

# THE ACCESS TO FINANCE IN MOLDOVA - BANKING COMPARED TO MICROFINANCE ORGANIZATIONS

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## Abstract

The objective of this article is the comparative analysis of the banking sector with the non-bank sector of the Republic of Moldova, by the elucidation of the main trends of development of microfinance and banking institution in the last five years, as being reflected by the improvement of all indicators. In this article, the author analyses the microfinance institutions in Moldova through the financial soundness indicators (the degree of financial intermediation). In the first part of the article, the author analyses the main trends in the microfinance sector compared to the banking sector in recent years, requiring the implementation of an effective and coherent strategic management for banking and non- performing strategies and to maintain the financial stability through appropriate policies administration and risk management. A very suggestive remark about the author is the difficult access to finance in Moldova, representing a particular importance to any economy. In this context, the shocks arising from the financial and economic crisis have affected both credit supply and demand as well. Thus, the existence of appropriate strategic policy to minimize risk in a bank and microfinance institution, condition a management with a high level of professionalism and quality.

**Keywords:** microfinance organizations, non-bank institutions, commercial banks, Global Competitiveness Report, finance

**JEL Classification:** G15, G21, G23

## 1. Introduction

The difficult access to finance in Moldova serves as a current constraint on which collides the entire SME sector. The financial market in Moldova consists of banks and non-banks. The banking institutions are represented by 14 licensed commercial banks, which

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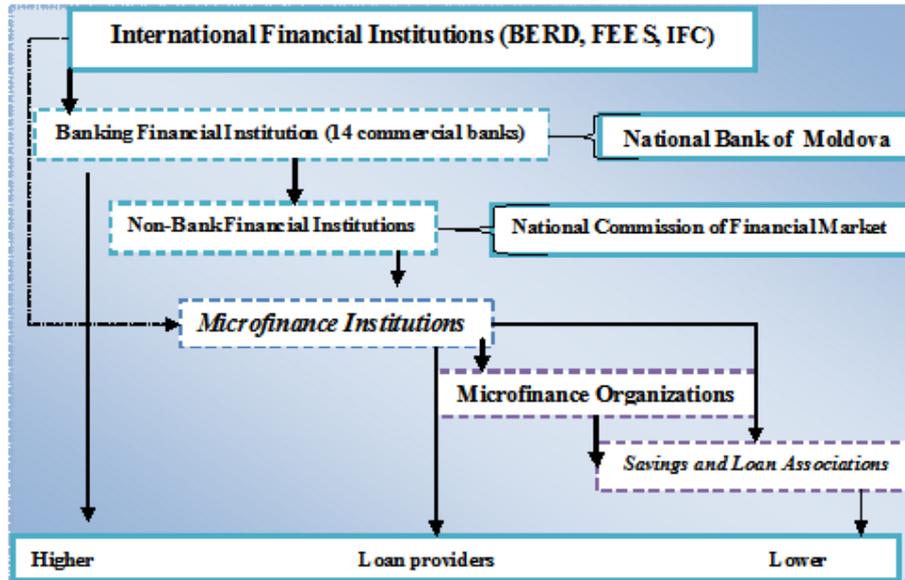
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are regulated by the National Bank and the non-bank sector consists of the central association, microfinance organizations and savings and loan associations. In turn, non-bank institutions are supervised and regulated by the National Commission of Financial Market (NCFM).

The microfinance institutions have developed as an alternative to the banking sector. Currently, the alternative for loans granted by commercial banks is the products offered by microfinance organizations. The goal of microfinance is to small business lending, mainly in rural areas, facilitating in this way, the access to cheap financial resources and stimulating private initiative. The microfinance institutions operates on the Law no. 280-XV from 22.07.2004 on Microfinance Organizations (hereinafter OMF) and allocate loans from its own resources/borrowed. The microfinance organizations opposed to savings and credit associations (SCAs) are entities engaged in lending activities with professional basis and do not accept deposits or other repayable funds to the public (members) (*The savings and loan associations Law no.139-XVI from 21.06.2007, Official Gazette of 03.08.2007 nr.112-116/506*). The microfinance institutions serve customers who do not have sufficient guarantees to obtain financing from banks or live in areas where banking services are not available.

In Figure 1 is elucidated the structure of micro financing system in Moldova. The potential credit providers may choose at least two lenders both banking and non-banking from (*The evaluation study of the microfinance market in Moldova (2013) available at: <http://www.cnpf.md/file/AEI/3.pdf>*).

Figure 1 - The structure of micro financing system in Moldova



Source: Prepared by the author according to the assessment of microfinance market in Moldova, available at: <http://www.cnpf.md/file/AEI/3.pdf>

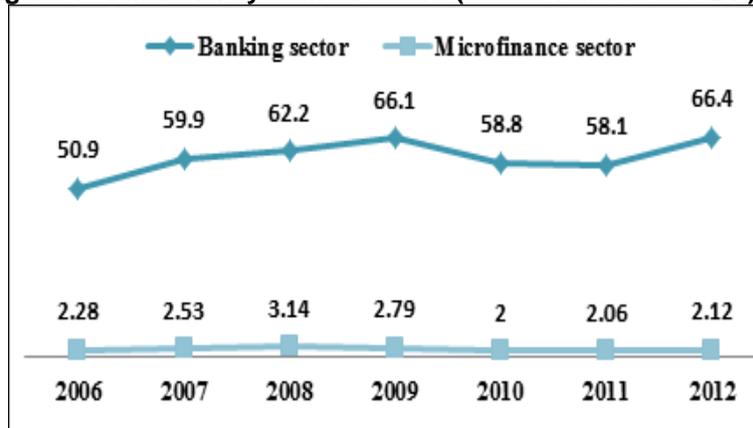
The banking system plays an important role in the economy as a whole of the Republic of Moldova, aimed at creating an efficient, functional and capable to provide a wide range of products and services to meet the requirements of all potential customers. As in any country both internationally and domestically, each country and also the Republic of Moldova is interested in creating an efficient banking system, which would ensure an appropriate organizational framework to develop financial mechanisms. Thus, by creating a competitive environment as appropriate, and maintaining financial stability, banks, through appropriate policies for administration and risk management, are necessary to implement an effective strategic management and consistent for the implementation of banking strategies.

Further, the author aims to assess the situation of the banking and microfinance sector through the main activity indicators that allow identifying risks, to remedy shortcomings in sectors and strengthen resilience to macroeconomic shocks.

## 2. Examining the issue of access to funding in Moldova

In 2012, the microfinance sector had total assets of 2227,4 million Moldavian Leu (OMF - 1892,9 million Moldavian Leu and AEI-334,5 million Moldavian Leu) and the banking sector had a heritage of 58304,4 million Moldavian Leu. The dominant position in the financial system is owned by the banking sector in 2012 the ratio of assets held by banks and GDP was 66,4 %, while for microfinance institutions, this indicator is only 2,12 %. After the 2009 crisis, the microfinance sector registered a recovery and slightly increased, so assets held by OMF to GDP in 2010-2012 period increased from 2% to 2,12 %. However, this increase represents a modest result and has a small weight in the economy and failed to reach the level before the crisis.

Figure 1 - Financial system structure (assets relative to GDP), %



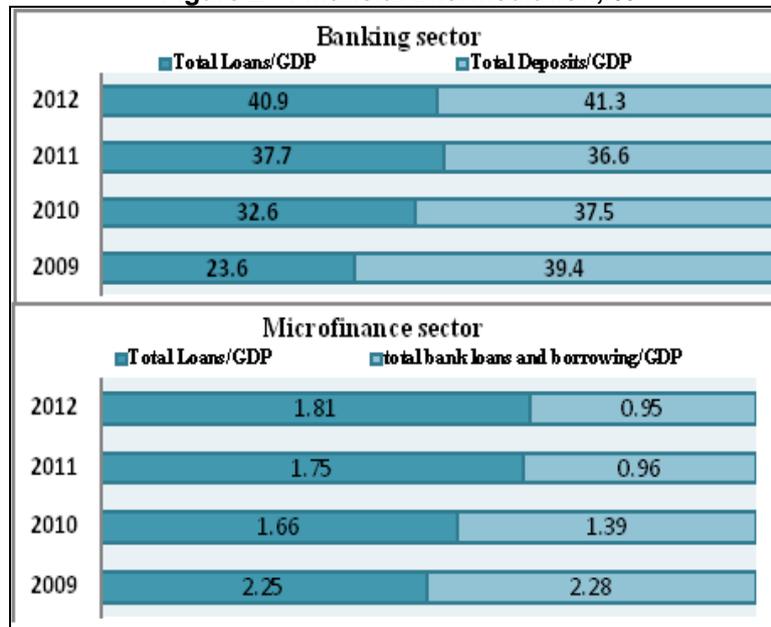
Source: Prepared by the author based on data from annual reports 2006-2012, NCFM, BNM

Analysing the degree of financial intermediation through the asset during the period 2006-2012, there is an increase in the banking sector in relation to GDP, with a slight deviation in 2008 and 2011. The bank assets relative to GDP increased from 50,9 % in 2006 to 66,4 % in 2012. Similar trends were recorded for microfinance organizations in relation to GDP. Thus, assets in relation to GDP increased from 2,28 % in 2006 to 3,14 % in 2008, and in 2012 this indicator decreased, reaching a level of 2,12%.

The consolidated value of the assets of microfinance organizations in 2012 increased by 3% compared to 2011. However, in 2011 there were decreases in assets by 5% compared to 2009,

due in large part to the influence of the global financial crisis. A steady increase in assets is evident in 2006-2008, developments increase mainly due to loans granted to customers, which have increased on average by 40 %. A portion of the assets of the institutions of OMF are placed temporarily in liquid assets such as cash accounts, securities, etc. At the same time, the banking sector recorded good performance in bank assets chapter, which increased to 31978,6 million Moldavian Leu in 2007 to 63516,2 million Moldavian Leu in the first half of 2013, was driven by strong growth in assets profits, and the largest share in total assets goes to the credit portfolio (62,3%) (Popa V, 2013).

**Figure 2 - Financial intermediation, %**



Source: Prepared by the author based on data from annual reports 2006-2012, NCFM, BNM

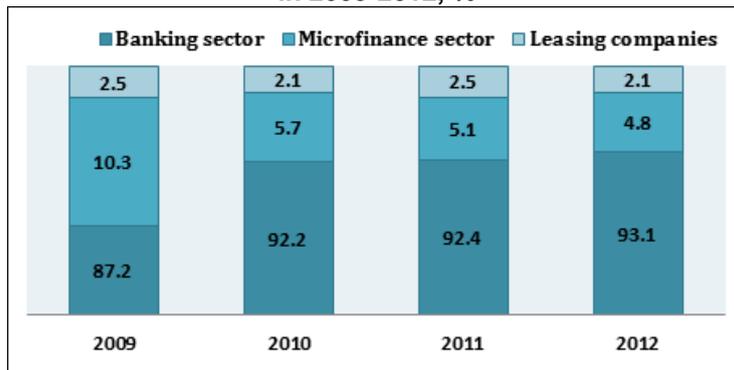
Another meaningful indicator reflecting the evolution in the banking sector are the loans granted by banks. During the period 2007-2012 this parameter increased continuously, except for 2009. In 2012, the volume of loans increased by 29,1 % from 2008 and the largest share of total loans granted to the private sector is 77,9 %. A positive and significant aspect for investment incentives are

increasing the share of long-term loans of one year (the end of 2012 this indicator was 70,7 % of total loans).

Although during the last years is registered a positive trend in the number and volume of loans granted by the banking system, small business enterprises continue to face difficulties in accessing finance. The 2012 year for the microfinance sector can be considered a recovery period, registering a growth of loans by 10% compared to 2011 and amounted to 1864 million Moldavian Leu (OMF - 1590,1 million Moldavian Leu and AEI - MDL 273,9 million Moldavian Leu). It is also necessary to highlight that the majority of loans granted to the small business subjects are resources from international financial institutions that grant credit lines to domestic commercial banks, the latter giving financial resources to the sector enterprises.

In 2012, the coverage level of lending activity by microfinance sector was 4,8 % and the banking sector (93 %).

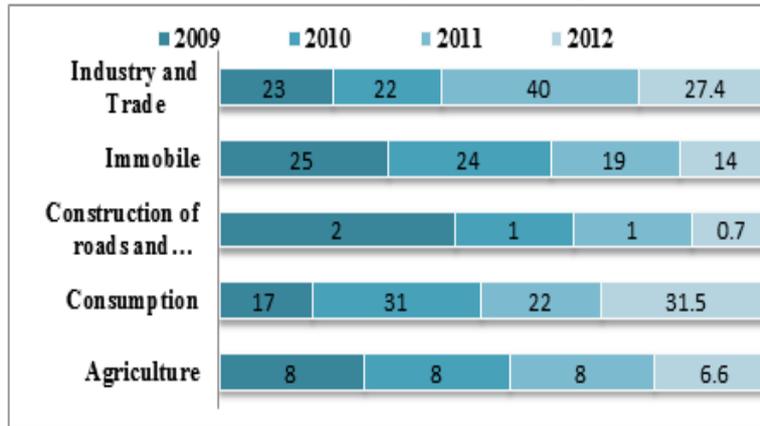
**Figure 3 - The share of the financing granted by banks and non-banks in 2009-2012, %**



Source: Prepared by the author based on data from annual reports 2006-2012, NCFM, NBM, NBS

An important feature highlighted in recent years is the relatively proportional dispersal of loans granted by the MOF on the whole spectrum of areas of the national economy. In 2012, the largest share of 31,5 % was represented by consumer loans, 27,4 % of loans were offered to industry and commerce, primarily micro, small and medium enterprises, and 14 % are loans to building. Loans of approximately 19,8 % were for "other purposes" and rose by 9,8 pp compared to 2011.

**Figure 4 - Classification of loans granted by OMF regarding the directions for use, in 2009-2012, %**



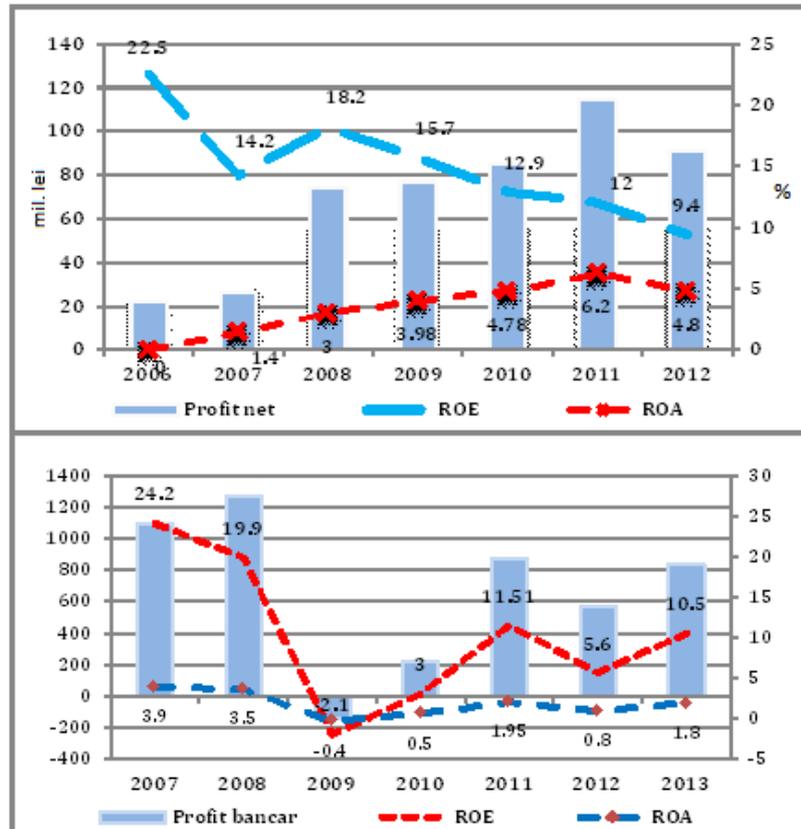
Source: Prepared by the author based on data from annual reports 2009-2012, NCFM

In Central and Eastern Europe, the average value of a loan granted by microfinance institutions is between 5,000 EUR and 5,200 EUR, while in Western countries, the average value of the loan goes up to 9,600 EUR, depending on the type of intervention and purpose of the loan.

However the problem of access to credit for Moldova remains one of the most important constraints for business. According to the Global Competitiveness Report, the issue of 2013-2014, this is the third issue of importance to local businessmen. Despite the ascent of 5 positions from the position indicated in the last report, Moldova ranked 104 of 189 countries included in this study, in terms of ease of access to credit (Stratan, A. and Septelici/Popa, V. 2012).

Despite the general situation, another important indicator reflecting the evolution of the banking sector is profit, which during the period 2007-2012 has witnessed a continuous growth, with the exception of 2009, when this indicator losses worth 145,5 million Moldavian Leu. In the first nine months of 2013, profits amounted to 838,6 million Moldavian Leu.

Figure 5 - Evolution of non-bank and bank profitability



Source: Prepared by the author based on data from annual reports 2006-2012, NCFM, NBM

The evolution of bank profitability shows that banks were able to increase the net income reported to assets reported to the share capital (ROE) of 6,2 pp in the first nine months of 2013, registering 10,5 % compared to 31.12.2012. With the increasing of shareholder capital and assets, the ROE and ROA increase shows that the net profit growth rate is much faster, which is quite encouraging. Within the microfinance system, the net income reported to the assets reported to the share capital is decreasing from 18,2 % in 2008 to 9,4 % in 2012. Respectively, the income of microfinance sector was 90,9 million MDL in 2012, decreasing by 21 % since 2011.

There are several factors that caused this fall: making new adjustments to some interest, developments in interest rates differ

from previous years, paying the income tax by microfinance organizations starting in 2012, the impact of new regulation on the methodology of calculating provisions.

During 2012, the most microfinance organizations have given more credit than they have received, such as ICS Prime Capital Ltd (291,62 million Moldavian Leu), OM Elat PROFIT (205,50 million Moldavian Leu), FCE Credit Fast Ltd (215,90 million Moldavian Leu) and "Rural Finance Corporation" JSC (198,33 million Moldavian Leu), etc. At the end of 2012 there were 21 losses in 60 microfinance organizations, including OMF Elat PROFIT (12,550 Moldavian Leu), etc. Among the organizations that have achieved positive results include: ICS Prime Capital - 40,8 million Moldavian Leu, ICS Credit Rapid SRL-24,3 million Moldavian Leu and the Rural Finance Corporation SA - 9,3 million Moldavian Leu.

**Table 1 - Concentration ratios of the banking and non-banking credit institutions, in 2011-2012, %**

No.	Name of bank / OMF	Market share on the assets value (%)		Market share by value of loans / borrowings (%)	
		2011	2012	2011	2012
<b>Banking sector</b>					
1	Victoriabank	17,1	17,4	16,3	17,5
2	Moldova-Agroindbank	19,5	19,6	21,6	21,7
3	Moldindconbank	14,2	14,7	15,4	16,8
4	Banca de Economii	12,4	11,4	9,7	6,5
5	Eximbank-Gruppo Veneto Banca	7,7	7,3	8,6	8,7
	<i>HHI (points)</i>	1211,1	1210,8	1264,0	1309,8
	<i>CR-4 (%)</i>	63,2	63,1	63	64,7
<b>Microfinance sector</b>					
1	I.M.O.M.F "Microinvest" S.R.L.	17,5	18,8	14,4	13,5
2	I.C.S. "Prime Capital" S.R.L.	17,3	16,6	20,0	18,3
3	"Corporatia de Finantare Rurala" S.A.	13,9	13,2	8,7	12,5
4	O.M.F. "Elat Profit" S.R.L.	11,9	10,5	16,0	12,9
5	I.C.S. "Credit Rapid" S.R.L.	11,6	11,6	14,5	13,6
	<i>HHI (points)</i>	1188,8	1161,6	1248	1132
	<i>CR-4 (%)</i>	60,6	60,2	65	58,3

Source: Calculations based on reports provided by commercial banks and OMF, 2011-2012

In 2012, the indicators that reflect the level of concentration in the banking sector by assets such as the Herfindahl-Hirschman Index (HHI) and the share of the first 4 banks on the market (CR-4) were

1210,8 points and 63,1 %, which is an area with a moderate concentration. To fall within the limits of a market with a moderate degree of concentration, the market concentration indices must fall within the following ranges: 35% <RC-4 <70%; 800 <HHI <1800. Although the indicators show a satisfactory degree of market concentration, the level of competition in the sector is moderate. In this respect, the high share is held by the top five banks, e.g. 70 % of the banking market assets and the total loans granted.

The concentration degree on microfinance market remains high, although there is a steady improvement in this indicator. This trend is explained by the increasing competition in this market, which leads to the balancing weights that is held by the sector operators. In 2012, 45,4 % of loans were granted to the three microfinance companies (Prime Capital, MicroInvest, Credit Fast) (Popa V.2013).

### **3. Conclusion**

Much of microfinance institutions are regulated and monitored as the commercial banks by the same standards of client review for granting credit. Consequently, the legislation regarding the consumer protection and the legislation on mortgage refers equally to banks and microfinance institutions. Also, according to the legislation that refers to the money laundering combat, as well as banks, the institutions are required to report suspicious transactions and those with cash that exceeds certain limits. In assessing portfolio quality, the formation of provisions, the classification of loans, the microfinance institutions are following banking standards.

The most important **advantages of microfinance institutions** compared to banking institutions are:

- The rapidity of processing the file, the affordability of services by reducing the number of acts and the flexible repayment schedule with a strong logistic support and taking a greater risk;
- Serving persons conducting entrepreneurial activity at the early stage and self-employed persons, customers without salary certificate.

In addition to the positive trends analysed, the **microfinance sector** is facing a number of problems that prevent its continuous development. Thus, the main constraints identified are listed:

- Imperfect legal framework,

- A weak system of risk management because of bad management,
- Lack of supervision by NCFM leads to unfair competition
- Poor product diversification offered by SCA;
- Lack of information about the history of lending to beneficiaries lead to increased risk for lenders;
- High interest rates;
- Risks assumed by the *reimbursement*, given the lack of a short-term mortgage loans.

The evolution of the microfinance sector shows that, although it has reduced proportion in the country's economy, compared to the banking sector, the radius of coverage is very extensive, offering complementary credit services to banking sector available to small and medium enterprises throughout the country.

Accordingly, the financial sector requires resolving deficiencies by recommending the following proposals:

- Improving legislation on microfinance organizations and legislation looking at commercial banks insolvency;
- Training and capacity development of the microfinance sector through continuing professional education;
- A well-functioning bureaus with credit history and imposing requirements for microfinance institutions to disclose information about customers;
- Improving the quality and diversification of banking and non-banking services through greater transparency;
- Proper management (capping) of banking and non-bank lending;
- Developing a Good Practice Guide for the provision of microcredit in Moldova (eg European Code of Good Practice 2013);
- Improved performance management in each commercial banks and microfinance institutions.

In the context of the above mentioned, **we conclude that an important pillar in the development and strengthening of bank and non-bank financial institutions is Moldova's geographical situation that would allow boosting the future of financial intermediation between East and West, in the perspective of integration of the Republic of Moldova in the European Union. Thus, in terms of European integration, it is appropriate to**

**promote public confidence in the banking and non-banking sector by providing a stable and transparent economic environment.**

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