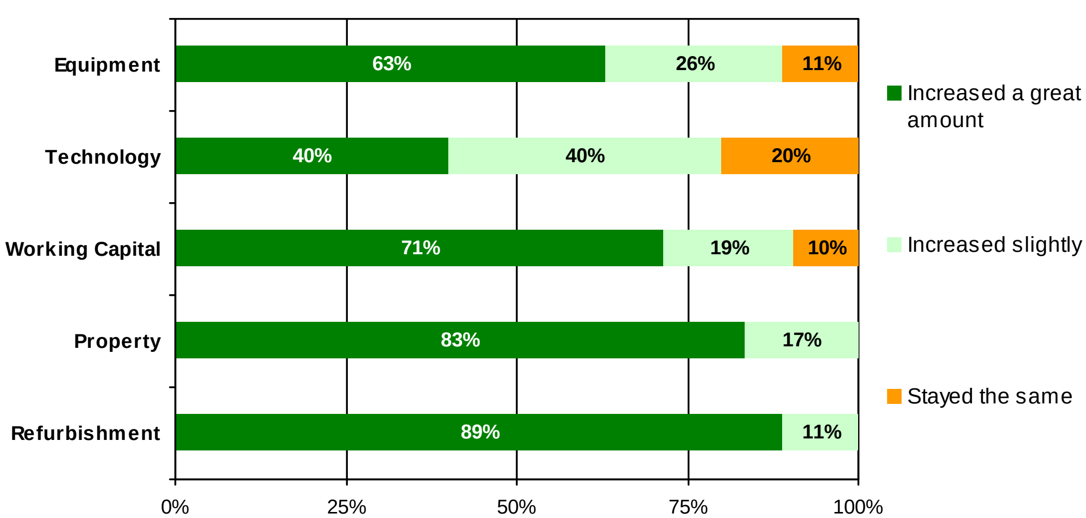
Figure 8 indicates changes in revenue by institutional affiliation. CHF-Express Finance clients reported the greatest level of change, with 90 percent of all CHF-Express Finance clients indicating that revenues increased a great amount. A factor which may contribute to this is that all CHF-Express borrowers interviewed come from a particularly economically vibrant part of the country–the Timisoara area. One reason for the lower than average reported revenue increase on behalf of the RFLD firms is that not all of the firms surveyed successfully applied for financing.

FIGURE 8: CHANGES IN REVENUE BY INSTITUTIONAL AFFILIATION



How financing is used appears to have a direct impact on changes in revenue. Figure 9 shows revenue changes by funding utilization. Only 40 percent of interviewees that used financing for technology purchases/improvements stated great increases in revenue.

FIGURE 9: REVENUE CHANGE BY FUNDING UTILIZATION AMONG CHF-EXPRESS FINANCE, RAEF–MLP, AND RFLD PROGRAM CLIENTS



Increases in Assets

There is evidence of enterprise growth since receiving financing among these clients, measured in terms of asset changes. Eighty-seven percent of respondents report an increase in total assets in the business since receiving financing. Enterprises in production and commerce report the greatest amount of increase.

FIGURE 10: ASSET CHANGES BY SECTOR AMONG MICROFINANCE AND RURAL FINANCE LEADER DEVELOPMENT CLIENTS

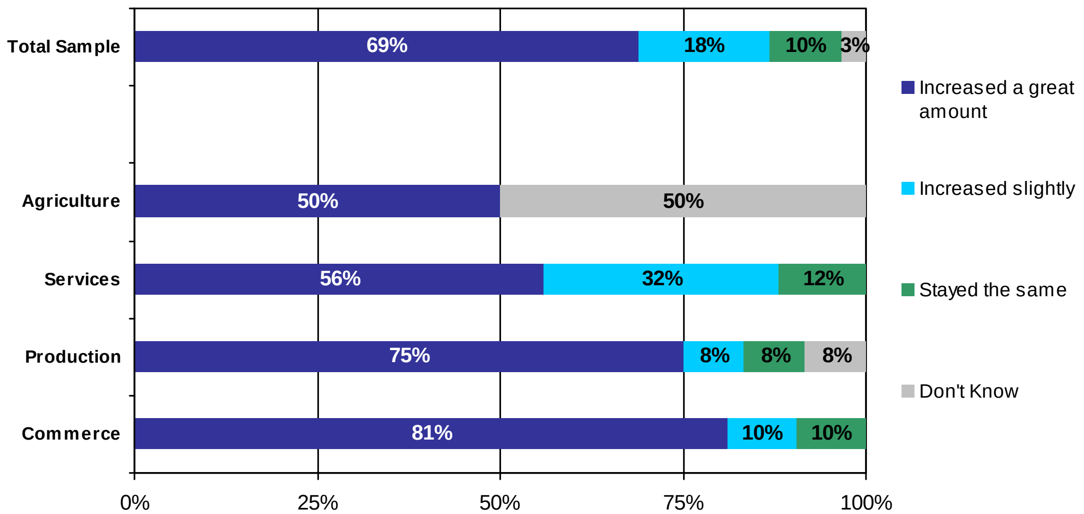
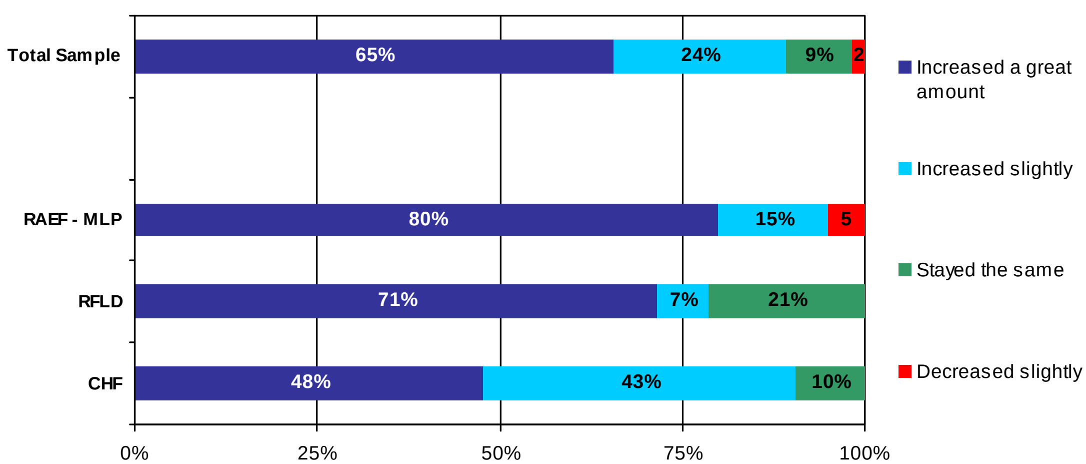


Figure 11 illustrates that the highest percentage of RAEF-MLP borrowers reported the greatest increase in assets, at 80 percent. Seventy-one percent of RFLD beneficiaries cited great increases in assets, and for CHF-Express Finance, 48 percent.

FIGURE 11: CHANGES IN ASSETS BY INSTITUTIONAL AFFILIATION



Market Share Increases

After receiving financing, 67.4 percent of microfinance and rural finance respondents report an increase in market share; 18.6 percent say that market share remained the same; and 2.3 percent cite a decline. Another important point to note is, since receiving financing, 58 percent of respondents introduced new products.

RESPONDENT PROFILE–MEDIUM AND LARGE FIRMS

The team held interviews with eight of the thirty-seven companies financed by **RAEF** since inception and owners/managers of six of the nine companies in the **SEAF-TBRF** portfolio. These firms are generally medium and large sized firms today, although most financed by **TBRF** were small at the time they received financing.

RAEF firms interviewed include DOMO Retail, S.A., Policolor, Rolast Rubber Company, Comtel Focus (Golden Tulips Hotels), Domenia Credit, Ralfi, Motoractive, and Raiffeisen Bank (Banca Agricola.) As the assessment team was focused on the firm and financial sector impact of the assistance, half of the businesses are in the financial services industry. Of the remaining, one is in the service sector, two in production, and one in retail. Three were greenfield investments, two involved bringing in outside foreign investors. Two were privatized with RAEF participation. One firm exports. Due to the constraints of the assessment, most firms are based in Bucharest with only one headquartered in another region of the country.

The TBRF firms represent an array of sectors–ICT, electronic parts distribution, retail supermarket, engineering, and real estate development. The managers interviewed represent six of the nine companies, two of the managers have had more than one company financed by TBRF. The firms are geographically dispersed, headquartered in Timisoara, Cluj, and Bucharest. Investments studied include: Totalsoft, Telezimex, Artima, InterPart Production (IPP), CRE, and CREI.

FINANCING SOURCES AND USES OF FUNDS

These medium and large sized firms financed by **RAEF** and **SEAF-TBRF** received mostly equity and some loan financing which served in most cases to initiate their ability to attract financing from commercial providers to fuel future growth. Funding was used to fund privatization, to make capital investments, and to form new companies.

When RAEF participated in privatization processes, little additional capital investment was made in the firms, thus RAEF's impact was characterized by financial restructuring, management and marketing innovations, and enhanced ability to attract other external financing. Although in most cases RAEF had a minority shareholding in investments, RAEF also used equity to form new firms, such as Domenia Credit, and to purchase controlling shares in others, such as Banca Romaneasca. For most firms financed by RAEF, the assessment team found that one of the greatest impacts on these firms was their ability to attract further investment or loans with attractive terms and/or a key strategic buyer of the company upon the exit of RAEF.

For the TBRF firms, which were mainly venture capital investments, equity funding was an important factor in the successful start-up and expansion of operations. This equity allowed some to access bank financing as their balance sheets were not highly leveraged. More than one of these firms recounted fruitless past attempts at finding financing before approaching TBRF successfully.

FIRM PERCEPTIONS

RAEF- and **SEAF-TBRF-**financed companies largely appreciated the partnering role of the equity investment vehicles. See Tables 7 and 8 for more detailed information.

Firms cite the main benefits of RAEF investment:

1. RAEF provided timely, needed capital
2. RAEF provided credibility during a time of unstable market development
3. RAEF introduced management structures and techniques that strengthened companies for growth and reassured other investors
4. RAEF helped draw in other investors and/or lenders

> "RAEF took an initiative and made it a business."
>
> *–Mr. Paul Marasoiu, General Manager, Golden Tulip Hotels*

The following benefits have been cited by the clients and relevant stakeholders:

For **Banca Agricola**, RAEF played a pivotal role in privatization and attraction of the Raiffeisen investment. For **Banca Romaneasca**, RAEF restructured the management, introduced new SME lending techniques, and prepared the bank for foreign investment and sale. For **Policolor**, RAEF advised the management of the company on new technology, cross boarder market expansion, and more modern, environmentally friendly production processes. For **DOMO Retail**, a home appliance retailer, RAEF provided key strategy guidance on marketing, business development, and structured a strategic partnership with RAEF's consumer finance arm, Ralfi/Estima finance. For **Comtel Focus (Golden Tulip),** on top of its equity and debt investment, RAEF assisted the firm with business development, management systems, and enhanced the company's ability to attract a foreign buyer. For **Domenia Credit**, RAEF, with technical assistance provided by Shorebank Advisory Services, laid the foundation for solid business development, trained personnel, professionalized internal structures and attracted the GE investment. See Table 7 for feedback from some of the firms interviewed.

SEAF–TBRF funded companies appreciated the efficient procedures and the timely and appropriately structured financing provided. A common comment among investees was the partnership relationship with TBRF management. Companies appreciated TBRF assistance in sourcing additional funding for continued growth. Although these firms were clearly assisted by technical assistance facilitated by TBRF from other donors or other USAID funded programs, this assistance was not mentioned by the funded companies as a major benefit of this fund's financing.

FIRM IMPACT

RAEF investments in financial services showed the greatest growth with the most wide spread impact on the private sector among all the firms in its historical portfolio. The companies surveyed reported increases in market share primarily, followed by increases in assets, employees and sales. Finance grew these firms, and allowed them to attract further investment and negotiate better terms.

> "In addition to the financial support, receiving direct investment from RAEF was like entering a new club. DOMO was now perceived by lenders and business partners as credible, trustworthy. RAEF funding was a measure of assurance that the company has good corporate governance and internal processes."
>
> *– Mr. Alexandru Mnohoghitnei, Chief Financial Officer, DOMO Retail SA*

The impact of RAEF's role on the boards of directors of firms appears to have made the greatest impact, beyond the financing received, on the development of these businesses. RAEF introduced new Western management techniques and business culture, marketing strategies and techniques, and attracted additional funding sources, often strategic in nature.

DOMO Retail's new logo.

In addition to much-needed financing, **production and retail sector** firms benefited from visionary marketing and product development guidance from RAEF. In the case of Policolor, with RAEF guidance this company instituted ISO 9000 environmental standards for its paint products and conducted the first foreign investment by a Romanian firm by purchasing a Bulgarian paint company. DOMO Retail, a consumer appliance retailer, is the only company in its subsector that did not experience a reduction in market share in 2006, which the management attributes in part to dividends of RAEF's ownership participation–the adoption of a new logo and branding has had marketing benefits and the leveraging of lower cost financing has helped the company negotiate better terms for retail space.

The firm in the **service sector** interviewed, Comtel Focus, a.k.a. Golden Tulips Hotels, benefited from RAEF's guidance in business development and the establishment of formal systems. Also, as a new entrant in the market for business travel hotels, the participation of RAEF as an owner helped with marketing the hotels in the early years.

RAEF: Financial leverage from investments in the financial services sector

Firms in the **financial services sector** experienced a significant impact from their investments received by RAEF due to the transformative nature of the financing. For instance, the privatization participation of the agriculture bank, the majority shareholding in Banca Romanaesca, the start-up of Domenia Credit, and the establishment of RALFI/Estima Finance.

These institutions in turn produced a broader impact on the financial sector and the SMEs and consumers for whom they provide financial intermediation.

The role the RAEF played in these investments resulted in many cases in the establishment of a new corporate culture and business direction, as was the case of Banca Romanaesca, which incorporated cash flow lending techniques and Western bank management practices into its operations—both quite new in the Romanian sector. Other institutions served to help create new markets in the financial sector, such as Domenia Credit, Motoractive, and RALFI, which all introduced product and service innovations to Romania and became market leaders in the their respective subsectors.

TABLE 7: ROMANIAN-AMERICAN ENTERPRISE FUND’S IMPACT ON SELECT INVESTEES

		Banca Agricola–financial services 100% equity	Banca Romaneasca-financial services-76% equity	Domenia Credit Financial Services (Mortgage)–100% equity	Motoractive-Financial services (Leasing) – 78% equity	RALFI (Estima Finance)–Consumer credit–95% equity	Policolor SA–Paints Manufacturing-33% equity+loans	Comtel Group (Golden Tulip Hotels) > 50% equity and convertible debt	ROLAST–Rubber Manufacturing-31% equity	DOMO Retail–(retail)–9.3% equity
1	Institution recapitalization									
2	Solved significant structural and financial problems									
3	Specialized management and technical assistance									
4	Fixed assets transfer to the state									
5	Credit portfolio valuation									
6	Negative equity valuation to be used for selling negotiation									
7	Drafted a rough sketch new balance sheet for takeover									
8	Sold the institution to strategic investor									
9	Management and services modernization									
10	Development of new products									
11	Training of staff / human resource development									
12	Restructure the balance sheet									
13	Gain market share									
14	Prepared to deal with new investors									
15	Introduced high standard of professionalism and ethics									
16	Increased numbers of employees									
17	Set up the company									

		Banca Agricola–financial services 100% equity	Banca Romaneasca-financial services-76% equity	Domenia Credit Financial Services (Mortgage)–100% equity	Motoractive-Financial services (Leasing) – 78% equity	RALFI (Estima Finance)–Consumer credit–95% equity	Policolor SA–Paints Manufacturing-33% equity+loans	Comtel Group (Golden Tulip Hotels) > 50% equity and convertible debt	ROLAST–Rubber Manufacturing-31% equity	DOMO Retail–(retail)–9.3% equity
18	Needed funding at the right time									
19	Legal framework incentives for the sector									
20	Mitigate the start-up risks and attract private money									
21	Introduced new technology									
22	Bridge for FDI									
23	Stimulate export									
24	Helped make company a leader in the market									
25	Ready to extend business on the Balkan region									
26	Raised environmental standards of products									
27	Operating profits increased									

> "If you want to help a country, you have to invest in the right companies."
>
> *– Mircea Jalba, General Manager, SEAF-TBRF*

SEAF-TBRF-financed firms showed the greatest rates of growth on average, measured by employment growth, among all firms studied under this assessment. In addition, these investments had very high rates of return, implying corresponding increases in asset values and revenues. These firms claimed that the equity investment and role of SEAF-TBRF professionals on their boards of directors, helped them to: access funds at a critical moment for their business; expand the business; restructure and reorganize the business; receive training and technical assistance from other specialized bodies; and access complementary funds needed for development. See Table 8 for details on firm level impact of SEAF-TBRF-financed firms.

SEAF-TBRF financing produced a remarkable impact on its investee companies, particularly in the areas of employment growth, capital creation and earnings growth.[15]

On average, each investment resulted in more than 100 new jobs, and the average projected internal rate of return on these investments is an impressive 37.3 percent. Each company received financing during an early stage, transitional period that is very pivotal for growing SMEs.

- Every dollar invested by TBRF generated an additional ten dollars in the local economy.
- The greatest share of benefits from the TBRF investments goes to employees (job creation and training) followed by governments (increased taxes paid.)
- Most new employment in the SMEs is for low-skilled workers, who received training, thus increasing the human capital value.
- The training creates a substantial asset for employees, generating professionals, wage increases and a skill mobility premium.
- Employees benefit from the stability of employment.
- When companies expand, they pay more taxes and contribute actively to community development.
- Some TBRF financed companies brought their business to second tier cities, contributing to local development.
- The investees' business development contributes to the competitive price stabilization.

Headquarters of Telezimex, an electronics parts distributor financed by SEAF – TBRF

- TBRF clients have assumed some responsibility for the social and economic development of the communities in which they are located.
- TBRF provided financing to firms unable to get adequate terms elsewhere, at key stages of their business development and growth.

[15] For more information on SEAF-TBRF impact on SMEs see "From Poverty to Prosperity, Understanding the Impact of Investing in SMEs: Data Survey and Case Study Analysis of SEAF Investments," July 2007, SEAF.

TABLE 8: SEAF-TBRF IMPACT ON FIRMS

		TotalSoft (Equity+ Convert.Loan)–It	Interpart Production (Equi/Ty)–Producer Of Auto/White Goods Parts	TELEZIMEX-(Equity)-Distribution Electronic Parts	Artima-(Equity)-Supermarket Chain	CASA Real Estate (Equity)-Real Estate Development	CASA Real Estate Investment- (Equity)-Real Estate Development
1	Expanded Product Lines						
2	Increased sales infrastructure						
3	Increased products profitability						
4	Training of staff including managers						
5	Introduced high standard of professionalism and ethics						
6	Increased employment						
7	Increased turnover						
8	Expert technical assistance from EU industry experts						
9	Reached break even point in a shorter time frame						
10	Gain new market shares						
11	Increased number of distribution points.						
12	Competent financial management						
13	Prepared to deal with new investors						
14	Accessed funds at the business' critical moments						
15	Improved efficiency & increased profit						
16	Increased integrity of the financial reporting						
17	Bridge for FDI						
18	Assisted in new business development						
19	Provided working capital fund growth						
20	Increased operating profits						
21	Transformed the SME into a large sustainable company						
22	Stabilize the competitive price						
23	Increased the company value						
24	Sold to strategic investor						
25	Achieved significant positive internal rate of return						

HOW USAID IS DIFFERENT

In Romania, USAID's long-term strategy of using diverse mechanisms to develop the financial sector in broad terms, thereby influencing the overall private sector, is distinctive from other donors' and from USAID strategy employed in other countries. The financial mechanisms supported by USAID differentiated themselves in their product offerings, management structures, and commercial approach to the market, which led to their direct and broader indirect impact on Romanian private firms, the financial sector, and the enabling business environment.

> "Carmen Retegan [CEO of Domenia Credit] and the people at RAEF did a very good job of establishing and growing a successful business. The mortgage finance company had to be successful to ensure the credibility to talk to the government about the changes that needed to be made."
>
> *– Jonathan Woollett, Director, Non-bank Financial Institutions Group, EBRD*

USAID's successful policy development was led by business needs and supported with donor coordination. A successful business initiative is more likely to draw government attention than a theoretical discussion of future legislative needs. In the case of the mortgage finance and consumer finance markets, USAID-supported RAEF was able to attract attention as a shareholder in a profitable business and a member of the Mortgage Task Force, which included a number of other donors. In the case of the Micro Institutions Law and the NBFI Law, USAID was supporting the three largest MFIs in the country, which were financially viable and provided much needed finance for microentrepreneurs, and thus formed the Microfinance Coalition, to lobby for reforms necessary to grow the sector.

USAID introduced innovative products and services into the Romanian market. Domenia Credit, the mortgage finance company, provided products that were hitherto rarely available in Romania at the time of its establishment. Combined with rapid and cordial customer service, it quickly served as a benchmark for the industry. The RAEF MLP in its relationship with implementing MFI CAPA, provided funding for the institution's growth, helping it to become the largest MFI in Romania. The structure of the funding and the relationship with RAEF MLP instilled a financial discipline that encouraged both portfolio growth and portfolio quality that has served to make CAPA a stronger more sustainable MFI over time. The CHF Romania micro lending program, now incorporated as Express Finance, differentiated itself among other lenders by being the "lender of choice" due to its high level of client services. The collaborative approach to the client relationship, and transparency in advertising interest rates, distinguish all of the MFIs supported by USAID from bank lenders.

SUCCESS FACTORS

The **success factors** of USAID's approach, which helped build sustainable legacy institutions and produced a wide-reaching positive effect on the economy, include:

- **Increasing the potential for positive impact by investing donor funds and efforts across sectors**

  The impact of USAID assistance on the financial and private sectors was increased by supporting investments in SMEs and larger companies with investment and loan finance as well as microenterprises with microfinance.

- **Using diverse financial instruments to help meet the needs of consumers and produce broader effects in the sector**

The ability of USAID-backed institutions to support both financial sector investments as well as those in businesses was remarkable and produced significant positive impact in Romania.

- **Taking a long-term approach to sector development**

  USAID began supporting SME finance in 1994 and microfinance in 1996. Over the years, this assistance was increased and modified using programs such as EDS. USAID programs demonstrated an appropriate degree of flexibility and awareness of the sector's needs, and importantly did not waver from supporting the sector over the past more than 10 years.

- **Employing a commercial approach to ensure sustainability**

  The ability to choose investee companies based on estimated commercial returns, such as in the case of SEAF-TBRF, helped ensure the success of these investments. In turn, development goals were met as a by-product of their growth and business achievements.

- **Adapting lessons learned from the region as an effective way to achieve development goals**

  RAEF effectively implemented initiatives drawn from the Polish-American Enterprise Fund experience (such as investing in financial services) as well as The US-Russian Investment Fund, in the case of mortgage finance lending.

- **Coordinating with other donors and government to accomplish ground-breaking activities with wide-ranging impact**

  By engaging and working closely with other donors, RAEF and USAID were able to pass important mortgage finance legislation enabling the development of the sector.

- **Encouraging knowledge-sharing among local and international professionals to create a change in business culture**

  Both RFLD and SEAF-TBRF successfully employed techniques to bring international technical experts to share experience with Romanians which served to bring new ideas and concepts of potential development to those who benefited.

- **Successfully promoting the adoption or reform of legislation or regulations to contribute to the wider development of the private sector**

  USAID's ability to work with the GOR unilaterally and/or with other donors or multilateral development banks (MDBs) to improve the enabling environment for financial institutions primarily, and secondarily for private businesses directly, had a wide and sustainable impact on the development of the private sector and the economy more broadly. For example, the passage of NBFI legislation is serving to transform the microfinance industry.

LESSONS LEARNED

Lessons learned from USAID funded activities begin with the finding that confirms industry trends: financing is an engine for growth at the firm and financial institution level. Other more specific lessons derived from USAID's experience in Romania include:

- Flexibility is essential to meeting financing needs as an economy changes. Coupled with a long-term approach to developing the sector, this strategy can yield significant results.

- Promoting a commercial approach, such that local partners and institutions profit, is essential to the sustainability of initiatives at the both program and institutional levels.
- Equity investments in an emerging economy benefit from a hands-on approach.
- Technical assistance for bank training can be effective to promote new services and products, although it is important to prove results in the form of profits to partner banks.
- Barriers to private sector expansion must be addressed head-on, while cooperating with government and other donors.
- Legal structures and the ability to enforce contracts are important to the success of foreign direct investment and the development of an equity market.
- A successful institution can serve as instrument for greater industry reforms.
- Government engagement is important and can have lasting effects.

ROMANIAN-AMERICAN ENTERPRISE FUND (RAEF)

ORIGIN AND EVOLUTION

RAEF was established under the Support for East European Democracy Act (SEED) of 1989 by the US Congress and endowed with $50 million from USAID in 1994. Set up as not-for-profit corporation, incorporated in Delaware in July 1994, the Romanian-American Enterprise Fund (RAEF or “The Fund”) had a mission to promote free enterprise through investments in and loans to small and medium sized enterprises. Subsequent grant modifications totaling $11 million provided by USAID facilitated expanded foreign and domestic investments by providing analysis and advice to companies wishing to invest in Romania. RAEF was one of 10 funds established by the US government from 1990 to 1995 to support the economic transition process in former Eastern Bloc and NIS countries with finance for private sector firms.

RAEF is managed by an independent private sector board of directors, with mostly American and one Romanian national director. RAEF was the first investment fund in Romania. The Fund was charged with taking a commercial approach to its investment activities. Revenues were meant to cover Fund expenses and to be reinvested, which sets it apart from most private sector funds. After a slow start-up period of one and a half years, investment activities began in 1996.

RAEF’s stated purpose at the time of its establishment was to encourage the creation and expansion of SMEs in Romania through initiating and expanding private enterprises (loans, grants, equity investments, feasibility studies); promoting and disseminating western business know-how and practices; and demonstrating to other investors that private sector investment can be undertaken profitability in Romania.

APPROACHES AND STRATEGIES

From inception, RAEF’s objectives in achieving its mission were to:

- Attract other private investment and additional funding
- Establish and strengthen SMEs across sectors

- Generate new private sector employment opportunities
- Develop key joint ventures between private US and Romanian companies
- Conduct activities intended to further investment in Romania
- Employ best practices and lessons from other funds

After the first three years of activities, the Fund management added the approach of initiating transactions to develop and strengthen financial markets, and began a shift from manufacturing and greenfield investments to those in financial services.

In 1996, RAEF established the following programs to implement its activities:

1. **The Major Transaction Program (MTP)** invested amounts in excess of $250,000 in companies that had strong growth potential, export possibilities, and good management. The investments were well dispersed geographically, covering diverse industrial sectors with above average growth potential.

2. **The Micro Loan Program (MLP)** loaned up to $15,000 to small businesses and provided training seminars on formulating business plans and understanding the basics of management, accounting and marketing. This program was the first of its kind in Romania, operating in different regions through one microfinance company. Today the MLP does not use training as part of its support to businesses, and lends up to $50,000 through two MFIs.

3. **The Small Loan Program (SLP),** disbursed loans ranging from $20,000 to $150,000 under Shorebank Advisory Services administration, operating through Romanian banks that had received loan officer training in cash flow lending analysis, a method previously not known or used in Romania.

4. **Technical Assistance Program "ACCES for Business",** provided management services tailored to the financial needs of SMEs.

5. **Small Business Investment Fund** was the first equity fund established to provide equity investments in SME in the amounts of $50,000 to $350,000. There were no other equity sources for small entrepreneurs at the time it was established. This fund operated from 1997 to 2001 at which point its product was not longer marketed due to perceived lack of demand. The existing investments are still being monitored until all funds are repaid.

RAEF management successfully incorporated lessons learned from the region in their strategy. From the Polish-American Enterprise Fund (PAEF), they adopted the concept of establishing the SLP and MLP and later, the approach of investing in financial institutions. From The US Russia Investment Fund (TUSRIF), the management adapted the idea of establishing a mortgage finance institution (Domenia Credit.)

RAEF MAJOR TRANSACTION PROGRAM – CLIENT PERCEPTIONS

The survey conducted with RAEF MTP clients revealed that the financial and technical support provided to clients were delivered at the right time in the right manner to generate companies' sustainable growth. In an unstable market, RAEF brought transparency and credibility in lending and investment to SMEs and large businesses. Access to finance permitted firms to grow by attracting further investment and by allowing firms to negotiate better terms. (See "Assessment Findings: the Impact on Firms" above, for more details.)

> "The team at RAEF has developed an excellent business and we look forward to working with the local management and clients to build an even more successful enterprise that serves consumers, retailers and dealers with unique solutions that meet their lending needs."
>
> *– President and CEO of GE Money in Central and Eastern Europe, Dmitri Stockton*

RALFI, Motoractive, Domenia Credit. In addition to providing needed capital and in some cases technical assistance, RAEF successfully promoting supporting legislation and brought in a strategic foreign investor (GE Money) to purchase and grow these institutions.

Banca Agricola. RAEF played a pivotal role in the privatization, recapitalization, and the sale of the bank, attracting Raiffeisen Bank to purchase the bank not long after privatization was complete.

Banca Romaneasca. RAEF restructured management, introduced new lending techniques, prepared the bank for foreign investment, and sold it to a strategic partner.

Policolor. RAEF advised the company's management on the implementation of new technology, modernization of processes, compliance with EU environmental requirements, and cross-border market expansion.

DOMO Retail. RAEF provided key strategic guidance on marketing and business development to this consumer appliance retailer, and developed the consumer finance company RALFI/Estima Finance which operated closely with DOMO Retail by providing financing for customers at retail outlets.

Comtel Focus (Golden Tulip). RAEF played a key role in improving business development and management information systems, enabling Comtel Focus to attract a foreign buyer.

INSTITUTIONAL PERFORMANCE AND SUSTAINABILITY

RAEF made mostly profitable equity investments and successful loans to small and medium-sized companies. The Fund attracted co-investors and other partners, leveraging the grant of $61 million many times over. The total impact of RAEF's activities added up to more than $875 million. This amount was efficiently put to use, and contributed to Romania's transforming economy. RAEF made $467 million available to private enterprises through bank loans. Another $372 million entered the Romanian economy through RAEF's small loan program and its work in mortgages, consumer credit, leasing, and the creation of equity funds. The original $1 million allocated for micro-loans resulted in a total of more than $38 million in lending from reinvestment of loans and from new capital. See Annex 3 for a summary of investment portfolio financial returns.

In terms of institutional performance and efficiency, the Fund managed to control costs while increasing total investments and loans in its portfolio. Large gains were realized in 2003 when RAEF exited from Banca Romanaesca and in 2006 following the sales of RALFI, Motoractive and Domenia

Credit to GE Money. For most years, operational expenses as a percentage of net assets is high compared with purely commercial investment funds, but low compared with other donor or government supported funds.

RAEF was established based on a model used throughout the region of USG government sponsored funds with private sector boards of directors and similar objectives. In comparison with these funds, all established between the years 1990 and 1995, RAEF ranks third out of ten in financial performance, as shown in Table 9. RAEF has been successful financially and has met its development objectives.

TABLE 9: ENTERPRISE FUNDS, FINANCIAL YEAR 2006[16]

Fund	Capital Received (Net of Technical Assistance)	Current Net Assets	Total Net Assets	Total NA/Capital Received
AAEF (Albania)	22	171	171	777%
BAEF (Bulgaria)	54	232	232	430%
RAEF (Romania)	**58**	**118**	**118**	**203%**
PAEF (Poland)	243	22	358	147%
TUSRIF (Russia)	307	297	297	97%
BalAEF (Baltics)	50	45	45	90%
WNISER (Ukraine/Moldova)	137	104	104	76%
HEAF (Hungary)	63	22	32	51%
SAEF (Czech/Slovak)	58	11	11	19%
CAAEF (Central Asia)	105	15	15	14%
Total	**1097**	**1037**	**1383**	**126%**

RAEF will leave behind four legacy institutions and a foundation when the present Fund structure changes per the USAID grant agreement in 2009. These new institutions were established well in advance of the conclusion of USAID's support for RAEF to ensure a smooth transition from RAEF to the new operations.

1. One of these institutions, Romanian Capital Advisors LLC (RCA), will carry forward RAEF's commercial activities attracting additional investment capital and providing advisory services.

2. Enterprise Capital is a Romanian company established by RAEF under which most RAEF employees were transferred in 2006, which now manages RAEF.

3. The Balkan Accession Fund (BAF) has EUR 110 million (approximately $157 million) under management from both RAEF and the Bulgarian-American Enterprise Fund (BAEF) and has already made at least one investment. BAF is managed by Enterprise Capital.

4. The Energy Efficient Fund is also managed by Enterprise Capital. This has limited capitalization and has been inactive due to constraints of the energy market.

[16] "Enterprise Funds at a Glance," Enterprise Funds Exchange of Experience Conference Proceeds, 2007, www.seedact.com.

5. The soon-to-be-established RAEF Foundation will pursue some charitable activities by supporting nonprofits with grant funding.

With a $14.5 million portfolio of SME loans already on its books and sufficient experience in microlending and bank management, RAEF would be well positioned to establish a bank specializing in the sector should this be of interest to its management and Board of Directors.

One of RAEF's greatest legacies is the skilled team of Romanians who will continue to play an important role in Romania's economic expansion. RCA and the RAEF Foundation will provide them a base from which to continue the important work they began under RAEF.

CONCLUSIONS: LESSONS LEARNED

> "When making an equity investment in a turn-around firm or bank, one cannot 'wait and see'–a hands-on approach is essential."
>
> *–Horia Manda, Vice President and CIO, RAEF*

USAID's programs implemented through RAEF were at the forefront in helping to create a vibrant financial market in Romania. RAEF's strong brand name and USG affiliation allowed the institution to get involved in difficult transactions. RAEF's team, which used a flexible approach and incorporated lessons learned in the region, manifesting determination, perseverance and creativity, succeeded in structuring very successful transactions. This success can be attributed to:

- flexibility of approach, looking to new structures and sectors as the market demanded;
- a proactive approach to managing on-going investments;
- the "non-financial" benefits of having a USG affiliated owner, the Western management structures and discipline that RAEF brought, and the credibility it attained to bring in other investors;
- technical assistance for financial institutions;
- a skilled and professional investment team;
- incorporating lessons from the region;
- approaching barriers to expansion head-on, orchestrating the divergent interests of the Romanian Central Bank, GOR, Ministry of Finance, and Privatization Commission with the real demands of investors willing to undertake responsibility for a turnaround;
- in the Small Loan Program, acquiring Banca Romaneasca allowed for a more clearly profitable participation and direct transfer of technology for allow this program to flourish; and
- proper structuring of the relationship between RAEF MLP and MFIs contributed to program growth and MFI capacity building.

SMALL ENTERPRISE ASSISTANCE FUNDS, TRANS-BALKAN ROMANIA FUND (SEAF–TBRF)

ORIGINS AND EVOLUTION

Small Enterprise Assistance Funds (SEAF)

Founded in 1989 as part of the international humanitarian organization CARE, SEAF is a not-for-profit corporation that sponsors the establishment and oversees the management of commercially sustainable, for-profit private equity funds in emerging markets. SEAF was founded by international finance institutions, including USAID, and has sponsored and managed 23 private equity funds with more than $400 million in capital, in 29 countries in Central and Eastern Europe, Asia, and Latin America.

In meeting its mission, SEAF has set up numerous fund offices throughout Central and Eastern Europe. With a joint SEAF and USAID contribution, SEAF setup the Trans-Balkan SME Equity Fund (TBF), to provide equity and quasi-equity financing as well as business assistance and trade linkages to SMEs in Balkan countries, Romania, Croatia, and Bulgaria. In addition to funds, SEAF has helped establish in several countries Centers for Entrepreneurship and Executive Development (CEED)–centers providing business development support to SMEs–as legacy institutions of its funds, wherein returns from divestments were donated to such non-profit centers to support operations. One such CEED has been created in Romania in 2006.

Trans Balkan Romania Fund (TBRF)

TBRF was incorporated in Delaware, USA in December 2000 with a total commitment of $8.5 million and began operations in March 2001. The sole shareholder of TBRF is the SEAF Trans-Balkan Fund, LLC (TBF). This fund has a shareholder structure as follows: SEAF (18.33 percent), International Finance Corporation (IFC) (22.11 percent), Norwegian Investment Fund for Developing Countries (22.91 percent), Black Sea Trade and Development Bank (18.32 percent), the State Secretariate for Economic Affairs, Switzerland (SECO) (13.75 percent) and the Finnish Fund for Industrial Cooperation Ltd. (FINNFUND) (4.58 percent) USAID/Washington grant funding supports the SEAF contribution to the TBF.

The Fund provides early stage financing and expansion capital to private SMEs in Romania. As of December 31, 2005, the Fund had drawn down over $8.3 million of the $8.5 million committed capital, with only $162,000 of total committed capital remaining. The Fund has committed to companies a total of over $7.4 million or 88 percent of the committed capital, which has all been disbursed. As of September 30, 2007, $9.09 million or 109 percent of paid in capital had been paid back to the shareholders.

APPROACHES AND STRATEGIES

The goal of TBRF is to promote the SME sector by providing debt and equity to allow SMEs to expand their productive capacity and by offering post-investment business support to help the firms to increase their sales, particularly export sales, and to improve their operational efficiency. Unlike RAEF, TBRF did not receive funds

> "When you invest in small businesses, you invest in the entrepreneur. If the entrepreneur is hard-working and honest, than you can build trust and have repeated projects."
>
> *– Constantine Bogdan, Chief Investment Officer, SEAF-TBRF*

from USAID for technical assistance or operational support. Operations were funded from the corpus from the outset, and technical assistance for firms was sourced from other projects or donors. TBRF had the approach of doing its own due diligence and using in-house legal advice to keep costs low. Other differences from RAEF in this fund's approach are that TBRF is prohibited from investing in financial institutions and, at exit, funds are not reinvested, but they are returned to the shareholders. Most of the originally invested funds have been returned to investors. When TBRF is fully divested, additional returns from investments related to USAID financing will be granted to CEED for operational support for business development activities in support of Romanian SMEs.

SEAF-TBRF took minority shareholdings with a position in the board of directors, in Romanian businesses with high growth potential. This early stage growth role allowed TBRF to prepare the groundwork for later investors. The SEAF-TBRF team relied heavily on the skills of the entrepreneurs and the strength and enforceability of contracts to ensure success and mitigate risk in their investments.

The assessment team found that TBRF's strategy targeted a subset of SMEs that were extraordinarily growth-oriented and willing to accept third party capital and governance input in order to grow. These firms had the ability to have a profound impact on their local economies through job creation, worker training, and export creation. While TBRF has made nine investments, only six ownership teams/owners were involved. The TBRF team employed the approach of working with individual owners who had proven to be good partners in the past.

INSTITUTIONAL PERFORMANCE AND SUSTAINABILITY

As of December 31, 2005, TBRF had completed its investment period. TBRF is now focusing on the exit negotiations and the positioning of the remaining portfolio companies to prepare them for a profitable exit. By all measures, the TBRF has been a commercial and development success, expecting to achieve a total gross IRR of 37.3 percent on its portfolio at the time it winds down operations in 2009. See Table 10 for a breakdown of actual and projected returns on investment in the TBRF portfolio.

TABLE 10: TBRF RETURNS ON INVESTMENTS IN PORTFOLIO[17]

Project	Investment ($000)	Gross IRR
Totalsoft	600	61.8%
ILS Group	500	-3.9%
Telezimex	232	28.0%
Artima	1,583	54.7%
Vinterra	710	8.1%
CRE	300	25.1%
IPP	536	N/A
CREI	1,500	24.3%
Elcomex	1,500	N/A

Source: TBRF Portfolio Summary (expected) results as of September 30, 2007

[17] Returns on ILS, Vinterra InterPart Production, Elcomex, and CREI are projected to be realized within the next 24 months at the time of this assessment. All others have been realized.

Select Exited Companies:

Total Soft is a software development and implementation company located in Bucharest. The company received an equity investment of $600,000 (40 percent interest) and was sold to a strategic investor, which will ensure development continuity. This transaction provided TBRF with an annual return of 62 percent, more than six times the invested capital.

Artima is a supermarket chain based in Timisoara, Romania. TBRF made a nearly $1.6 million equity investment in Artima in two rounds (2002 and 2003). This investment provided TBRF with an annual return on investment of over 54 percent, which is almost three times the invested capital.

TBRF expects total investment proceeds at the time of exit to amount to $17.4 million, which is over twice the amount of money invested.

While TBRF is slated to wind down according to its charter, funds received from exits will be directed both to shareholders and, for those related to USAID contribution, to CEED as its legacy institution in Romania.

CLIENT PERCEPTION AND FIRM-LEVEL IMPACT

The general perception of the TBRF clients is that the equity investments allowed them to access funds at a critical moment to expand their businesses. The clients benefited from managerial advice on how to develop, restructure, or reorganize their businesses, from the training and technical assistance they received from other specialized bodies, and from access to complementary funds needed for development. (See the section "Assessment Findings: the Impact on Firms" above for more details.)

The companies reshaped both their strategy and organizational flowchart in order to put more emphasis on quality control, reliability of the products and repetitive sales in accordance with the technical assistance received from TBRF.

These enterprises contribute to economic growth and poverty reduction by creating jobs, introducing business methods, products, and services that help restructure weak sectors, connecting small-scale producers with lucrative urban, national, or export markets and, in the reverse direction, connecting large urban businesses with mass consumer markets in remote areas. In total over 600 jobs were created by SEAF–TBRF investments. The fact that three of the original six investment companies reapplied and entered into new investments with TBRF is testament to the fund's financial value and positive relationship with investee firms.

The equity investments helped the investees grow, become sustainable, develop adjacent activities to their main activity or product lines, and/or expand the business into new sectors.

CONCLUSIONS: LESSONS LEARNED

The assessment revealed that targeting both development and financial returns could be accomplished successfully with skilled staff, a flexible, commercial approach, and a high amount of comfort in the enforceability of contracts, particularly for minority shareholders.

The commercial and flexible approach is a key success factor. Tracking the developmental impact of equity investments on different groups of stakeholders could give donors and governments a more accurate picture of what those institutions are doing to achieve their missions responsibly. Investing in the right growing and value-adding companies, investors can support country-level development as well.

Technical assistance must be integrated with fund management rather than as a stand-alone program, given the superior linkage between the entrepreneur and the financial partner. In addition, technical assistance should, as much as possible, integrate professional expertise sharing.

RAEF MICRO-LOAN PROGRAM (MLP)

ORIGINS AND EVOLUTION

In 1996, RAEF launched its Micro Loan Program (MLP) for small businesses needing loans up to $15,000 for up to 3 years. Today, loans may be extended up to $50,000 under the program for up to 5-year terms. All RAEF MLP loans are denominated in US dollars.

RAEF created the MLP to provide viable financial services to promising under-served micro and small businesses. Initially, RAEF's MLP funds were $1 million, today its total portfolio is $14.5 million.

The primary and longest-standing partner lending institution in the MLP is CAPA Foundation—the World Vision micro-credit program, which is currently registered as CAPA Finance, a NBFI. Specially created by World Vision to co-operate with RAEF in microlending, CAPA was the first microfinance institution in Romania, offering the first microfinance loans in the country with RAEF funding. Operations started from CAPA's office in Cluj county and in several months were extended to Craiova–Dolj county.

In September 1998, RAEF launched the MLP in Timis county and entered into an agreement with Cooperative Housing Foundation (CHF) Romania, now the NBFI Express Finance. A $1 million loan borrowed by RAEF from the Soros Economic Development Fund made possible the growth of the MLP's operations both with CAPA and CHF.

A loan to Opportunity International–IZVOR Foundation, later named Opportunity Microcredit Romania (OMRO,) expanded the MLP's operations to eight additional cities in January 2000.

In 2004, another $3 million loan borrowed by RAEF from the IFC was placed in microloans through CAPA Finance and boosted the MLP portfolio to $7 million. In 2007, when the IFC loan was paid-off, RAEF increased its commitment to the MLP by replacing this loan with its own funds.

Over 10 years MLP's portfolio has increased from $1 million to $14.5 million and has been financed not only

The RAEF Small Loan Program

From 1996–2003 RAEF operated a Small Loan Program (SLP). Initially implemented through Banca Transilvania and Banca Romaneasca (BR) with technical assistance provided by Shorebank Advisory Services, the SLP provided loans to small businesses in the range of $20,000 to $250,000. RAEF provided bank lender training and technical assistance in the context of an agreement that allowed the banks service fees for originating and servicing the loans. Banks and RAEF shared the risk of the loans, although they were assets owned by RAEF.

Small business lending was a new concept in Romania in the early years, and the profitability of the program was not immediately evident to Banca Transilvania. The agreement with that bank terminated around the time of a slight change in the administration of the program, and RAEF's purchase of BR in 1998. At that point. the loan program merged into the BR's operations changing the profit sharing arrangement to one where the bank was the lender, assuming all risks and rewards. The program truly began to flourish through the sale of the bank in 2003.

with newly allocated funds, but with revenues generated by the microloan portfolio and reinvested into MLP.

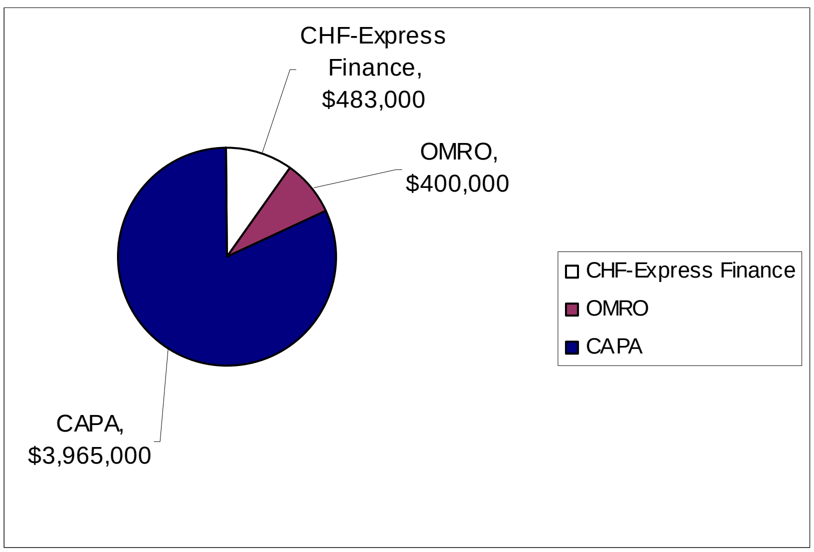
APPROACHES AND STRATEGIES

MLP created a special partnership with CAPA to administer RAEF's MLP portfolio. MLP's manager is a member of CAPA's credit committee. CAPA is responsible for portfolio administration and defaults, but the loans themselves are on the balance sheet of RAEF. Credit extension and repayments are processed by the MLP.

MLP pays an administration fee to CAPA for the loan services provided that is directly linked to portfolio quality and volume of loans. This approach allowed MLP to become operationally sustainable in 2001 and to improve the portfolio quality and efficiency of fund utilization.

A part of the MLP's funds were lent to CHF-Express Finance and OMRO in 2002. The MLP loaned a lump sum to these two MFIs, which then on-lended to microenterprises. The individual micro-loans were assets on the MFIs' books, not pass-throughs to the MLP. The portfolio was distributed as follows:

FIGURE 12: THE MLP'S PORTFOLIO DISTRIBUTION IN 2003



In 2003, CHF Romania began repaying funds borrowed from the MLP. Since that time, the RAEF MLP has been implemented primarily through CAPA and to a lesser extent through OMRO.

Today, the credit methodology used by CAPA and OMRO is the same: individual lending to individual entrepreneurs and micro and small companies located mainly in urban areas. The distribution of loans per area of activity financed in 2006 was as following: 42 percent for trade; 44 percent services; 8 percent for agriculture and food processing; and 6 percent for manufacturing. The loan products were designed and continuously adjusted to meet clients' needs for working capital, small investments, and refurbishment of enterprise premises.

CLIENT PERCEPTION AND IMPACT[18]

Most of the clients identify the partner lending institutions, especially CAPA, as spin-offs of the RAEF MLP. CAPA Finance is one of the well-regarded institutions that provides microfinance and support services to entrepreneurs in four of the historic regions of Romania: Transilvania, Oltenia, Moldova and Dobrogea. CAPA's microfinance lending capacity was built through its relationship with the MLP and the funding and good on-the-job and structural guidance it provided.

The loan terms, loan period, grace period, collateral and documentation requirements are considered good and competitive. The retention rate of over 56 percent is a measure of client satisfaction.

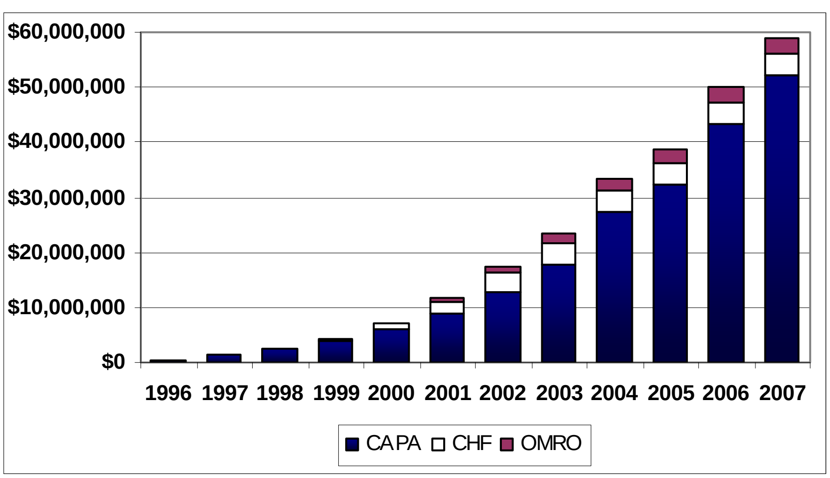
Clients perceive the institutions' operations to be efficient, because services are offered in a timely manner, with the average time from loan application to disbursement of less than a week. The decision to lend is based upon the on-site assessment of the business as well as the repayment capacity and the character of the borrower. Clients value the personal relationship they have with the institution and staff, and the sense that CAPA is looking out for their business development.

Another reason for CAPA's client loyalty is the transparency about the interest rates and fees charged and the competency of the credit officers.

INSTITUTIONAL PERFORMANCE AND SUSTAINABILITY

In 2000, the MLP program reached breakeven with 700 loans disbursed and an outstanding portfolio of $2 million. The retention rate that year reached over 50 percent. RAEF's MLP has been financially sustainable since 2003. Its commercially and market-oriented approach in managing the fund combined with its development mission were transferred to the partner lending institutions, which contributed to their ability to implement a sound lending methodology and procedures, to design and test financial products, and to develop long-term relationships with their clients. Figure 13 shows the trajectory of the loan program's development over the years. Today the MLP has an outstanding portfolio of $14.5 million.

FIGURE 13: RAEF MLP CUMULATIVE PORTFOLIO[19]



[18] See the section "Assessment Findings: The Impact on Firms" above for details on client perception and impact.

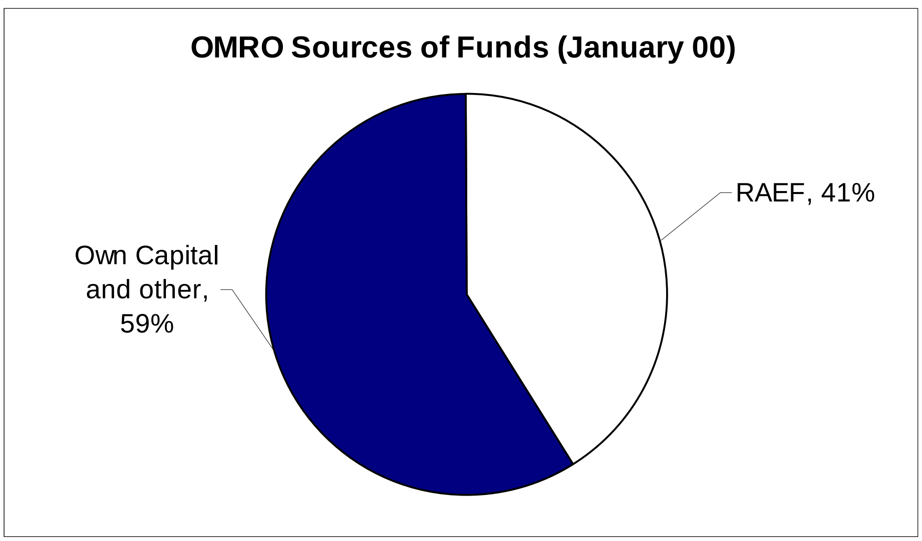
[19] Source: RAEF MLP internal reporting. 2007 data is as of September 30, 2007.

One appropriate indicator of the MLPs effectiveness is the outstanding performance, both financial and social, of the MLP's partner lending institutions.[20] When the MLP first began working with CAPA (then part of World Vision) the institution had no microfinance experience. With World Vision's support and the RAEF MLP agreement encouraging both portfolio growth and quality, as well as training and on-the-job technical support from RAEF staff, CAPA became a more competent and strong MFI. The funding of the MLP combined with this technical support helped CAPA grow from the first MFI in Romania to the largest in 2007.

MLP provided funding to OMRO, CHF-Express Finance, and CAPA at a time when they had little capacity to attract other donor or commercial funds.

Today, OMRO and CAPA have an impressive fund leverage capacity and financial and operational self-sufficiency. CHF-Express Finance has developed into a stronger institution, now capable of attracting more diversified funding sources. Today, only 12 percent of CHF-Express Finance loan funds originated from USAID, compared to a 1998 breakdown of 63 percent of funds borrowed from RAEF MLP and the remaining funds coming from USAID directly. See the figures below for a depiction of OMRO and CAPA's progression of early dependence on RAEF funding to current ability to attract diversified funds, including commercial bank loans.

FIGURE 14: OMRO SOURCES OF FUNDS (JANUARY 2000)



[20] CHF-Express Finance funding sources and performance indicators are presented in the section "CHF – Express Finance" below.

FIGURE 15: OMRO SOURCES OF FUNDS (JUNE 2007)

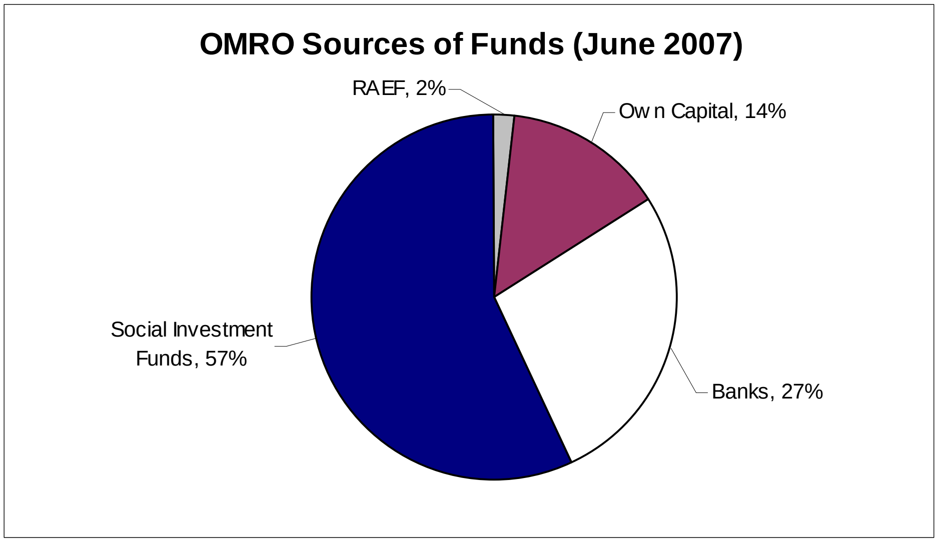


FIGURE 16: CAPA SOURCES OF FUNDS (JANUARY 2000)

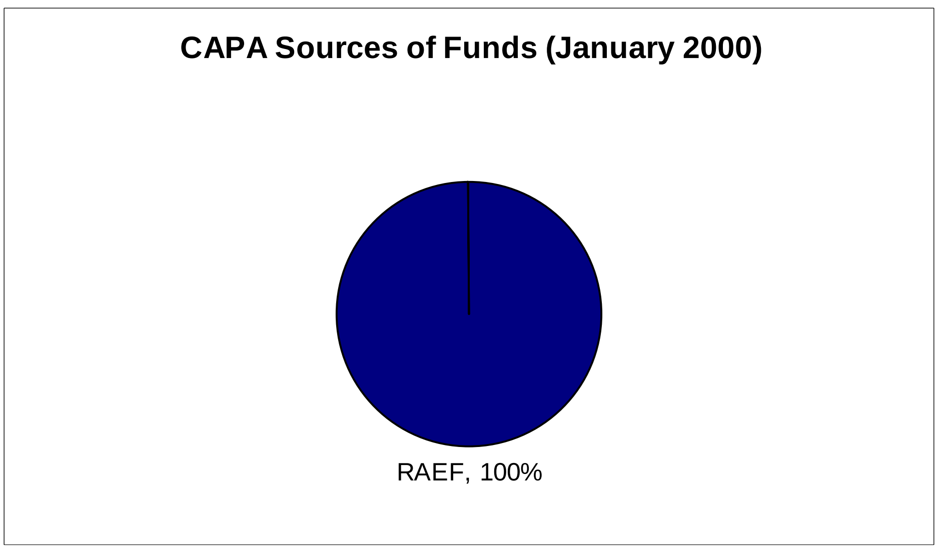
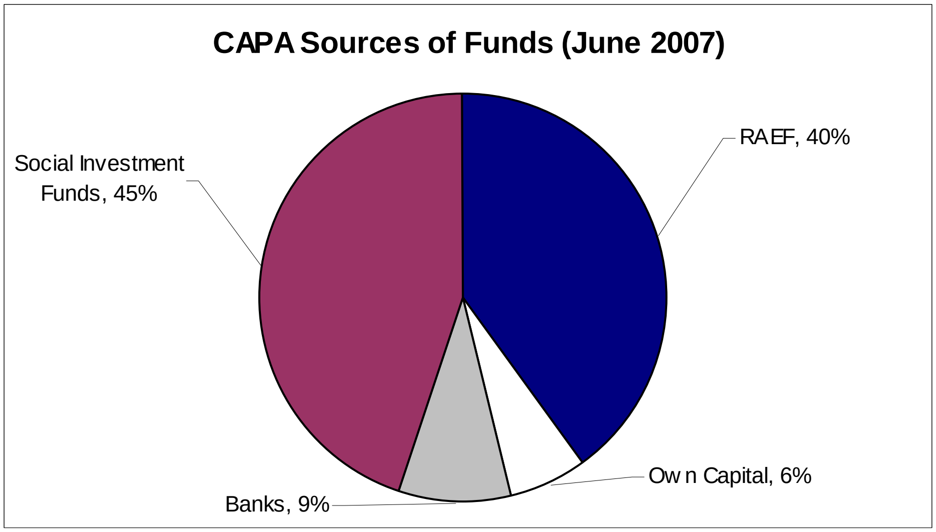


FIGURE 17: CAPA SOURCES OF FUNDS (JUNE 2007)



Both CAPA and OMRO are fully financially sustainable institutions.

In 2007, the MLP’s implementing partners attained geographic outreach of 20 counties in all eight regions of Romania. See below for the geographical outreach of CAPA and OMRO, the MLP implementing partners.

FIGURE 18: OMRO GEOGRAPHICAL COVERAGE (AS OF 12/31/2006)

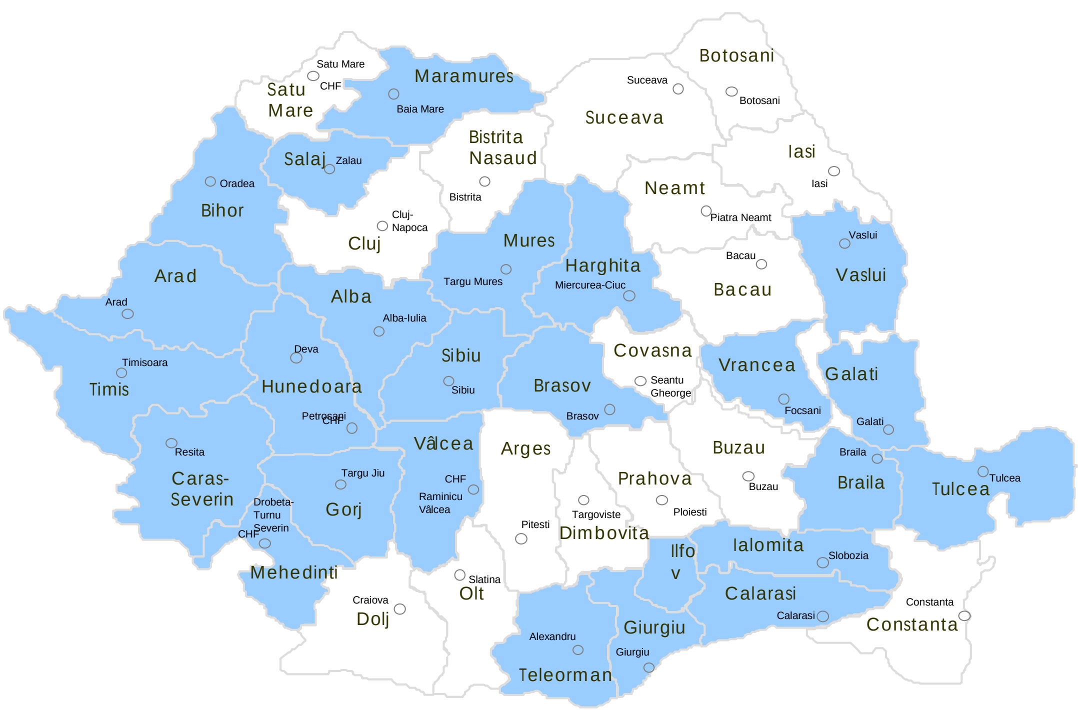
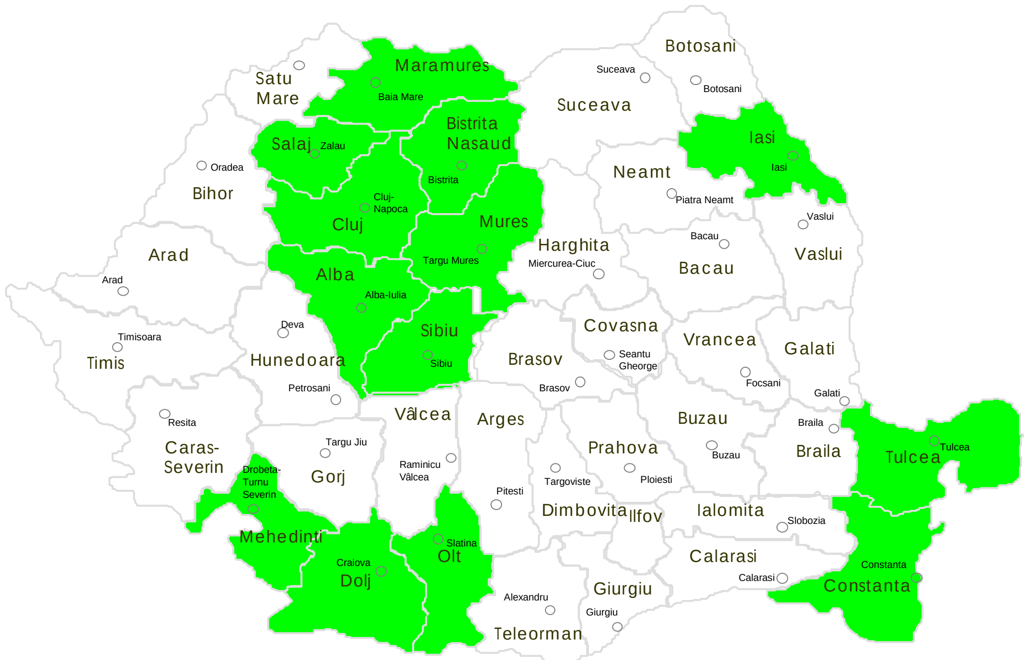


FIGURE 19: CAPA FINANCE GEOGRAPHICAL COVERAGE (AS OF 12/31/2006)



The MLP's past and present partner lending institutions--CAPA Finance, OMRO and CHF-Express Finance--are leaders in the Romanian microfinance sector, with their performance and experience being shared with the peer MFIs in Europe and worldwide. They report to the industry clearing house for MFI financial and other information, the MIX market, are members of the Microfinance Center in Poland, and are participating in a cross learning program with EU member MFIs.

One future possibility is that the RAEF MLP will be implemented by the RAEF Foundation when RAEF operations shut down in 2009. Another option, is that with RAEF MLP experience and a quality $14.5 million portfolio, the program may consider converting to a bank specializing in SME lending.

CONCLUSIONS: LESSONS LEARNED

The three MFIs that participated in the MLP appreciated RAEF employing a commercial criterion in the financing decisions and making available financial resources when they were most needed.

One lesson that can be learned from the RAEF MLP experience is that taking a completely social approach to microlending is not enough to grow and sustain these activities. A model that encourages a responsible approach to lending can lead to dividends in the form of institutional capacity building and portfolio growth, as was the case with CAPA.

Another lesson to be learned is that finance is an engine to growth not only for SMEs, but for the MFIs that finance them. As MFIs grow, they need to plan for that growth and find funding sources willing and able to grow with them. In the case of CAPA, RAEF was always there when needed. The structure of the program, wherein CAPA only earns loan service fees, enables CAPA to keep its debt levels down, giving it an advantage when seeking new funds.

CHF-EXPRESS FINANCE

ORIGINS AND EVOLUTION[21]

The Cooperative Housing Foundation (CHF) International started operations in Romania in 1994 to operate a capacity-building project for local business associations, Model Project for NGO Development. CHF was the lead organization for the Overseas Cooperative Development Council, a group of U.S. cooperative development organizations. CHF International Romania is a member of a broader international network and is the national representative of CHF International, a US-based non-profit international development organization.

In 1996, CHF received $150,000 from USAID to introduce a pilot microfinance program through a few business associations. These associations screened the clients and submitted the loan applications to CHF for review and approval. Based on this pilot's early success, in 1999, USAID gave CHF $1 million to expand its microfinance activities to three counties in Western Romania. CHF also leveraged funds from other sources, including RAEF, the World Bank and the GOR.

Beginning in 2003, as part of the Enterprise Development and Strengthening (EDS) Program, CHF received funds from USAID to create an independent, self-sustainable microfinance institution. The purpose was to provide financing to SMEs which were then underserved by the banking system. This entailed $1.2 million for operations, investment and technical support. Additionally, $500,000 was provided to fund loans for flood victims. In January 2006, CHF Romania registered this MFI as a non-bank financial institution (NBFI) called Express Finance, and began the process of transferring all assets and liabilities, staff, and field offices to Express Finance.

APPROACHES AND STRATEGIES

CHF-Express Finance's target market is defined as the registered micro and small enterprises in the 25 Romanian counties served by the institution. It offers individual loans ranging from below $1,000 to approximately $37,000 (EUR 25,000) at loan terms of 3 months to 3 years. In addition to MSE loans, CHF-Express Finance issued low-interest housing loans with additional USAID funding to flood victims in early 2005.

From 1996 to 2003, CHF Romania worked exclusively through local business associations, with the associations screening and referring individual clients to the institution. For loan origination services, the institution paid the association a portion of the interest received from the loan. At the end of 2003, CHF-Express Finance modified its approach, so that it no longer relies solely on associations for loan origination. Today, more than 90 percent of all new loan applications are received directly, without the involvement of associations. In addition, instead of receiving a portion of the interest, associations now receive an origination fee for all disbursed loans.

[21] For the purposes of this assessment only microfinance activities of CHF Romania and the subsequently established NBFI Express Finance are described. These activities are generally referred to as CHF-Express Finance in this assessment.

CHF-Express Finance's decision to move into particular counties was driven predominantly by its social mandate: providing financial services in areas with unmet demand. This mandate has coalesced with donors' development objectives, which have also served to drive regional presence and expansion. For example, the World Bank's rural finance program and mining area credit program had specific geographic requirements. However, this geographic / social focus has also affected institutional sustainability. CHF-Express Finance is operating in some of the poorer and more difficult to reach counties. In the case of the USAID grant for loans to flood-victims, geographic as well as product restrictions applied. Interest rates charged to borrowers are very low, around 2 percent per annum, which are inadequate to cover the operational expenses related to the program. The flood portfolio outstanding as of end of 2006 was $373,439 representing 3.46 percent of the total portfolio. The geographic expansion of branch locations and product features have had an impact on the financial performance of the institution.

In recent years, there has been a significant cultural shift within the institution to a more commercial approach, as well as long term plans to completely localize management, and to continue marketing standardized products, as opposed to niche market products, in the increasingly competitive market.

CLIENT PERCEPTION

CHF-Express Finance is well-regarded and often referred to as the lender of first choice because:

- Loan products meet clients' working capital needs and are offered at competitive interest rates.
- Customer service is good. Loan officers are polite and respectful and sometimes provide invaluable business advice to the business owners.
- Many clients believe that the CHF-Express Finance's decision to lend is based more upon the character of the borrower (such as ability to manage and entrepreneurial spirit) than on a strict analysis of the financial viability of the business, which they see as a positive aspect of CHF-Express Finance's lending operations. In fact, CHF-Express Finance does indeed use quantitative techniques for credit analysis.
- The waiting time from loan application to disbursement is short, especially compared to that of banks.
- CHF-Express Finance is transparent about the interest rates and fees charged. Some interviewees mentioned that it is often difficult to understand how much a loan will cost at a bank. Bank advertising may quote one rate, but the borrower ends up paying much more in interest and commissions.

Clients are loyal to CHF-Express Finance. The institution had in 2006 a 67 percent client retention rate. According to client interviews and focus groups, customer satisfaction is high.

In focus groups, clients stated that CHF-Express Finance issued credit to them when they most needed it and were unable to access financing from other sources. Because of this loyalty to CHF-Express Finance, many clients want the institution to grow with their financing needs. Some entrepreneurs stated that the maximum loan sized offered is too small to allow them to take on large, longer-term investment projects—such as housing construction.[22]

INSTITUTIONAL PERFORMANCE AND SUSTAINABILITY

Management is centralized. Branch offices are seen as cost centers and are staffed with the bare minimum necessary to run effective and efficient operations. The headquarters in Timisoara is responsible for credit risk management, loan portfolio management, accounting, and financial administration. The institution has attained impressive geographic reach. It manages 17 branch offices covering 25 counties, which represents more than 60 percent of the country.

The CHF-Express Finance microfinance program is performing well, as indicated by Table 11.

The portfolio has grown almost 300 percent in the past four years. Portfolio outstanding as of March 2007 was near $12 million. Since inception, CHF-Express Finance has cumulatively disbursed more than 12,500 loans, worth approximately $50 million. CHF-Express Finance is on the path to operational and financial sustainability. For the months of February and March 2007, CHF-Express Finance achieved sustainability, with operational sustainability over 100 percent and close to 100 percent financial sustainability. Management feels that the institution will achieve financial sustainability by the end of 2007.

TABLE 11: CHF-EXPRESS FINANCE'S PERFORMANCE FROM 2003 TO 2007

Performance Indicator	2003	2004	2005	2006	March 2007[23]
No. of Active Borrowers	924	1,839	2,265	2,393	2256
Portfolio Outstanding ($)	4,099,710	5,098,604	8,047,350	9,378,680	11,979,519
Operational Self-Sufficiency[24]	75.1 %	82.5 %	114.3 %	80.6 %	104.81 %
Financial Self-Sufficiency[25]	53.0 %	61.9 %	93.2 %	67.9 %	90.37 %
Portfolio at Risk (greater than 30 days)	1.66 %	1.7%	1.22 %	1.64 %	0.99 %

Asset quality, as indicated by a low portfolio at risk, is high. Portfolio at risk (PAR) at 90 days is less than one percent–indicating a higher asset quality than industry standards. CHF-Express Finance acknowledges that this low PAR may indicate a level of conservatism within the institution's lending practices. Because demand for CHF-Express Finance's products is great and CHF-Express Finance has a limited amount of capital to lend, the institution can be very selective regarding to whom it lends.

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[22] For more information on client perception and firm level impact of CHF-Express Finance see the section "Assessment Findings: Impact on Firms" above.

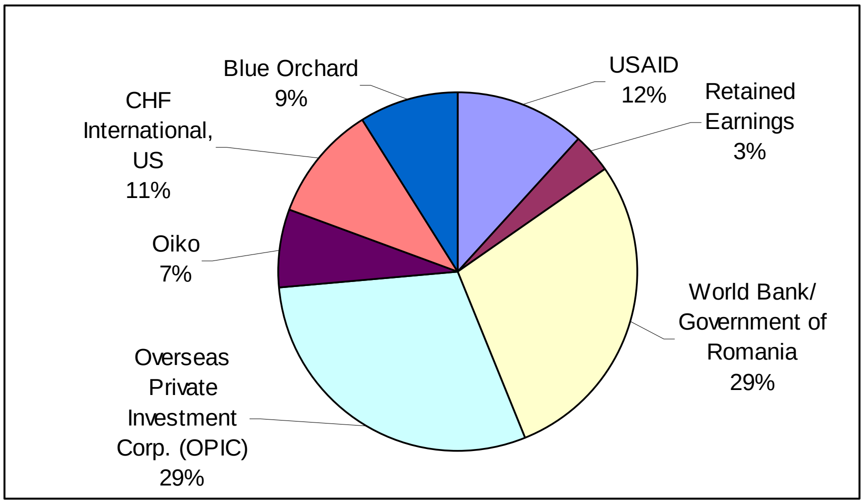
[23] These statistics come from the EDS final quarterly report for the period ending on March 31, 2007. All other statistics come from CHF-Express Finance financial reports.

[24] The operational sustainability calculation includes all expenses related to loan operations (consolidated CHF and Express Finance) and it is calculated based on a rolling 6-month average, including CHF headquarters overhead.

[25] Financial sustainability calculation includes all operational expenses plus adjusted imputed cost of funds, and loan loss provisions.

From its origins as an institution 100 percent funded by USAID a loan from RAEF, CHF-Express Finance has proven to be effective and successful at raising funds from various sources. Participation in the World Bank / Romanian Government programs in the former mining and rural areas, and in the first EU funded micro-credit scheme in Romania implemented by European Bank for Reconstruction and Development (EBRD) affirm international financial institutions' (IFIs) interest in collaborating with CHF-Express Finance to develop the Romania SME sector. However, access to affordable capital is a challenge for the organization. CHF-Express Finance is already highly leveraged and needs to improve its equity position. CHF is, at present, pursuing an equity investment from an IFI to increase the amount of capital to on-lend.

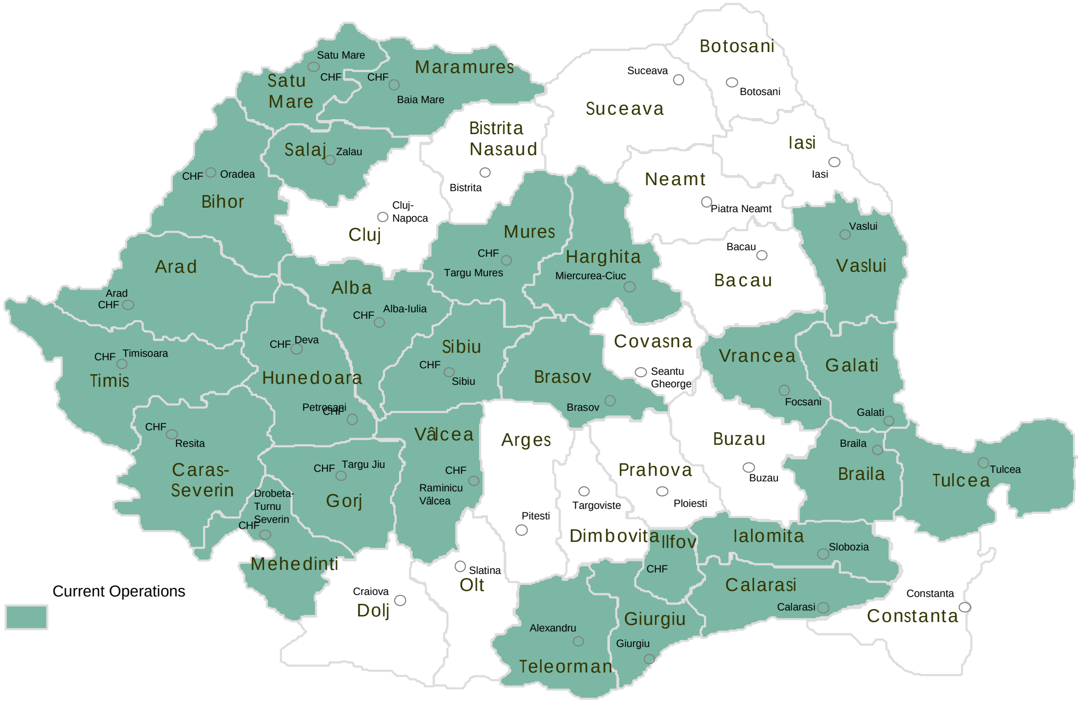
FIGURE 20: CHF-EXPRESS FINANCE SOURCES OF FUNDS (JUNE 2007)



CHF International has been and continues to be highly involved in the development of CHF-Express Finance in Romania. CHF International (USA) is the only shareholder of CHF-Express Finance, itself holding 99.656 percent of the shares, and its wholly-owned institutions AMEEN SAL (Lebanon), MEMCC (Jordan), CHF International Romania, and LIDER (Bosnia-Herzegovina) holding the remaining shares. CHF International not only provides guidance to CHF-Express Finance management, but plays a critical role in attracting funders as well.

The future for CHF-Express Finance looks good. The institution is led by a capable and committed Romanian management team and possesses and active but non-intrusive board. It has in place appropriate and robust financial management and risk management practices and procedures.

FIGURE 21: CHF–EXPRESS FINANCE GEOGRAPHICAL COVERAGE (AS OF 12/31/2006)



CONCLUSIONS: LESSONS LEARNED

With its financial support to CHF, USAID has contributed to the creation of a permanent, Romanian microfinance institution, Express Finance, one that will continue to provide much needed financial services to micro and small enterprises in Romania long after USAID closes its mission in the country.

USAID's commitment to develop CHF-Express Finance's microfinance activities has been long running, from the start of the first pilot microfinance activity through the associations in 1996 until 2007. This long-term approach has been essential to the institution's development. USAID/Romania kept in regular contact with CHF-Express Finance and the institution's clients, enabling them to guide and contribute to the technical implementation of the program, and permitting program adjustments, when necessary.

By all accounts, this program has been successful. CHF-Express Finance, by employing best practices in microfinance, has exceeded most of the targets outlined in its cooperative agreement with USAID. The institution is on the path to full operational and financial sustainability, and clients are satisfied with the product offerings and the customer service provided.

RURAL FINANCE AND LEADER DEVELOPMENT (RFLD) PROGRAM

ORIGINS AND EVOLUTION

The Rural Finance Leader Development (RFLD) program, funded by USAID and implemented by the United States Department of Agriculture (USDA) with $970,000 in grant funding from May 2003 to September 2007, aspired to:

- Provide small rural and agricultural enterprises with the tools to access credit, including an understanding of the commercial loan process and business and financial planning, as well as increasing information about existing programs (i.e. SAPARD) designed to assist agricultural enterprises;
- Build the capacity of private and government consultants on how to develop business plans for small agribusinesses; and
- Form relationships with local banks to better understand the changes taking place in the sector and the credit products available to farmers and agribusinesses.

USDA sub-contracted Iowa State University from 2003-2006 and the Center for Entrepreneurship and Executive Development (CEED) from 2006-2007 to implement the rural credit component activities of the program.

The program started in 2003 in Oltenia and Banat and expanded to Iasi in 2005 and to Transylvania in 2006. By the end of 2006, RFLD had reached nearly 60 percent of the country.

In October 2006, RFLD began collaboration with CEED, a Romanian foundation legally established in August 2006, to continue providing training to rural consultants, government leaders and enterprises. At project close, RFLD transferred its material and technical resources to CEED, including equipment and training materials. When direct US government support to CEED ended in September 2007, CEED expressed a commitment to continue to support rural and agricultural enterprises in Romania using the approach and tools developed by RFLD.[26]

APPROACHES AND STRATEGIES

The RFLD model was based on the belief that by working together, networks of local organizations (such as businesses, consultants, banks, and governments) can solve credit facilitation problems for agricultural and rural businesses. The participation of local stakeholders ensured that the program would reflect local needs and realities and adjust quickly to changes in the local business environment.

Specific RFLD objectives included:[27]

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[26] CEED was established by SEAF in response to a SEAF study that revealed that Romanian executives and mid-level managers need additional skill development and that the existing business programs did not adequately address this need. The continuation of RFLD activities in only one of CEED's objectives.

[27] These objectives are excerpted from the RFLD final report.

- increase the number of loans, in the range of $50,000 to $500,000, being approved by local banks for agribusinesses;
- encourage business owners to overcome their mistrust of commercial banks and private consultants;
- illustrate to commercial banks the profit potential of working with the agricultural sector; and
- provide business planning, record keeping and financial analysis training to team members, as needed.

To facilitate project implementation, RFLD developed the following tools:

1) a **financial directory** including the contact information for bankers, consultants, and government agency representatives in the 22 counties where RFLD worked;
2) a **Credit Tool Kit** containing a record book and worksheets for cash flow, income statements and balance sheets; and
3) an **agribusiness resource center** comprising of county extension consultants (OJCA) capable of providing business consulting services to agricultural and rural businesses.

PROGRAM PERFORMANCE

With a relatively small investment of $970,000, RFLD achieved these objectives.

Increased access to finance. During the life of the project, RFLD reviewed 415 screening reports, totaling nearly $102 million. Of these, 212 received financing for $49 million as of July 2006 and another 81 (for an amount of $24 million) were in process of being approved and funded. The table in Annex 4 shows project results in terms of number and amounts of funding broken down by project year. For the 122 that decided not to continue pursuing financing, their main reasons were that they did not possess sufficient working capital or that, after completing the business planning process, they decided that they were not prepared to take on the risk. This type of rational decision-making should be seen as another positive consequence of RFLD.

RFLD facilitated a great deal of SAPARD funding, which is funding provided by the European Commission for agricultural projects in support of Romania’s steps towards accession into the EU. This program had a number of bureaucratic requirements, as well as requirements for borrowers to present a business plan and obtain matching funds from a commercial source. RFLD was instrumental in navigating potential borrowers through this process as well as building capacity of local consultants to deliver this assistance on a fee basis.

Encouraged banks to lend to agricultural SMEs. RFLD has shown financial institutions that rural and agricultural finance can be a safe and profitable business. When RFLD began its pilot project in 2003, the team hoped to facilitate five loans in Oltenia and Banat. RFLD far exceeded this goal, achieving seven loans in year one and more than 140 loans by project end. The number of commercial banks participating in this program increased dramatically from two funding a total of seven projects in 2004 to ten institutions funding 95 projects in 2006.

Professionalized the consulting industry. More than 68 public and private business consultants in Banat, Moldova, Oltenia, and Transilvania received training and assistance through RFLD. RFLD trained consultants how to use the Credit Tool Kit and to develop more realistic business plans.

Helped improve the business environment. RFLD played an important role by providing guidance to businesses on how to work with government to address business environment problems.

STAKEHOLDER AND CLIENT PERCEPTIONS

To evaluate the effectiveness of RFLD, the assessment team conducted key informant interviews and focus groups of bankers, private and public consultants, SAPARD program representatives, RFLD representatives and rural and agricultural enterprises benefiting from RFLD assistance. In addition, the team implemented a structured questionnaire of these enterprises. All of the surveyed expressed positive views of RFLD. The key perceptions are presented below.[28]

- According to the entrepreneurs, the most useful aspect of RFLD was that it initiated and facilitated communication among the various actors and encouraged groups to work together to solve problems. One focus group participant stated, “We learned the value of teamwork. Romanians have been reluctant to associate in the past.”
- Administrative procedures and requirements were easy to follow, efficient, and not burdensome.
- The Credit Tool Kit and financial directory were especially valuable contributions of RFLD. For example, with training in the credit tool, OJCA consultants taught farmers how to use the tool and went with the farmers to banks, and worked with banks to use the tool in the assessment of loan applications.
- The program encouraged and facilitated the creation of strong networks and linkages among businesses, consultants, financial institutions, government agencies and programs (such as SAPARD). The financial directory was very useful in promoting these networks and connections.
- RFLD demonstrated to rural entrepreneurs that they can get financing from financial institutions and that they can benefit from business consulting services.
- Bankers agree that one of the main successes of RFLD is that the farmers now come to the banks well prepared to present their business plans. It is evident that the loan applicants understand their business aspects of their operations and that they participated in the business planning process.
- The only suggestion for improvement of RFLD was the expansion of the program. Many interviewees stated that RFLD, because it was so successful, should have been expanded to other counties.

PROGRAM SUSTAINABILITY

The RFLD program activities will continue as a component of a USAID legacy institution –CEED- which is committed to carry on some of the activities previously conducted under RFLD in a sustainable manner. CEED, established with support from the Small Enterprise Assistance Funds Trans-Balkan Romanian Fund (SEAF-TBRF) in August 2006, is the USAID/Romania legacy

[28] See the section “Assessment Findings: The Impact on Firms” above for more information on firm level impact of RFLD.

providing business development support to SMEs. It is the responsibility of CEED to ensure the continuation of activities started under RFLD. CEED is well-positioned to continue these activities, as it benefits from a team of highly competent and well-regarded staff. Because this transfer of responsibility is a relatively new occurrence, many RFLD stakeholders and clients (whether government consultants or enterprises) are unaware that CEED is continuing RFLD activities. There is an opportunity for CEED to use the good name of RFLD to market its rural development activities. See Annex 6 for more information on CEED.

CONCLUSIONS: LESSONS LEARNED

RFLD was successful by all accounts. The program met all of its objectives, with a relatively small budget. Consultants trained by RFLD continue to deliver consulting services to RFLD beneficiary enterprises and to other enterprises as well. The quality of the services and the tools provided (financial directory and Credit Tool Kit) are still well regarded by the businesses.

One key to RFLD's success was the strategy to partner and leverage resources from other sources. The RFLD team recognized that with a budget of $970,000, the program could not directly finance or assist the enterprises, but by training a network of consultants, partnering with SAPARD, and encouraging banks to lend to rural and agricultural enterprises, the target beneficiaries would receive the financial and technical assistance they needed. Another ingredient of program success was the apparent skill and dedication of the Romanian regional program directors employed by the project.

RFLD's approach was well-received by rural private sector, government and donor stakeholders and is attributed to the program's success. By considering the rural and agricultural enterprises' specific needs and circumstances when designing program activities, RFLD ensured that the activities would lead to concrete results. RFLD was open to working with any stakeholders (including government consultants and other donor programs) that could supply the enterprises with the technical and financial support needed.

MORTGAGE FINANCE AND MARKET DEVELOPMENT

ORIGINS AND EVOLUTION

In 2001, RAEF launched the first non-bank financial institution ("Ro-Fin") dedicated solely to providing mortgage financing for individual home ownership under the Romanian Mortgage and SME Program. This joint effort comprised operational support funded by USAID, Shorebank Advisory Services (SAS) technical assistance, and equity funds from the Romanian-American Enterprise Fund (RAEF). RAEF established Ro-Fin based on the successful experience of The US Russia Investment Fund (TUSRIF) in mortgage lending.

The company, later renamed Domenia Credit, pursued business objectives and allocated resources to develop a housing finance system based on secondary mortgage market model. By late 2002, the SAS technical assistance ended and the company began operations as a commercial institution in earnest.

It was soon clear that the company needed additional funding to grow. USAID Romania worked to help structure a Development Credit Authority loan portfolio guarantee in cooperation with the USAID Office of Development Credit to support a $5 million loan from Raiffeisen Bank. The DCA provided a partial loan loss guarantee to the bank. This was an innovative use of the DCA and proved highly essential and successful. Soon after this loan was received, additional capital was attracted in the form of equity from the EBRD and DEG (20 percent each) and loans from the IFC ($5 million, later increased to $7.5 million) and later, an unsecured loan from Raiffeisen Bank.

APPROACHES AND STRATEGIES

At inception, Domenia Credit offered mortgage loans of up to 15 years, which was longer than any loan term offered at that time. In addition to longer terms, the institution offered good customer service and fast turn around of loan applications.

While the company was established with broad developmental goals in mind, the shareholders (RAEF, EBRD, and DEG) felt it was important that the management focus on achieving a successful business in order to earn credibility on behalf of the government to get laws and regulations passed for the industry. One such regulation that was recently changed restricted household debt to 30 percent of total net family income.

During the early years of establishing operations, Domenia Credit and its shareholders, through the Mortgage Task Force, worked with the GOR to create laws enabling mortgage lending and the establishment of the secondary mortgage market. The IFC and World Bank worked to set up a real estate framework that also supported these operations. The WB provided technical assistance for the legislation for mortgage lending secondary market.

Another strategy of RAEF was to cultivate a strategic buyout of the company, to sell to an investor well-placed to grow the business after USAID participation ends.

Today, Domenia Credit offers 30-year term loans at time of origination. In the sector, products offered by both banks and mortgage companies are competitive and meet the needs of consumers, with fixed rate mortgages and 30 year terms becoming standard product features. Domenia Credit continues to differentiate itself with better customer service and a more specialized approach to mortgage lending than the banks. Eighty-five percent of applicants get an answer to their application on the spot, and an official response letter within three days.

INSTITUTIONAL PERFORMANCE AND SUSTAINABILITY

Domenia Credit today is among the top three mortgage finance companies in Romania, although its total market share is low due to bank domination of the sector. Domenia Credit has grown from three employees in 2001 to 70 today working out of nine offices. There are nearly 2,000 borrowers represented in the company's $70 million portfolio. Since being purchased by GE Money, the cost of capital to Domenia Credit has decreased by 3 percent, a savings the institution has passed on to consumers, increasing its competitiveness.

> "The capable staff and well structured internal systems and practices drew GE Money to Domenia Credit, as did the fact that it was a market leader."
>
> *– Mark Hampson, Integration Leader, GE Money*

In addition to its role as a retail credit provider, Domenia Credit was also created as a vehicle for sector reform and has been largely successful in that regard, particularly pushing the development of the retail mortgage finance market. One target not met was the development of the secondary mortgage market. While all necessary legislation is in place, this market has not yet been accessed. An important component of Domenia Credit's original business model, the secondary market is a less important source of funds under GE Money ownership in the near term.

In late 2006 Domenia Credit, along with Ralfi (Estima Finance) and Motoractive, was purchased by GE Money. GE Money had been sought as a buyer due to its strategic ability to grow the market for these financial products and its access to funding for growth. It was a profitable transaction for the shareholders and the nature of the investor ensures that the company will continue to grow. It is likely that GE Money eventually will merge these finance companies to create a universal bank.

CONCLUSIONS: LESSONS LEARNED

The main lesson that can be learned from the Domenia Credit experience is that an institution can be an effective vehicle for sector-wide reforms. By bringing in other lenders and investors into a successful, growing enterprise, RAEF was able to expand the base of stakeholders and leverage additional influence for discussing with GOR institutions the needs of the industry. It is important for the institution to be a commercial success. Donor interest can be driven by development objectives but financial viability is also important to show impact on the economy as well as for a demonstration effect. Thus, Domenia Credit and the Mortgage Task Force not only pushed the retail mortgage lending sector to be more competitive by offering better services and terms, it also served to promote the establishment of legislation and norms which laid the foundation for the development of the mortgage market more broadly.

A secondary lesson that can be drawn from this experience is the external effective use of a USAID DCA to leverage commercial funding for a USAID-supported financing vehicle.

RECOMMENDATIONS

While much has been accomplished by Romania, with USAID assistance, to grow the private sector, there are still a number of challenges to private sector growth, which other donors and the GOR may choose to address.

Private enterprises and consumers still have unmet demand for credit. Access to finance from banks is improving with banks expanding in product offerings and branch networks rapidly, but the microfinance industry could still use more funds for growing their niche client base. MFIs' debt to equity ratios are a challenge, which could be overcome with equity or quasi equity financing or fee for service arrangements. These MFIs could also use assistance in financial risk management, including asset and liability management.

The stock, bond and securities markets are in early stages of development, particularly the mortgage finance market, with no secondary mortgage finance yet available. Donors could take measures to improve investor confidence and the supporting industries necessary for this market to develop.

In rural areas, small land parcels and a lack of a developed wholesale market inhibit market development. These issues still need to be addressed by policymakers and, potentially, donors. Assistance for local communities to access EU structural funds is needed in the form of training and consulting, possibly by building capacity among locally emerging business-consulting firms.

Another gap in the market is the energy sector, where greater liberalization is necessary to stimulate and maximize investment.

SMEs continue to cite government bureaucracy as being an impediment to growth. Laws and regulations affecting SMEs should be rationalized to encourage further economic growth. Decentralization of government processes will facilitate reforms and allow local governments to move more swiftly, and be more responsive to the needs of their local private sector communities.

CONCLUSIONS

The Romanian private sector has grown tremendously in terms of sheer size and contribution to GDP over the past ten years. USAID programs had an important role to play in driving this growth and contributing to the Romania success story.

The assessment of USAID financial and private sector programs revealed a number of key findings. USAID funded programs that supported access to financing drove firm and sector growth at the SME level. Foreign direct investment, facilitated by USAID, resulted in the growth of larger firms. It was found that firms with the highest growth rates were SMEs funded by SEAF-TBRF, confirming industry findings that finance grows small firms at higher rates than microenterprises or large firms. RAEF played a special role in the development of the financial sector, particularly in terms of microfinance, SME finance, bank restructuring and the development of the mortgage market. CHF-Express Finance developed from a small micro loan program to a the third largest microfinance institution in the country, now capable of attracting other funding sources while continuing to provide much needed financial services in underserved areas. Most USAID funded programs will leave behind at least one financially sustainable institution. The Romanian economy and the policy reforms that enabled its growth both benefited from and contributed to the success of USAID programs.

USAID’s long-term, multisectoral approach to deepening the financial sector, thereby growing the overall private sector, differentiates it from other donors and from USAID strategy employed in other countries. This tactic helped build sustainable legacy institutions and produced a broader ripple effect on the economy. The success factors of USAID’s assistance in the financial sector in Romania include:

- Increasing the potential for positive impact by investing donor funds and efforts across sectors
- Taking a long-term approach to sector development
- Using diverse financial instruments to help meet the needs of consumers and produce broader effects in the sector
- Employing a commercial approach to ensure sustainability
- Adapting lessons learned from the region as an effective way to achieve development goals
- Coordinating with other donors and government to accomplish ground breaking activities and wide-ranging impact
- Encouraging knowledge-sharing among local and international professionals to create a change in business culture
- Successfully promoting the adoption or reform of legislation or regulations to contribute to the wider development of the private sector

It is clear that Romania is stronger as a result of US support for the business and financial sectors. Finance has been an engine for growth among the firms that received support from USAID assisted institutions. Programs with a commercial approach coupled with minimal technical assistance achieved the greatest successes over the past 10 years. One of the greatest evidences of that success is that today several sustainable financial institutions remain as legacies of these programs, and market forces fuel the development of the financial sector for the benefit of consumers and businesses.

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ANNEX 2: LIST OF CONTACTS

CAPA/World Vision
Adrian Chindris, Executive Director,
Adrian_chindris@capa.ro,
Elena Ciuca, Finance Director,
Elena_ciuca@capa.ro, Tel: +40 264 597 442
Cluj, Romania
Cristina Anca Frincu, Area Manager Craiova,
Cristina_frincu@capa.ro
Str. C.D. Fortunescu nr.18, Craiova 200385,
Dolj County Romania

Center for Entrepreneurship and Executive Development (CEED) Romania
Cristina Manescu, Executive Director,
Cristina.manescu@ceed-romania.org
Bulevardul Octavian Goga nr. 4, Bloc M26,
scara 1, tronson A, parter, Sector 3,
Bucureşti, România, 030982
Tel: +40 21 323-42-72

CHF International Romania
Mazen Fawzy, Country Director,
mfawzy@chf.ro
Brian King, EDS Project Manager,
bking@chf.ro
Kirill Kravchenko, Director of Finance and
Administration, kkravchenko@chf.ro
Str. Londra nr. 25, Sector 1, 011761,
Bucharest Romania
Tel: 021-231 32 93

Emerging Markets Group
Horia Sas, Project Manager, Financial Markets
Reform Project, horiasas@yahoo.com
11 Rabat Street, Sector 1,
Bucharest, Romania
Tel: +40745341390

Express Finance
Silke Mueffelmann, General Manager,
smueffelmann@express-finance.ro
Dan Orodan, Deputy General Manager,
dorodan@chf.ro
Bd. Liviu Rebreanu nr.13
300479 Timisoara Romania
Tel: 0256-204 550
Fax: 0256-490 219

European Bank for Reconstruction and Development (EBRD)
Jonathan Woollett, Director, Non-bank
financial institutions group,
woolletj@ebrd.com
Jana Sivcova, Associate Banker, Group for
Small Business, sivcovaj@ebrd.com
Marilena Viui, Associate Banker, Bucharest
Head Office, viuim@ebrd.com

EU PHARE Project Competitiveness in Europe
Daniel Gogescu, Regional Coordinator,
ANIMMC, roca.craiova@consortium.ro
Bd. Decebal, Bl. U12
Parter, Craiova Romania
Tel: +40351 442 200

National Bank of Romania (NBR)
Florin Georgescu, First Deputy Governor
25 Lipscani Street, Sector 3,
030031–Bucharest
Tel: 4021-313.04.10
Fax: 4021-312.38.31

Romanian-American Enterprise Fund (RAEF)
Horia Manda, Senior Vice President and Chief
Investment Officer, Horia.Manda@raef.ro
President and CEO, Enterprise Capital
Bogdan Giurginca, Chief Financial Officer,
bogdan.giurginca@raef.ro
Alin Giurgiu, Investment Officer,
Alin.Giurgiu@enterprisecapital.ro
Angela Popescu, Micro Loan Program
Director, Angela.Popescu@raef.ro
Eva Orza, Portfolio Management Officer,
Eva.Orza@EnterpriseCapital.ro
33 Aviatorilor St., 4th Floor, Sector 1
Bucharest Romania
Tel:+40 21 207 7100
Fax:+40 21 222 8504

Romanian Ministry of SME
Bogdan Dumitrache,, Secretary General GOR, Directorate of SME, bogdan.dumitrache@mimmc.ro,
Tel: + 40 21 335-3156.

SAPARD Agency
Dan Gherghelas, General Director
Str. Stirbei Voda No.43, Bucharest Sector 1
Tel: +40 (21) 402.27.79
Fax: +40 (21)402.27.77

Shorebank International, Ltd.
Edward Siegel, Vice President, esiegel@sasbk.com
403 Coppergate House, 16 Brune Street
London, England E17NJ
Tel: +44 0207 953 8677

Small Enterprise Assistance Funds-Trans Balkan Romania Fund (SEAF-TBRF LLC)
Mircea Jalba, General Manager, mircea@jalba.ro
Constantin Bogdan, Investment Director, C_bogdan@tbrf.ro
Bd. Octavian Goga, nr. 4, bl. M26, tronson A. groundfloor, Sector 3, Bucharest Romania
Tel 021 326-7340

USAID/Romania
Corina Mararu, Director of the Office of Economic Growth
Carmen Podani, Project Management Specialist, cpodani@usaid.gov
Mihaela Popescu, Project Management Specialist, Private Sector Initiatives Office, mpopescu@usaid.gov
Florentina Tautu, Director, Program Office, ftautu@usaid.gov
Opera Center Building
1-5, Costache Negri St., 4th Floor,
Bucharest 5,
Tel: 40-21-316 1222
Fax: 40-21-316 1202

Current and past RAEF Investments

Banca Romanesca
Daniel Antonescu, Head of Secretariat Division, daniel.antonescu@brom.ro
Union International Business Center
11, Campineanu Str., Sect.1
Bucharest, Romania
Tel: +40 21 305 9010

Comtel International, Golden Tulip Hotels
Paul Marasoiu, Area Director Romania & Moldova, paul.marasoiu@goldentulip.com
Mona Cardas, Assistant Manager, office@goldentulipskygate.com
126-130 Calea Dorobantilor, bl. 8 st. 1, 1st Floor, Suite 1, Sector 1,
Bucharest, Romania
Tel: +40 21 231 0265

DOMO Retail, SA
Alexandru Mnohoghitnei, Chief Financial Officer, alexandru.mnohoghitnei@domo.ro
Bd. Dimitrie Pompei Nr. 10A
Sector 2 Bucharest, Romania
Tel: +4- 21 361 9393

GE Money
Mark Hampson, Romania Integration Leader, mark.hampson@ge.com
Carmen Retegan, CEO, Domenia Credit, carmen.retegan@ge.ro
Cristian Dragos, Sales and Marketing Leader, cristian.dragos@ge.com
Aviatorilor no.33, Sector 1, Bucharest
Tel: +40 21 222 8550
Fax: +40 21 222 8554

Opportunity Microcredit Romania (OMRO)
Charles Ertzinger, COO
Janos Berezcski, Credit Manager
Donna Gaga, Chief Accounting Officer
Str. Tineretului 2
Tirgu Mures 540027 Romania
Tel: + 40 265 263 644

Policolor
Ioan Florescu, Administrator
Str. Bd. Th. Pallady Nr. 51,
Bucharest Sect.3
Tel. +40 213 451 730

Raiffeisen Bank, S.A.
James Stewart, Vice President, Member of the Board, James.Stewart@rzb.ro
15 Charles de Gaulle Square
Sector 1 Bucharest Romania
Tel: +4021 306 12 00
Fax: +4021 230-0870

Ralfi–Estima Finance, Motoroactive
Stefan Coroianu, CEO Motoractive Leasing and Estima Finance, stefan.coroianu@ge.com
Tel: +4021 317-7444

Current and Former SEAF-TBRF Investments

Artima & InterPart Production
Banu Florentin, Owner, office@interpart-production.com
Plautius Andronescu street nr. 10
Timisoara, Romania
Tel: + 40 (0)256 296 054

CASA REAL ESTATE INVESTMENT
Nagy Zoltan Director General
Diana Calfa, Executive Director, office@cre.ro
Str. Eftimie Murgu, nr. 11C
Cluj-Napoca, 400504
Tel. +40264 430 842

TELEZIMEX
Nagy Zoltan, General Director, nagy.zoltan@telezimex.ro
Calea Turzii nr. 231-233
400495 Cluj-Napoca, Romania

TotalSoft S.A.
Liviu Dragan, GeneralManager
Calea Şerban Voda, nr. 30-32,
Sector 4, Bucharest, Romania
Tel: +40 744 640-257

Rural Finance Leader Development Program (RFLD) Participants

Nicolae Calin, Independent Consultant
Tel. +40 723 636 272
Targu Jiu–Gorj County

Constantin Dascalu,Vice-president, Dolj County Council, c.dascalu@cjdolj.ro
str. Unirii nr. 19
200585 Craiova, Romania
Tel +40 251 417 420

Adriana Ecobici, Independent Consultant
Tel.+40 723 631 388
Craiova, Dolj County, Romania

Nita Gheorghe, Mayor, Horezu, primaria@horezuonline.ro
Comuna Horezu City hall
Tel. +40 744 471 377

Stela Marcu, Ex-Area Program Coordinator, Head of Food Processing Department of the Chamber of Commerce and Industry of Timis County, marcus@mail.dnttm.ro
Piata Victoriei, 3
Timisoara Romania
Tel: + 40 0256-490-771

Illie Matei, Director, Commercial Bank of Carpatica, bcctimisoaraatraian@carpatica.ro
Carpatica Bank Agentia Timisoara
Piata Traian Nr. 2
Timisoara, Romania
Tel: + 40 0256-286-522

Marian Mocan, office@expertconsulting.ro
Expert Consulting SRL
Str. Unirii, 6
Timisoara, Romania
Tel: + 40256-294-350

Marcel-Livu Munteanu, OJCA Cara, Severin ojca@cs.ro
Resita, Str. Paul Iorgovici, No. 34
Caras Severin Romania
Tel: + 40 0255-215-304

Pavel Nefir, Director OJCA Caras-Severin,
ojca@cs.ro
Resita, Str. Paul Iorgovici, No. 34
Caras Severin, Romania
Tel: + 40 0255-215-304

Daniel Popescu, Director,
sapardcraiova@oltenia.ro
Agent for Rural Development for SAPARD
Program, Oltenia
Str. Amaradia, 4–Craiova
Tel: + 40 0251 40 64 01

Dorina Tarau, Ex-SAPARD Director
for Arad County
Valerian Trupina, Independent Consultant,
Director of Accounting, Expert Agency
Valcea
Tel.+40 740 817 548

ANNEX 3: RAEF FINANCIAL PERFORMANCE OF MAJOR TRANSACTION PROGRAM EQUITY INVESTMENTS

Total Investment (# of deals)	Total Investment (mm)	Realized Investment (# of deals)	Realized Cost (mm)	Realized Value (mm)	Gross Realized IRR	Unrealized Cost (mm)	Unrealized Value (mm)	Gross Unrealized IRR	Gross Realized & Unrealized IRR
21	$67,270,489	19	$55,420,576	$190,186,663	33%	$11,849,913	$45,154,453	19%	29%

Source: RAEF internal financial reports, June 30, 2007.

ANNEX 4: RFLD PROGRAM RESULTS

	2004 Results		2005 Results		2006 Results		Project Total	
Total Project Activity: 2004–2006	**No.**	**Amount**	**No.**	**Amount**	**No.**	**Amount**	**No.**	**Amount**
Projects that chose not to continue	56	$13,040,301	25	$6,145,803	41	$9,486,501	122	$28,672,605
Projects in process of approval	3	$1,757,604	2	$2,572,040	76	$19,743,721	81	$24,073,365
Projects funded (as of Aug. 2006)	20	$638,329	66	$12,873,606	126	$35,601,032	212	$49,112,967
Total	**79**	**$15,436,234**	**93**	**$21,591,449**	**243**	**$64,713,922**	**415**	**$101,867,937**
Projects Funded: Funding Type	**No.**	**Amount**	**No.**	**Amount**	**No.**	**Amount**	**No.**	**Amount**
SAPARD (Self-funded)	10	$178,416	22	$2,900,896	27	$4,424,527	59	$7,503,839
SAPARD (Bank co-financing)	2	$151,003	17	$9,427,140	92	$30,675,430	111	$40,253,573
Direct Bank Financing	5	$158,703	21	$240,824	3	$67,873	29	$467,400
Self-Funded Project	3	$150,207	6	$304,746	4	$433,202	13	$888,155
Total	**20**	**$638,329**	**66**	**$12,873,606**	**126**	**$35,601,032**	**212**	**$49,112,967**
Commercial Bank Activity	**No.**	**Amount**	**No.**	**Amount**	**No.**	**Amount**	**No.**	**Amount**
BCR	6	$302,633	15	$5,225,743	27	$14,247,127	48	$19,775,503
BRD			1	$32,151	53	$14,308,018	54	$14,340,169
CAPA			1	$6,475	2	$175,542	3	$182,017
Carpatica			1	$376,262	4	$708,919	5	$1,085,181
CEC			0	0	3	$410,539	3	$410,539
Italo Romena			0	0	1	$255,918	1	$255,918
Procredit Bank			14	$95,587	2	$120,599	16	$216,186
Raiffeisen Bank			2	$675,153	1	$32,151	3	$707,304
Banca Romanesca	1	$7,073	1	0	0		2	$7,073
Romexterra			0	0	1	$51,441	1	$51,441
Banca Tiriac			1	$2,397,600	1	$433,047	2	$2,830,647
Banca Transilvania			1	$59,757	0	0	1	$59,757
Unicredit			1	$799,236	0		1	$799,236
Total	**7**	**$309,706**	**38**	**$9,667,964**	**95**	**$30,743,301**	**140**	**$40,720,971**

ANNEX 5: CHF–EXPRESS FINANCE INSTITUTIONAL ASSESSMENT

This institutional assessment is not intended to be an in-depth analysis of the institution's strengths, weaknesses, opportunities and threats. It is not the assessors' aim to make recommendations to CHF-Express Finance for improvement. Instead, it is the assessors' goal to understand the legacy that will remain after USAID's departure and to highlight lessons learned from CHF-Express Finance's successful experience lending to micro and small enterprises in Romania and the role USAID has played. This assessment focuses on: organizational structure; human resource management; board management issues; services, market, and clientele; administration; financing; and financial management.

ORGANIZATIONAL STRUCTURE

Express Finance's operations are highly centralized, with the headquarters in Timisoara fulfilling the credit risk management, loan portfolio management, accounting, internal audit, and financial administration functions. In addition to the headquarters, Express Finance operates 16 branch offices, located in urban centers. These branch offices are managed by a group of five regional managers that travel from branch office to branch office supervising operations within their respective regions.

At the end of March 2007, CHF-Express Finance employed 62 staff members, of which 31 were loan offices and five were part-time employees. Administrative staffing is sufficient and not financially burdensome.

HUMAN RESOURCE MANAGEMENT

Express Finance is managed by a strong, primarily Romanian, management team, possessing the necessary skills and knowledge in strategic planning, credit and financial management, and fundraising. The general manager of Express Finance is currently an ex-patriot who is providing mentoring and on-the-job training to the deputy general manager in preparation for an eventual hand-over to all-Romanian management in the very near future. Express Finance's management expressed interest in receiving support to train middle managers and develop/pilot-test new products.

In general, employee retention remains high, despite increased turnover during this period of structural change (from CHF as a MSME finance project to Express Finance as a NBFI). High retention may be due to job satisfaction, competitive salaries, and the introduction of a loan office incentive scheme. In 2003, CHF-Express Finance increased loan officer salaries to better reflect local market rates. In so doing, the institution was able to retain its well-trained staff and compete with the local banks for qualified candidates.

BOARD MANAGEMENT

The board provides vision and policy leadership and participates in setting performance targets and monitoring progress. Most members of the board are located internationally and are affiliated with CHF International. Members of the board possess extensive experience in microfinance, with the President of CHF International serving as the President of the Board. The Board's roles and responsibilities are clearly defined in the organization's bylaws. The Board and the Executive Director are effective at mobilizing funds from domestic and international sources. Management spends a substantial amount of time on this task. On a day-to-day basis, the institution is fairly self governing.

SERVICES, MARKET, AND CLIENTELE

At the end of June 2007, CHF-Express Finance served a customer base of more than 2,194 clients, divided as follows:

- 1,708 loans for individual businesses
- 222 loans for individual housing
- 152 loans for flood-affected families in the western part of Romania
- 95 loans for flood-affected families and 10 loans for flood start-up businesses in South–East Romania
- 7 loans for group housing

The geographic distribution of the portfolio, as of June 2007, is:

- West region–30.53%
- North-West region–15.26%
- Central Region–25.90%
- South-East region–17.26%
- South-West region–11.05%

As of December 2006, the sector stratification was:

- 50.72% commerce
- 27.46% services
- 12.38% production
- 3.04% agriculture
- 2.18% constructions
- 4.22% housing

As of December 2006, the loan stratification by loan size was:

- Below $2,000–7.22%
- $2,001-$5,000–23.46%
- $5,001–$10,000–31.60%
- $10,001–$25,000–31.17%
- $25,001–$30,000–6.54%

CHF-Express Finance offers a fairly limited range of individual lending products. Specific information about these products is described on the institution's website. This limited offering has worked well to simplify the financial management team's workload. While there remains unmet credit needs among Romanian micro and small enterprises, CHF-Express Finance's products address perhaps the most important of those needs.

CHF-Express Finance tends to rely on its local association partnerships for a steady stream of customers. Also, satisfied customers provide another source of marketing and outreach. Given the limited capital available and the organization's partner strategy, advertising and independent marketing efforts by loan officers have been limited.

CHF-Express Finance's organizational structure includes the position of marketing/public outreach. It is the responsibility of this position to publicize a professional image for Express Finance as a microfinance provider; perform market research in new expansion areas; and create quality advertising materials.

CHF-Express Finance is well-regarded by its clients, often referred to in focus group sessions as the lender of first choice. Clients state that CHF-Express Finance issued credit to them when they most needed it and were unable to access financing from other sources. The loan products meet their working capital needs and are offered at good interest rates (compared to what is available on the market). Also, customer service is good and the waiting time from loan application to disbursement is short. Many believe that the MFI's decision to lend is based more upon the character of the borrower (such as ability to manage and entrepreneurial spirit) than on a strict analysis of the financial viability of the business, which they see as positive aspect of CHF-Express Finance's lending operations. However, CHF-Express Finance does take into account other business performance criteria when analyzing and approving a loan.

Clear and consistent credit policies and procedures are in place. Should the institution expand its product offerings, it may need to revisit these policies and procedures to make sure they are sufficient and still appropriate. The local associations support CHF-Express Finance's lending activities by serving as loan packaging providers and/or marketing partners. CHF-Express Finance has correctly left these institutions out of the credit decision-making process.

CHF-Express Finance has improved its credit committee structure by adapting readily available IT tools (such as Yahoo! Messenger) to allow for a more decentralized loan decision-making process. Loan officers use e-mail to send loan forms to credit committee members. Loan offices then use Yahoo! Messenger to present and discuss clients' loan applications to other loan officers and the regional manager. The transcript of the online discussion is saved and attached to the minutes of the regional credit committees. This process, which was implemented in mid-2005, has resulted in cost reduction, shortened loan processing/loan disbursement time, and has facilitated the work of the internal audit department.

ADMINISTRATION

In 2006, CHF-Express Finance began the process of transferring its loan portfolio management from an Excel-based system to Web Abacus, a system developed by CHF International. This system will permit CHF-Express Finance to receive real-time data and reports for multiple funds, products, branches, and users, thereby improving decision-making ability; track the loan approval process; standardize reporting; and consolidate data for entire portfolio.

CHF-Express Finance has a formal and comprehensive system of internal controls in place to prevent corruption and misuse of funds. Two internal auditors work for the institution, checking on whether the institution's procedures are applied correctly, focusing primarily on credit policies. Internal auditors visit each office at least once a year. On a monthly basis, they randomly select between three and five loan applications per site for review. The internal auditors report to the Board.

In addition to regular and routine internal audits, twice per year CHF-Express Finance hires a reputable audit company to conduct an external audit.

FINANCIAL MANAGEMENT

Reliable information is available for assessing the institution's current financial position. Express Finance regularly and routinely generates financial reports used in management decision-making, particularly for budgeting and liquidity management purposes. Financial statements present an accurate picture of the institution and are audited by external auditors each year.

Since 2001, CHF-Express Finance management has tracked the credit program's operational and financial self-sufficiency. The program, as indicated in the table below, is performing well and is approaching full operational and financial self-sufficiency. Asset quality is high, with portfolio at risk at 90 days at less than one percent.

CHF-EXPRESS FINANCE'S PERFORMANCE INDICATORS FROM 2003 TO 2007

Performance Indicator	2003	2004	2005	2006	March 2007
No. of Active Borrowers	924	1,839	2,265	2,393	2256
Portfolio Outstanding ($)	4,099,710	5,098,604	8,047,350	9,378,680	11,979,519
Operational Self-Sufficiency	75.1 %	82.5 %	114.3 %	80.6 %	104.81 %
Financial Self-Sufficiency	53.0 %	61.9 %	93.2 %	67.9 %	90.37 %
Portfolio at Risk (greater than 30 days)	1.66 %	1.7%	1.22 %	1.64 %	0.99 %

(From CHF audited and internal reports, using end of year figures as of September 30.)

FINANCING

A major challenge for CHF-Express Finance is finding sufficient and affordable capital to serve its target market's needs and support its growth. To date, CHF-Express Finance has proven successful at accessing significant amounts of capital from various sources. Future funding possibilities include EBRD, CitiGroup, and Symbiotics.

CHF-Express Finance recognizes its need to improve its equity position. It is expected that USAID will approve the disposition of the flood funds to Express Finance. CHF International will then withdraw this debt from Express Finance and give the funds to Express Finance as an equity investment. The institution would benefit from attracting funding from sources, which allow flexibility in the use and pricing of funds, which would help the organization in its path to full financial sustainability.

CONCLUSION

The future for CHF-Express Finance looks good. The institution is led by a capable and committed Romanian management team and possesses an active but non-intrusive Board. It has in place appropriate and robust financial management and risk management practices and procedures. The institution has attained impressive geographic reach. It manages 17 branch offices covering 25 counties, which represents more than 60 percent of the country.

The portfolio is performing well. The portfolio has grown from 831 active borrowers in 2003 to 2,256 in March 2007. Portfolio outstanding as of March 2007 was near $12,000,000. Since inception, CHF-Express Finance has disbursed more than 12,500 loans, worth approximately $50,000,000. CHF-Express Finance is on the path to operational and financial sustainability. Asset quality, as indicated by portfolio at risk, is high. Portfolio at risk at 30 days is less than one percent.

The institution is well on its way to full financial sustainability and needs to continue to make institutional and cultural adjustments in order to achieve this goal.

CHF-Express Finance is well-regarded within the marketplace and demand for the institution’s products is high. Although portfolio growth is limited by the institution’s access to affordable capital, CHF-Express Finance has proven to be effective at raising funds from various sources. The management recognizes its need to improve its equity position and, at present, is pursuing different options.

ANNEX 6: CENTER FOR ENTREPRENEURSHIP AND EXECUTIVE DEVELOPMENT (CEED) INSTITUTIONAL ASSESSMENT

This institutional assessment is not intended to be an in-depth analysis on the institution's strengths, weaknesses, opportunities and threats. It is not the assessors' aim to make recommendations to the Center for Entrepreneurship and Executive Development (CEED) for improvement. Instead, it is the assessors' goal to understand the legacy that will remain after USAID's departure and to highlight lessons learned from CEED and RFLD's successful experience improving Romanian rural and agricultural enterprises' access to finance in Romania and the role USAID has played. This assessment focuses on CEED's: organizational structure; human resource management; board management issues; services, market, and clientele; administration; financing; and financial management.

ORGANIZATIONAL HISTORY AND STRUCTURE

CEED is a Romanian foundation legally established in August 2006, with SEAF-TBRF as the sole founder. CEED's mandate is to provide entrepreneurs and executives of SMEs access to effective business training unavailable on the local market. It is CEED's belief that with access to such training, SME managers will not only build their skills but will improve their networks and consequently grow their businesses in the region.

CEED is a project funded by USAID Washington and USAID Romania offices and is viewed as a legacy business development institution of USAID. In 2006, CEED partnered with the Rural Finance Leader Development program (RFLD) to continue USAID's support to rural consultants and rural and agricultural enterprises and build synergies among different USAID programs.

When RFLD closed on September 30, 2007, CEED committed to continue the support of rural and agricultural enterprises in Romania using the approach and tools developed by RFLD.

HUMAN RESOURCE MANAGEMENT

CEED is led by a capable and well-regarded Romanian professional, Cristina Manescu, as Executive Director. Ms. Manescu managed the agreement between CEED and USDA aimed to provide project management, as well as administrative and specialized support for RFLD. During focus group sessions and other meetings, interviewees expressed complimentary opinions of Ms. Manescu, citing the good work she did under RFLD.

BOARD MANAGEMENT

CEED possesses both a Board of Directors and an Advisory Board, both of which play an active role in the management of the organization. The Board of Directors is composed of three individuals, who serve for a three-year term and are appointed by SEAF-TBF. Two members are senior employees of SEAF-TBF. The third is Cristina Manescu, the CEED Executive Director.

The Advisory Board, composed of three to nine members, is appointed by the Board of Directors and serves for three years. It is the role of the Advisory Board to: guide the activities of CEED; inform CEED about economic and social trends; and facilitate communication with administrative authorities, financial institutions, NGOs, and international organizations. The Advisory Board meets bi-annually. The current Advisory Board ensures the full support of the US Embassy and USAID mission to CEED activities.

SERVICES, MARKET, AND CLIENTELE

The creation of CEED was demand-led as the response to a SEAF study concluded that the demand for high quality business training for regional SME executives and mid-level managers was not being met by the local market. CEED's service offerings are designed to meet this market gap. These services include: 1) business networking opportunities; 2) business training; 3) access to regional markets; and 4) assistance accessing/absorbing EU funds.

ADMINISTRATION

CEED's operations and administration have benefited greatly from SEAF's experience in the region. For more than 16 years, SEAF has operated investment funds in the region and around the world, and starting early 2005 is managing the CEED regional network with successful centers in Bulgaria, Slovenia, Montenegro, and Macedonia.

FINANCIAL SUSTAINABILITY

CEED operates under a small $600,000 budget at the present time. At the closeout of all TBRF investments, funds will be returned to shareholders and a portion of returns will be provided to CEED to fund ongoing activities. This is expected to be received at the end of 2008. Until that time CEED will continue to operate with low overhead costs, using a network of consultants, to provide training and technical assistance on a financial sustainable basis. Management has good ideas and plans in place to cover costs and pursue additional funding.

CONCLUSION

CEED is well-positioned to serve as USAID's legacy in Romania and continue the activities started under RFLD. The Center is managed by highly competent and well-regarded staff and has benefited greatly from its connection to SEAF.

Because the transfer of responsibility from RFLD is relatively recent, many RFLD stakeholders and clients (whether they be government, consultants or enterprises) are unaware that CEED is continuing RFLD activities. There is an opportunity for CEED to use the good name of RFLD to market its rural development activities.

ANNEX 7: CASE STUDY POLICOLOR

BUSINESS SUMMARY

With 40 years of experience in the varnish and paint market in Romania, Policolor is the largest Romanian manufacturer in the field. Between 1965 and 1990, the state-owned Varnish and Paint Enterprise Bucharest, as it was initially called, was one of the most important suppliers of the national automotive, furniture and electronics industries.

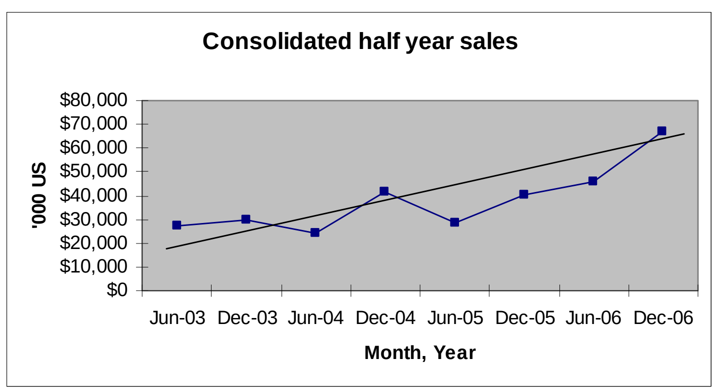
Beginning in 1990, the year when the Varnish and Paint Enterprise was transformed into a joint stock company under the name of Policolor S. A., its brands gained recognition in different market segments due to their quality and as the result of complex marketing strategies.

RAEF INVESTMENT

In 1997, Policolor's shares began trading on the first tier of the Bucharest Stock Exchange. After that year, the company benefited from important investments, including the investment made by RAEF, which were received mainly during the privatization process. Since that time, RAEF has played an active role on the board of directors of the firm, encouraging market expansion and product quality improvements. The investments were used to modernize the factories and the production capacities. RAEF currently is a minority shareholder with 33 percent ownership. The Romanian Investment Fund Cyprus Ltd owns 44 percent and Romanian Reconstruction (Cyprus) Limited and Citibank Romania own the rest.

In 1998 Policolor acquired Orgachim, based in Bulgaria, in a privatization tender becoming the first Romanian company involved in a major trans-border acquisition process. RAEF was instrumental in arranging the leveraged buy-out of Orgachim, and attracted a local bank to finance the acquisition. The financing and cross border acquisition were the first of their kind in Romania.

DEVELOPMENT HIGHLIGHTS

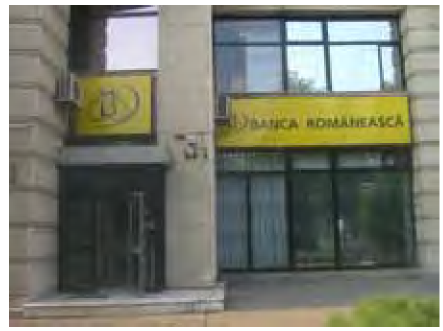


Today, Policolor is a fully certified company meeting ISO 9000 domestic and EU requirements, and is one of the few companies producing ecological products. Over the last three years, Policolor has seen continuous growth of sales at an average rate of 27 percent per year.

Market demand for paints and varnishes is growing in Romania. The company has 42 percent of the domestic market share and is a major supplier to industries such as civil and industrial construction, furniture, automotive, machine building, shipping, electric and electronic manufacturing, and household goods. The strategy of the group is to reach the leading position in the coatings and resins market in Southeast Europe by becoming stronger domestically and by pursuing export opportunities to the Middle East and Russia.

ANNEX 8: BANCA ROMANEASCA S.A. CASE STUDY

BACKGROUND

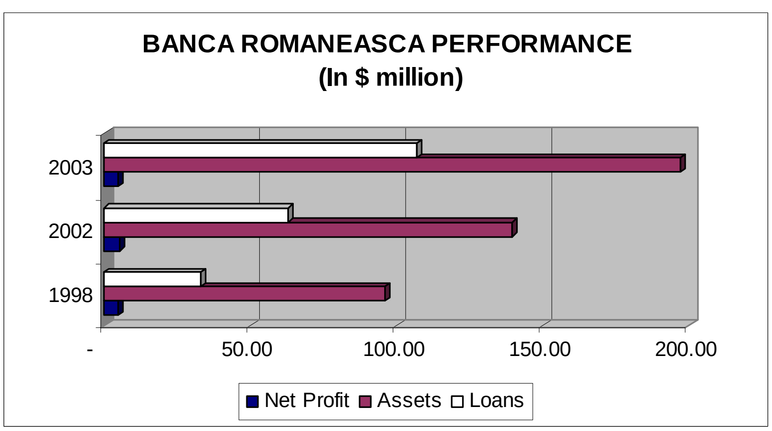


Banca Romaneasca, one of the first Romanian private banks, was established in 1993 with seed capital of approximately a little over $833,000. In 1998, Romanian-American Enterprise Fund worked with Banca Romaneasca to implement the Small Lending Program. Shorebank Advisory Services provided technical advisory services in SME lending and the International Finance Corporation (IFC) provided loan funding in addition to RAEF's funds. As a result of this assistance, Banca Romaneasca became the first SME lender using cash flow analysis to make credit decisions.

RAEF INVESTMENT

In 1998, RAEF acquired Banca Romaneasca (BR), a bank with the right scale and locations to provide a basis for business lending to small and medium enterprises. Using a technical assistance provider, RAEF trained BR staff in cash flow lending techniques and expanded the bank's branch network. The bank was sold in 2003 to the National Bank of Greece at the highest multiple achieved to date in Romania. Under RAEF's management, the bank substantially increased its assets, equity and loan activity. Its branch network grew to a national scale. BR established its reputation as a key bank for the small and medium enterprise sector in Romania.

> "The Fund's [RAEF's] contribution has been more than financial. They have delivered foreign banking expertise and progressive management practices. It puts us to be the undisputed market leader serving SME"
>
> *– Petru Rares, former Chairman Banca Romaneasca*



DEVELOPMENT HIGHLIGHTS

Immediately after acquisition, RAEF initiated the bank reorganization process, putting in place a strong and experienced management team. The bank prepared its first real business plan, introduced corporate governance and customer relationship management, strengthened the sales departments, and implemented a training program. The bank developed new consumer lending products, serving as the first bank in Romania to lend to individuals and starting consumer credit in the country.

Banca Romaneasca expanded its loan program to eight counties in Romania. More than 600 jobs were created as a result of loans made to SMEs. Banca Romaneasca became the exclusive distributor of the RAEF's small loan program through its 12-branch network, with the bank using its own capital to invest up to one third of the amount of each loan. Other funds were borrowed from the IFC. From 1998 to 2003 the value of outstanding loans grew from 26 percent to 40 percent of total assets. In October of 2001, Banca Romaneasca was recognized in the local business press as the most dynamic bank for small and medium enterprises in Romania.

RAEF's exit from the bank was the result of a carefully executed growth plan that saw in excess of five fold increases in assets, equity, and loan activity from 1998 to the time of the sale.

ANNEX 9: TELEZIMEX CASE STUDY

BACKGROUND

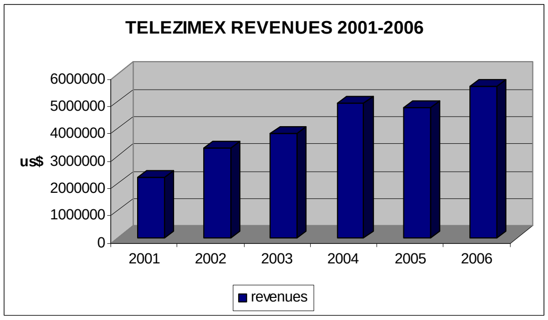
Telezimex SRL, based in Cluj Napoca, is a company that imports and distributes electronic components; provides after-sale and repair services; and manufactures small furniture for export. During the start-up phase of the business, Telezimex acted as a one-stop shop for assemblers (manufacturers, repair workshops, and specialty clients), selling a wide range of imported and self-manufactured products. Telezimex worked out of expensive rented space, which limited business growth and expansion. The company needed investment funds to grow. At that time, however, the president and entrepreneur, Mr. Zoltan Nagy, was unable to access appropriate and sufficient sources of funds in the market.

SEAF INVESTMENT

In 2001, SEAF–TBRF invested in Telezimex, supporting the business' expansion by providing it with the capital needed to purchase a plot of land (8,000 square meters) in Cluj Napoca, on which to build the Telezimex headquarters. SEAF has invested a total amount of $232,000 in both debt and equity.

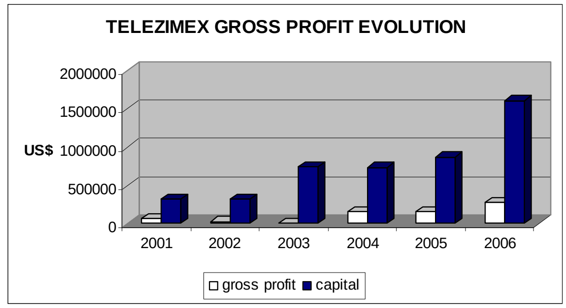
DEVELOPMENT HIGHLIGHTS

At present, the company manages its core business, the import and distribution of electronic components, from its headquarters in Cluj Napoca and has two branches, one in Bucharest and the other in Timisoara. It also sells components by mail and via resellers. Other business activities, including the repair service, manufacturing, and transportation, are managed by other subsidiaries. The graphs below illustrate the financial performance of Telezimex's core business only.



Telezimex completed a complex reorganization to better focus on clients and to increase the operational efficiency as well as to make the organization more customer-relationship based. The SEAF-TBRF team helped the management to develop short-term financial planning skills, and the company is now using a more accurate forecasting model. Also, the SEAF-TBRF team provided Telezimex with assistance in developing the new organizational chart.

Employees: The decrease in the number of employees at Telezimex, from 125 in year 2001 to 77 in 2006, is largely due to the company's reorganization. The employees involved in non-core business activities have been transferred to the new subsidiaries. The business reorganization process improved the efficiency of the core business activities by reducing operational expenses and by shifting employees to the newly-created self-sustainable subsidiaries. The company aims to improve employee productivity by providing on-the-job training and subsidizing employees' continuing education costs. Telezimex provides non-salary benefits, such as meal tickets, a mobile phone allowance, and health insurance, and promotes the professional development of its staff.



Social impact: The SEAF- TBRF investment in Telezimex has had an effect on the development of the community as well, especially through the creation of employment opportunities. Mr. Zoltan relocated one of the subsidiary businesses, the small furniture manufacturer, to his hometown in the North-West Region of Romania as a way to create employment and to improve the residents' quality of life. Furthermore, Telezimex management and employees are often involved in charity and other social development programs in the areas in which they work.

EXPANDING THE BUSINESS: CASA REAL ESTATE AND CASA REAL ESTATE INVESTMENT

The SEAF-TBRF exit of the Telezimex investment was a buy-back of shares by the initial shareholders after the repayment of the convertible loan in 2006. The high-yield loan, which brought an overall return in excess of 28 percent per year to SEAF-TBRF was initially planned to be repaid starting mid-2005. Telezimex's positive experience with SEAF-TBRF led the owner to apply for a postponement of the repayment and to instead start a new project with SEAF TBRF. At the time Telezimex had a plot of land in excess of company's needs for its core business, which it contributed to a real estate development project called Casa Real Estate, consisting of 12 houses. SEAF-TBRF contributed to the project with $300,000 of equity and loan financing.

Based on the success of the initial Casa Real Estate Project Zoltan Nagy proposed to extend the Casa Real Estate in a second, larger residential development. The project's potential was significant and it enjoyed the first mover advantage. With supplementary funds from TBRF of $1,500,000, Telezimex established a new company, called Casa Real Estate Investment, to invest in a residential complex consisting of 48 villas and condominium apartments, to meet the needs of the emerging middle class of Cluj Napoca. The expected return is about 25 percent. The real estate companies created 15 new jobs. During project implementation, the collaboration with more than 30 construction companies further contributed to local employment.

The SEAF–TBRF collaboration was very profitable for Telezimex. Telezimex received the needed financial support at the right moment in the business' development. Telezimex also greatly appreciated the technical advice and managerial support from SEAF-TBRF, which will have a lasting impact on the growth and expansion of the Telezimex group of companies.

ANNEX 10: CASE STUDY FROM CHF-EXPRESS FINANCE

Daniela Dosa is the owner of a publishing company in Petrosani, whose core customers are kindergartens located throughout Romania.

When GENERAL TEHNOART LTD. opened for business in 1998, Daniela was determined to build a viable business, even though her finances were limited. Although it was hard at first, she trusted her instincts, as company revenues increased steadily.

When it became apparent that additional commercial space was needed to grow the business, Daniela applied to CHF Romania for a $6,000 loan (16 percent, 24 months). The money was used to help purchase the company's new headquarters.

Daniela takes pride in the quality service she offers her customers. She plans to apply for another CHF loan to renovate the firm's headquarters and further expand her client base.

As a result of General Tehnoart Ltd.'s success, the economy of Petrosani has been strengthened by the creation of seven new jobs, many of them held by women. As business continues to flourish under Daniela's capable leadership, she plans to hire additional employees as business warrants.

Daniela Dosa is an example of a successful businessperson, one who wisely continues to reinvest in the company for its continued growth.