Competitiveness and Private Sector Development

REPUBLIC OF MOLDOVA

FOSTERING SME DEVELOPMENT

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Foreword

Small and medium-sized enterprises (SME) are an important component of the Republic of Moldova's economy, representing 98% of all businesses in the country and 59% of employment. Within the SME sector, although the economic and social role of micro-companies is essential – they make up 76% of all SMEs – enterprises in the small and medium-sized segments tend to be larger contributors to employment and economic growth. In the post-economic crisis period, the challenge for policy makers in the country will thus be to support the development of these micro-businesses while at the same time strengthening the competitiveness of "larger" SMEs. The effectiveness of this policy will determine the success of economic recovery. In this context, the report provides a detailed assessment and benchmarking of critical policy settings and institutional conditions that shape the environment for SMEs in the Republic of Moldova.

This report was carried out within the framework of a three-year project that aims to improve the quality and effectiveness of government policies towards SMEs and to increase the capacity of central government institutions in charge of SME policy elaboration and implementation in the Republic of Moldova. The project is jointly conducted by the OECD Private Sector Development Division, the Ministry of Economy of the Republic of Moldova and the Moldovan Organization for Small and Medium-sized Enterprises Sector Development (ODIMM) and is supported by a grant from the Government of the Netherlands.

This study is one among a number of studies and advisory projects on SME policy undertaken by the OECD Private Sector Development Division. In particular, assessments of SME policy in South East Europe and in the Middle East and North Africa have been conducted by the OECD since 2007. Two regional assessments will be launched in 2011, one in South East Europe and Turkey and the other in countries of the European Eastern Partnership. These projects will provide a regional perspective on the elements already highlighted in this report.

We believe that this work will contribute to ongoing policy debate and will provide useful information for the government and stakeholders with the aim of developing a balanced and effective SME policy in the Republic of Moldova. We also hope that a wide consensus will emerge on the priorities and direction of SME policy from the various debates within the government and through consultation processes. For the next phase of this project, the OECD is ready to work with the Government of the Republic of Moldova and stakeholders to identify suitable and effective public policy tools to address these priorities.

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Acknowledgments

The following report presents the findings of an assessment that was undertaken in the Republic of Moldova between March 2010 and December 2010. This work is part of a project to support the development of micro, small and medium-sized enterprises in the Republic of Moldova conducted by the OECD with the financial support of the Ministry for Development Co-operation of the Government of the Netherlands. As part of its review, the OECD team conducted several missions to the Republic of Moldova to review findings and to conduct interviews with government officials, representatives of public authorities and of the private sector and with international organisations.

Antonio Fanelli, Deputy Head of the Private Sector Development Division, is in charge of the overall project implementation. The report was co-ordinated by Nicolas Philiponnet, policy analyst in the OECD Private Sector Development Division. The principal authors of the report are Antonio Fanelli, Nicolas Philiponnet, Lotte Van Mechelen and Jakob Fexer.

The supporting documents provided by the government and independent experts in the Republic of Moldova have been central to this assessment. We are thankful to ODIMM and its director general, Iulia Iabanji, and to the consultancy Business Intelligence Services and its director, Andrei Chitanu, for their essential contributions to this report. Special thanks are due to the staff of ODIMM, in particular to Olga Melniciuc, Marina Lapusneanu and Oxana Ungureanu, for their sustained support throughout the preparation of the report.

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This report has benefited from extensive comments and feedback from Nicola Ehlerman-Cache, Marina Cernov, Barrie Hebb, Sara Sultan and Alan Paic from the Private Sector Development Division of the OECD. The report was also reviewed by Marco Marchese, economist in the Centre for Entrepreneurship (LEED division) of the OECD. Additional comments were provided by experts from the Enlargement and South Eastern Europe Department of the European Training Foundation, which is headed by Arjen Vos.

The report was prepared for publication by Nicolas Philiponnet, Lotte Van Mechelen, Vanessa Vallée and Edward Smiley.

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Abbreviations

ALB	Albania
ARM	Armenia
AZE	Azerbaijan
BGR	Bulgaria
BIH	Bosnia and Herzegovina
BLR	Belarus
HRV	Croatia
MKD	Former Yugoslav Republic of Macedonia
MDA	Republic of Moldova
MNE	Montenegro
ROU	Romania
SRB	Serbia
UKR	Ukraine
XK	Kosovo under UNSCR 1244/99
2KR	Moldovan-Japanese Grant Assistance for Underprivileged Farmers
AGEPI	State Agency on Intellectual Property of the Republic of Moldova
AITT	Agency for Innovation and Technology Transfer
ANOFM	Employment Agency of Moldova
ASM	Academy of Sciences of Moldova
BEEPS	Business Environment and Enterprise Performance Survey
CAECP	Accreditation enter in the Field of Products Conformity Assessment
CCI	Chamber of Commerce and Industry
CEFTA	Central European Free Trade Agreement 2006[1]
CEN	European Committee for Standardization
CENELEC	European Committee for Electrotechnical Standardization
CIS	Commonwealth of Independent States
CNAA	National Council for Accreditation and Attestation
CNPF	National Commission of Financial Market
CORDIS	Community Research and Development Information Service
EA	European Co-operation for Accreditation
EBRD	European Bank for Reconstruction and Development
EC	European Commission
EIB	European Investment Bank
EP	Eastern Partnership[2]
EPO	European Patent Office
ETF	European Training Foundation
EU	European Union
FDI	Foreign direct investment

FIA	Foreign Investors Association
GDP	Gross domestic product
GIZ	Gesellschaft für Internationale Zusammenarbeit
GNI	Gross national income
GOST	Gosudarstvennyy standart or state standard
IAS	International accounting standards
ICT	Information and communication technology
IDA	International Development Association (World Bank)
IDSI	Institute for the Development of the Information Society
IFC	International Finance Corporation (World Bank)
IFRS	International Financial Reporting Standards
ILAC	International Laboratory Accreditation Cooperation
IMF	International Monetary Fund
IPR	Intellectual property rights
IRI	Investment Reform Index, OECD
IT	Information technology
JNPGA	Japanese Non-Project Grant Aid
LFS	Labour Force Survey
MFI	Microfinance institution
MIEPO	Moldovan Investment and Export Promotion Organization
MNE	Multinational enterprise
NBS	National Bureau of Statistics
NGO	Non-governmental organisation
NISM	National Institute for Standardization and Metrology
NPL	Non-performing loan
ODIMM	Moldovan Organisation for Small and Medium-sized Enterprises Sector Development
R&D	Research and development
RIA	Regulatory impact analysis
SBA	Small Business Act
SBIR	Small business innovation research
SCA	Savings and credit association
SEE	South East Europe
SME	Small and medium-sized enterprises
SNA	Skill needs analysis
SPS	Sanitary and phytosanitary standards
SSR	Soviet Socialist Republic
TNA	Training needs analysis
UNSCR	United Nations Security Council Resolution
USAID	United States Agency for International Development
USPTO	United States Patent and Trademark Office
VET	Vocational education and training
WDI	World Development Indicators
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

Notes

1. CEFTA parties include Albania, Bosnia and Herzegovina, Croatia, the former Yugoslav Republic of Macedonia, the Republic of Moldova, Montenegro, Serbia and UNMIK/Kosovo.
2. The Eastern Partnership is an initiative launched by the European Union to strengthen its ties with economies in Eastern Europe. It includes Armenia, Azerbaijan, Belarus, Georgia, the Republic of Moldova and Ukraine.

Executive Summary

Over the last five years, small and medium-sized enterprises (SMEs)[1] have expanded their role as main employment generators. SMEs represent 59% of employment in 2009 compared to 55% in 2005. This trend has been fueled, up to the end of 2007, by a high rate of enterprise creation, with an average enterprise birth rate of 22% over the period.[2] In 2009, while the economy contracted by 6.5% in real term compared to 2008 (World Bank, 2010a), SMEs experienced a less severe downturn than large enterprises, both in terms of employment and in turnover. As the country recovers from the impact of the global financial crisis, improvement of the productivity of SMEs could contribute to foster a new wave of economic expansion in the country. In order to benefit from this potential, reforms need to be made to improve the business environment and help SMEs cope with specific obstacles to their development. In the European Union (EU), the need to further develop the contribution of SMEs and entrepreneurs to the establishment of a competitive and dynamic economy has translated into the adoption of a "Small Business Act", which provides recommendations and guidelines for best practices in SME policy (European Commission, 2008a). In the Republic of Moldova, although a number of positive reforms and programmes have been established, further efforts need to be made to promote the competitiveness of SMEs. The State Programme for Supporting SME Development in the Republic of Moldova will come to an end in 2011 and a new strategy will need to be developed. This will provide an opportunity for the government to reorient its SME policy to reflect international best practices and to address the main policy barriers that limit the development of small businesses.

The challenge of economic reform

The Republic of Moldova has a relatively small and open economy. With a gross domestic product (GDP) of EUR 3.9 billion in 2009, the economy represents only a fraction of that of its immediate neighbours. Furthermore, GDP per capita in the Republic of Moldova is clearly below that of other South East Europe countries and is lower than in most markets in the Commonwealth of Independent States (CIS). The country's openness to trade is confirmed by the ratio of the sum of total value of imports and exports over GDP (134% in 2008), which is high compared to its neighbours (86% for Albania, 131% for the former Yugoslav Republic of Macedonia in 2008) (World Bank, 2010a).

The geographical position of the Republic of Moldova – a landlocked economy with limited access to natural resources besides arable land – has contributed to its relatively modest economic performance. In this context, the economy is primarily driven by trade in agricultural products and basic manufacturing, in particular textiles, and by rising domestic consumption financed by the flow of remittances from emigrants. These remittances are a vital source of finance for the economy, representing 22% of GDP in 2009 (World Bank, 2010a).

The first phase of the transition process in the Republic of Moldova from a centrally planned to a market-based economy led to a contraction of GDP by 64% between 1990 and 1999 (World Bank, 2010a). This was followed by a period of economic recovery, which accelerated considerably as of 2005, particularly in the non-tradable sectors (*e.g.* retail, construction, finance). A number of economic reforms – aiming at stabilising macroeconomic conditions and improving the legislative and regulatory framework – were implemented, resulting in deep changes in the structure of the economy. In the past few years, however, the economic reform process has stalled due the lack of political stability. Furthermore, in several areas, although positive measures have been developed, the dearth of financial resources and the limited capacity of key institutions have been a primary constraints to the effective implementation of economic reforms. This situation leaves an important role to the donor community. Indeed, the main projects in the field of economic reform have been conducted with the strong support of the international community.

As the political tensions that marked most of 2010 seem to abate, policy makers need to develop strategies to confront the challenges facing the economy and ensure sustainable economic growth.

The role of the SME sector

Based on the various registries for companies (although uncertainties exist as to the actual number of micro-companies and sole entrepreneurs), it is estimated that at least 65 000 SMEs operate in the Republic of Moldova, as compared to only 975 companies considered to be "large"[1] by the National Bureau of Statistics (NBS). Data provided by the NBS, which does not cover sole entrepreneurs and tends to under-report micro-enterprise activities, shows that SMEs make up 57.6% of employment and 41.6% of the enterprise sector turnover. Micro-companies[1] represent 76% of companies in the SME sector. These companies tend to operate predominantly in labour-intensive sectors such as retail, construction, agriculture and manufacturing. Moreover, most of these companies are concentrated in the Chisinau municipality, which concentrates 68% of total turnover and over 50% of employment in the SME sector.

The performance and population of the SME sector are closely linked to economic cycles and to the situation of large companies. Between 2005 and 2008, the economy experienced a steady pace of economic growth. During this period, turnover increased by 54.1% and the profitability of SMEs increased significantly (profit margins on turnover increased from 2.6% in 2005 to 8.4% in 2008). During the same period, the restructuring of large and medium-sized companies led to a reduction of employment in these segments. In 2009, the impact of the financial crisis accentuated this phenomenon. The difficulties faced by medium and large companies, as well as new opportunities, in particular in the service sector, contributed in a high level of enterprise creation. In particular, despite the crisis, the micro-enterprises segment continued to expand in 2009, both in terms of number of companies and in employment.

Within the SME sector, the micro-company segment has developed much faster than the medium-sized segment. Between 2005 and 2009, employment in the micro-enterprises segment grew by 26%, while the number of jobs in medium-sized companies contracted by 21%. While these developments show a healthy rate of entrepreneurial activity, the rising share of micro-enterprises may also be a sign of an increasingly subsistence-led economy. Medium-sized companies are more likely to engage in innovative activities and export their products, driving an increase in the productivity and competitiveness of the economy. However, they are also more sensitive to an adverse business environment as they are more likely to use external sources of finance and to engage in cross-border trade. While SME policy needs to take into account the very important social role of micro-enterprises, reforms must also help companies in the medium-sized segment improve their contribution to wider economic development.

The way forward: Priorities for SME policy reform in the Republic of Moldova

In February 2009, the Government of Moldova adopted a State Programme for Supporting SME Development (herein the "SME Programme") covering the 2009-11 period. This programme will need to be revised and updated to prepare for its following phase. For this next phase, the government should move from defining a three-year indicative programme, as achieved for the 2009-11 period, to a medium-term strategic programme elaborated with the active participation of stakeholders in the SME policy community. The programme should be comprehensive and well-articulated, covering horizontal and targeted policy issues covering entrepreneurship, enterprise creation and enterprise development and support. It should include concrete plans to enhance and conduct policy dialogue, to structure inter-ministerial policy co-ordination and to monitor policy implementation and evaluate policy impact. This report highlights a number of areas, listed below, where policy intervention is critical for medium-term SME development in the Republic of Moldova.

Adapting economic policy design to the needs of companies

Until recently, the Republic of Moldova performed poorly in cross-country surveys of its investment and business climate. However, a new emphasis by policy makers on addressing critical issues in this area through policy reform has led to some improvements. For example, the complexity of the country's regulatory framework and the number of inspections has been reduced, and the tax burden on enterprises has been lightened. Much work remains to be done, however, particularly in strengthening the rule of law, improving the judiciary system, promoting anti-corruption measures and completing regulatory reform. Such reforms to improve the general business environment are critical for the effectiveness of a SME policy. However, the SME perspective must be properly considered in the design and implementation of those horizontal policies. To achieve this, a constructive policy dialogue must be established with representatives of the SME sector.

Looking more specifically at SME policy, the measures taken to support entrepreneurship and micro-enterprises appear to have contributed to employment generation and enterprise creation. Examples of such policies include the introduction and revision of the patent system, the simplification of the registration process, the entrepreneurship and training programmes conducted by ODIMM and other organisations and the establishment of micro-credit facilities. Nevertheless, there has been very little focus on targeted enterprise support and on the provision of business services. In particular, small and medium-sized enterprises with high-growth potential have been at the margin of the government's SME policy. The main support to this segment of the enterprise population has come from donors or projects funded by international financial institutions (IFI).

Small and medium-sized enterprises are key contributors to economic development and, in particular, some of them grow much faster than the average SME by innovating and exploiting new business opportunities. Although there is growth potential in the small enterprise segment, there is no effective tool in place to provide targeted business support services to those enterprises. Similarly, no policy has been set up to support the medium-sized enterprise sector through the current phase of restructuring. In particular, there are only limited tools to support export-oriented medium-sized enterprises, to adopt technical standards or to facilitate the transfer and absorption of technology.

Key actions:

- Develop a monitoring framework to assess the needs of SMEs and the policy barriers they face.
- Support the development of business services for SMEs.
- Strengthen the framework for export promotion and develop programmes to help exporting companies enter foreign markets.
- Increase training programmes for SMEs by: *i)* supporting training programmes offered by public institutions; and *ii)* encouraging and monitoring programmes offered by private providers.

Improving access to finance

Bank financing is and will remain the main source of external funding for SMEs, particularly for small and medium-sized enterprises with growth needs which cannot be covered by microfinance. Other sources of financing, such as business angels, industrial and financial leasing or factoring, should be explored, but it will take time to develop new, more diversified, financial intermediaries. It is likely that, due to the deterioration of their balance sheets, banks will continue to be highly risk averse and real interest rates will remain high.

High-growth enterprises will face serious constraints in raising working capital and investment funds, particularly if they cannot offer the required level of collateral. In some cases, credit guarantee schemes can partly relieve those collateral constraints. Credit guarantee schemes can be further leveraged if they operate in synergy with the SME credit lines allocated by IFIs to banks in the Republic of Moldova. It is necessary, therefore, to review the design and operations of the existing credit guarantee schemes to ensure that they play a role in improving access to credit for enterprises with high cash-flow potential, as opposed to providing additional guarantees to risk-averse banks for existing clients.

Key actions:

- Ensure that the design of credit guarantee systems effectively broadens SME access to finance, consider developing linkages with credit lines supported by international financial institutions.
- Support the development of credit bureaus and provide assistance for SMEs in adopting international financial reporting standards.
- Support the development of the microfinance sector and strengthen monitoring capacities of the regulatory body.
- Consider solutions to restore the portfolio of banking institutions in order to develop their capacity to finance the economy.

Reviewing innovation policy and supporting business services and network development

The current innovation policy model is highly centralised and focused on supporting the application of domestically developed innovation. This model should be reviewed in the light of internationally recognised good practice and taking into account the needs of domestic enterprises. The mandate and the operations of the Agency for Innovation and Technological Transfer (AITT), which is in charge of innovation policy implementation, should be reviewed. In particular, much more emphasis should be placed on technology transfer and the improvement of technology absorption capacity of companies.

A large number of initiatives exist in the area of innovation policy. These initiatives were conducted both by the government and by the donor community. In particular, a number of business incubators and technology parks have been set up. It is important that the government reviews the results of these projects, in close dialogue with donors and the enterprise community, to make successful programmes sustainable and to extend coverage and accessibility even after donor support is concluded.

Linkages should be strengthened between public research institutions and private companies and inter-company networks should be further promoted. These actions can take different forms such as enhancing the establishment of specialised technical laboratories, sharing of training, testing and research facilities, the organisation of product transformation centres or logistic facilities and the establishment of incubators, science and industrial parks or of export consortia. The scope for network development is very wide and diversified. Government action will need to be closely co-ordinated with action taken by the business community.

Several additional schemes, derived from international good practice, could be explored to improve the effectiveness of the innovation system. These include business support services, voucher schemes, grant contributions and targeted tax incentives. In order to develop the market for business support services, the government could assume the role of active broker, co-ordinator and monitor of service providers.

Finally, as innovation is a transversal issue, the government must also be able to count on a number of executive agencies specialised in SME development, export promotion, innovation support, technical standards development, etc., often responding to different line ministries and operating under different policy guidelines. Therefore policy co-ordination tools need to be put in place to foster synergies among different programmes and to co-ordinate effectively with the donor community.

Key actions:

- Review innovation policy to target the needs of innovative enterprises and SMEs.
- Change the mandate of the AITT to explicitly include support for innovative companies.
- Support the technology absorption capacity of SMEs irrespective of the origin of the technology in question.
- Develop public-private partnerships in the field of both technological and non-technological innovation.
- Increase dialogue between the institutions in charge of research policy, in particular the Academy of Science, other institutions leading SME policy and private stakeholders.

- Assess the output of innovation infrastructures (*e.g.* business incubators, science and technology parks), identify domestic good practices and, when necessary, adapt design to increase effectiveness.

Strengthening policy dialogue

In the Republic of Moldova, SMEs engage in policy dialogue, but the scope of this dialogue is limited to instances of consultation related to regulatory reform and to a relatively small number of participants. This means that often the most dynamic parts of the SME community are not included. Moreover, important components to support an effective dialogue – such as a cost-benefit analysis that sets the framework for policy elaboration and supports the selection of policy options – are not always properly developed. Finally, the existing policy dialogue does not cover policy monitoring and evaluation. The programme's current strategy needs to examine the existing policy dialogue mechanisms and consider newer, more representative mechanisms for its next phase.

Strengthening the policy dialogue will require in particular two elements: a positive attitude by the government towards the policy dialogue process in general, and the inclusion in this dialogue of private sector organisations able to properly represent the interests of a fragmented and highly diversified SME population. The policy review contained in this report shows that currently there are limitations as regards both elements. The consultation process is still restricted mainly to regulatory reform issues and SME representation is weak and limited. Furthermore, inter-ministerial co-ordination may need to be intensified to ensure that the Ministry of Economy, and in particular its SME policy unit, is able to provide inputs on a wide range of policy issues.

The advocacy and co-ordination roles of ODIMM should also be further developed. ODIMM should have access to technical expertise and be engaged in dialogue with the other governmental agencies operating in the SME policy area. Close co-operation should be established with the National Bureau of Statistics, as SME policy relies on reliable and timely statistical data, complemented by regular company surveys conducted in co-operation with organisations representing the private sector.

An SME consultative council could be created to bring together key SME policy stakeholders: private sector associations, experts, policy makers and representatives of the donor community. Such an institution would support the Ministry of Economy and ODIMM in providing inputs and advice on policy elaboration, policy delivery and implementation, and in conducting regular policy monitoring.

Key actions:

- Ensure a better representation of the various segments of the SME sector in public-private dialogue institutions.
- Widen the scope of public-private dialogue beyond policy reform and better involve private sector representative at the drafting and monitoring stages.
- Support the development of organisations, sectoral or horizontal, representing the private sector, and in particular SMEs.
- Consider creating a SME consultative council to formalise and enhance dialogue between key stakeholders of SME policy.

Key findings according to the ten principles of the Small Business Act

In order to allow benchmarking with countries in the European Union and to be consistent with similar reviews of the Western Balkans, Turkey and Eastern Partnership countries, this report assesses SME policy in the Republic of Moldova against the ten principles of the Small Business Act (European Commission, 2008a). These principles provide a comprehensive overview of the difficulties and challenges that SME policies need to address in order to successfully foster the development of small businesses. The main findings of the assessment are listed below.

1. **Create an environment in which entrepreneurs and family businesses can thrive and entrepreneurship is rewarded.**

   Programmes to develop entrepreneurial learning in the Republic of Moldova have been established by the Ministry of Education, the National Employment Agency, and ODIMM as well as by non-governmental organisations (NGO) with the support of international donors.

   Next steps: Measures should also be developed to expand the scale of the different programmes. Furthermore, awareness of institutions needs to be improved. Coordination between the various initiatives should be developed to ensure a common understanding of the objectives of entrepreneurial learning.

2. **Ensure that honest entrepreneurs who have faced bankruptcy quickly get a second chance.**

   The regulatory framework in the Republic of Moldova is well developed. Both liquidation and re-organisation processes of insolvent companies are well structured. The main barrier to improving bankruptcy procedures is overly long delays.

   Next steps: A framework to develop out-of-court settlement should be developed to increase the effectiveness of insolvency procedures. Skills of insolvency administrators should be monitored and, when necessary, specific training courses developed.

3. **Design rules according to the “think small first” principle.**

   Regulatory simplification programmes have been led. A working group – including both government and private sector representatives – was set up for that purpose. The working group is now permanent and responsible for assessing the impact of new regulations on businesses.

   Next steps: The working group should have the power to block laws which are not supported by a positive regulatory impact assessment. Training of public officials could increase the quality of these assessments.

4. **Make public administration responsive to SMEs.**

   The Republic of Moldova performs relatively well in promoting faster and cheaper start-ups. In order to promote competitiveness for investors, taxes on businesses, and in particular income tax, have been reduced sharply.

   Next steps: In order to further simplify administrative procedure, the “silence-is-consent” principle should be introduced. Furthermore, as remaining taxes are primarily based on salaries, this may introduce distortions and encourage informal employment. The set of incentives linked to tax policy should be reviewed and adapted to foster development and innovation.

5. **Adapt public policy tools to SMEs’ needs.**

   A clearly-defined process has been established to promote transparency in the attribution of public procurement contracts. There is also no specific barrier that would bar SMEs from accessing public procurement contracts. However, in practice, procurement expenditures tend to concentrate around a small number of large contracts, which may be a factor limiting SME participation.

   Next steps: Measures should be taken to ensure higher participation of SMEs in public procurement. Furthermore, existing national preference clauses in public procurement regulation need to be lifted in order for the Republic of Moldova to comply with its international obligations.

Key findings according to the ten principles of the Small Business Act *(cont.)*

6. **Facilitate access to finance for SMEs and develop a legal and business environment supportive to timely payments in commercial transactions.**

   Access to finance is among the main obstacles faced by SMEs in general. The legal framework for access to finance in the Republic of Moldova is comprehensive and does not represent an obstacle for companies. However, the difficulties faced by the banking sector translate in limited availability of SMEs to access loans despite the development of credit guarantee schemes and of a credit bureau.

   Next steps: Resources for guarantee schemes need to be further developed. Their design should be reviewed to ensure that they indeed broaden SME access to finance. In order to increase effectiveness, the use of credit guarantee schemes could be closely associated with the credit lines for SME finance supported by international financial institutions (IFI). Availability of financial information and adoption of international reporting standards by SMEs should also be promoted.

7. **Help SMEs to benefit more from the opportunities offered by the single market.**

   The participation of the Republic of Moldava in major multilateral trading systems has strongly shaped its trade policy. The Republic of Moldova has been a member of the World Trade Organisation (WTO) since 2001. It was granted autonomous trade preferences by the European Union in 2008. It is also a member of the CIS and has established free trade agreements with most CIS economies.

   Next steps: Measures should be developed to support SME efforts to comply with technical regulation and standards in export markets. In particular, capacity and availability of certification services should be further developed. Transition from *gosudarstvennyy standart* or state standard (GOST) to international standards should be completed in priority sectors to improve clarity for SMEs.

8. **Promote the upgrading of skills and all forms of innovation.**

   Training programmes are operated by ODIMM and by the National Employment Agency. Besides these public bodies, training sessions are mainly provided by private institutions and non-governmental organisations. Innovation policy is conducted by the AITT, which depends from the Academy of Science. The main mandate of the agency is to support companies that market products developed by researchers in public institutions.

   Next steps: Measures should be considered to expand the public offer of trainings. Private training offers should be monitored, and ODIMM could develop a role of broker for private providers. The government should consider changing its top-down approach to innovation policy in order to strengthen the links between academia and the private sector and to develop a more inclusive innovation agenda.

9. **Enable SMEs to turn environmental challenges into opportunities.**

   Environmental policy is not included among the key priorities of the government in the Republic of Moldova. Preliminary initiatives were conducted to develop environmental standards in the operations of SMEs. In the current institutional structure, responsibility is divided between the Ministry of Ecology, Ministry of Agriculture and the Institute for Ecology and Geography.

   Next steps: Relationships between the various institutions responsible for environmental policy needs to be clarified. Measures to promote the energy efficiency of SMEs should be considered.

10. **Encourage and support SMEs to benefit from the growth market.**

    Customs procedures represent a significant obstacle for firms in the Republic of Moldova. In particular, the time and costs required to complete the procedures are higher than in the rest of South East Europe and in most Eastern Partnership countries. The Moldovan Investment and Export Promotion Organization (MIEPO), which acts as focal point for companies that seek information on export markets or that are willing to invest in the Republic of Moldova, conducts a number of promotional events in the country and participates in international events.

    Next steps: Customs procedures need to be streamlined and the design of existing information technology (IT) services and one-stop-shops should be reviewed to ensure that company access is improved. The capacities of MIEPO, both in terms of human resources and budget, should be better aligned with the scope of its mandate. In the longer term, additional export promotion services, including for example export guarantee, could be developed.

Notes

1. The definition used for SMEs throughout the report is based on the Law No. 206-VXI of 7 July 2006 on supporting SMEs. Micro-enterprises are defined as enterprises with under 10 employees and under MDL 3 million (EUR 182 000) average annual revenues or total balance sheet. Small enterprises are defined as having less than 50 employees and averages annual revenues or total balance sheet below MDL 25 million (EUR 1.5 million). Medium companies have less than 250 employees and an annual average revenue or total balance sheet below MDL 50 million (EUR 3 million). Other companies are considered large.
2. Birth rate is defined as the ratio between the number of newly created companies and the number of active companies.

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Fostering SME Development

Chapter 1

The Micro, Small and Medium-sized Enterprise Sector in the Republic of Moldova

This chapter provides a profile of the small and medium-sized enterprise (SME) sector as a background for the SME policy review conducted in this document. A description of the macroeconomic environment is followed by an analysis of the structure of, and recent trends in, the SME sector. The size of the SME population has been estimated; the profile of entrepreneurs in the Republic of Moldova is based on data emerging from Labour Force Surveys (LFS). This section is followed by a review of the evolution of the business climate and a presentation of the SME institutional framework and of the various programmes being carried out with the support of the donor community. The chapter concludes with a set of final considerations on the issues faced by SMEs in the Republic of Moldova and the identification of a number of key structural factors that may constrain the development of this sector.

1.1. The economic environment: Key structural features of the economy

The Republic of Moldova is a relatively small, land-locked country, with independent access to the Black Sea secured through an opening onto the Danube Delta. It is set on the frontier between the trade blocks of the European Union (EU) and the Commonwealth of Independent States (CIS). The Republic of Moldova became independent in 1991 as a result of the dissolution of the former Soviet Union. Its independence process was marred by a conflict with the breakaway Russian-speaking territory of Transnistria. The issue of Transnistria has been a constant divisive feature of political life in the Republic of Moldova throughout the transition process. It has constrained domestic economic development and conditioned political, trade and economic relations with its neighbours, in particular with the Russian Federation. Moreover, it has been an obstacle to the country's process of integration within the EU.

With a total gross domestic product (GDP) of EUR 3.9 billion in 2009, the economy of the Republic of Moldova represents only a fraction of that of its immediate neighbours, Romania and Ukraine, whose GDP in 2009 amounted to EUR 116 and 82 billion, respectively. In terms of GDP per capita, the Republic of Moldova ranks at the bottom among the transition economies in South Eastern Europe. It also compares unfavourably with a number of economies in the CIS. This is partly due to the fact that the Republic of Moldova has no significant natural resources, with the exception of fertile agricultural land.

After a prolonged and deep recession during its transition, with GDP contracting by almost two-thirds compared with 1990 levels, in 2000 the economy started to expand and entered a phase of sustained economic growth. This was further accelerated in 2007 and 2008 (see Table 1.1). GDP at constant prices grew at an average rate of 6.4% between 2001 and 2008, albeit from a low base. However, this expansion phase was interrupted by the global economic and financial crisis. In line with other Black Sea and Eastern European

Table 1.1. **Key macroeconomic indicators, 2005-10**

	2005	2006	2007	2008	2009[1]	2010[1]
GDP, current prices (EUR millions)	2 402.97	2 716.86	3 211.09	4 128.09	3 906.68	3 864.67
GDP, constant prices (EUR millions)	513.5	511.88	522.7	611.66	549	516.68
GDP, constant prices (% change)	7.47	4.78	3	7.8	–6.49	3.2
GDP per capita (current EUR)	667.42	756.81	896.67	1 155.46	1 097.00	1 088.71
Inflation, consumer prices (annual % change)	11.85	12.71	12.382	12.7	0.01	7.37
Unemployment rate (% of total labour force)	7.3	7.6	5.1	4	6.43	7.5
General government gross debt (% of GDP)	36.43	33.75	26.9	21.33	27.56	32.57
Current account balance (% of GDP)	–7.56	–11.41	–15.31	–16.31	–8.13	–11.22
Total population in millions	**3.6**	**3.59**	**3.58**	**3.57**	**3.57**	**3.56**

1. Estimated values.
Source: IMF (2010b), *World Economic Outlook Database*, IMF, Washington DC.

economies, economic activity contracted sharply in 2009, with a real GDP contraction of 6.5% (IMF, 2010). Budget revenues dropped significantly and the national currency came under pressure. At the same time the country was experiencing a period of political instability.

The economy began emerging from recession in the last quarter of 2009. Positive economic growth returned in the first quarter of 2010 (an increase of 4.7% compared to the first quarter of 2009), supported by the replenishment of inventories, growing private consumption and net exports (International Monetary Fund, 2010a). Furthermore, the government which emerged from the July 2010 general elections responded to the crisis by launching an economic recovery programme and entering into an economic stabilisation programme with the International Monetary Fund (IMF). However, economic growth is expected to remain sluggish and IMF projections indicate that growth over the next two years will remain below the pre-crisis average (3.2% in 2010 and 3.6% in 2011) (IMF, 2010a).

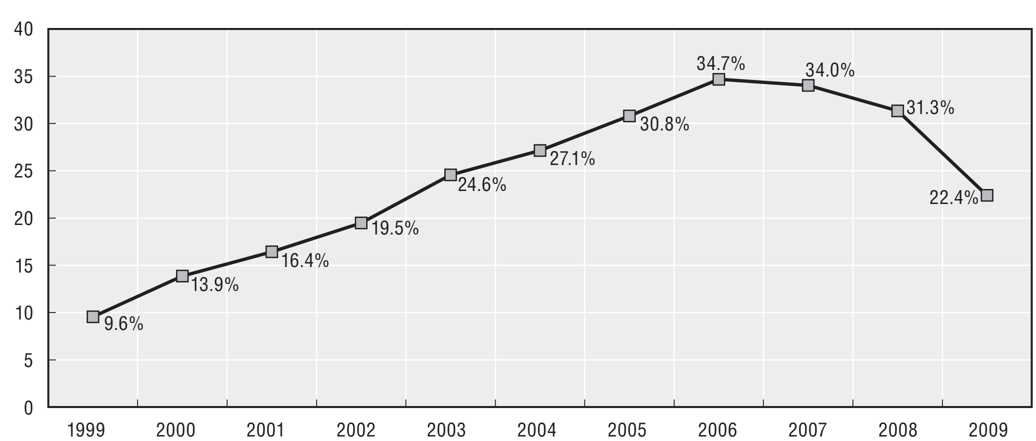
Transition path

The transition path of the Republic of Moldova has been broadly in line with that of other former Soviet Union Republics. The initial transition recession was followed by a prolonged expansion phase, after macroeconomic stabilisation was achieved and the state-owned company restructuring and privatisation process started to generate results. Two developments have contributed considerably to the economic transition process in the Republic of Moldova: emigration and trade specialisation.

Since the beginning of the transition process, the Republic of Moldova has experienced a significant population outflow. The number of citizens living abroad was estimated to be above 571 000 in 2005, representing over 16% of the country's population. The bulk of migrants are concentrated in the 21 to 40 age group and the emigration flows are mainly directed towards the CIS countries (61% of the total), Israel and Western Europe (29%) (IMF, 2005). While emigration deprives the Republic of Moldova of valuable human resources, reducing in particular the supply of young and qualified workers, the remittances generated by migrant workers have been one of the major drivers of economic growth. Over the last five years, remittances have contributed to reshaping the country's economic structure. In 2004-08, the remittance inflow was very significant (see Figure 1.1),

Figure 1.1. **Workers' remittances received in the Republic of Moldova, 1999-2009**

As a % of GDP



Source: World Development Indicators (World Bank, 2010a).

representing 31% of GDP in 2008 (World Bank, 2010). The inflow had a marked positive effect until 2009 when, due to the impact of the global economic and financial crisis on the EU and the Russian Federation, remittance inflows showed a sharp contraction (EIU, 2010). Remittances have fuelled mainly private consumption, real estate investment and an expansion of the bank deposit base and therefore access to credit.

During the Soviet era, the Republic of Moldova specialised in the agrobusiness and the defence and armament sectors. The dissolution of the Soviet Union led to the disappearance of the defence and armament industries, while the wine sector survived and expanded, thanks to successful restructuring, privatisation and active government support. In 2005, a study conducted by the United States Agency for International Development (USAID) showed that vineyards still represented eight per cent of the total agricultural land surface (United SAID, 2005). In spite of several programmes aimed at quality improvement and market diversification, the sector remains heavily dependent on the CIS market and in particular on the Russian market. In 2009, over 72% of the country's wine exports were directed to the Russian Federation and the CIS. However, wine exports, as well as other agricultural exports, are subject to sharp year-on-year production variations due to weather changes and other factors. Agricultural exports are also influenced by price oscillations and a wide range of tariff and non-tariff barriers. In particular, wine exports recorded a sharp drop in 2006, when the Russian Federation imposed a ban on wine imports from the Republic of Moldova on the basis of non-compliance with domestic phytosanitary standards. Given the importance of this sector, such vulnerabilities are a potential threat to the sustainable development of the economy of the Republic of Moldova as a whole.

In general, between 2005 and 2008 there was a considerable shift in favour of non-tradable rather than tradable sectors. Moreover, domestic demand took the lead in driving economic expansion. Between 2005 and 2008, the value-added contribution of agriculture to GDP went down from 20% to 10%. This was partly due to the sharp contraction of the wine sector, caused by the 2006 drop in exports to the Russian Federation. At the same time, the contribution of value-added provided by industrial production decreased from 16% to 13% of GDP, while the share of the service sector increased from 64% to 77% (World Bank, 2010a).

Other important structural features of the economy of the Republic of Moldova include:

- A large degree of trade openness, measured by the ratio of the sum of the total value of imports and exports over GDP (132% in 2008, compared with a ratio of 92% for Albania, 104% for the former Yugoslav Republic of Macedonia and 87% for Georgia) (World Bank, 2010a).
- The presence of large external sector imbalances, resulting from a large structural trade deficit, a negative import-export dynamic, and a growing current account deficit. Total imports are valued at more than double the total exports. In addition, between 2006 and 2008 the ratio of total exports to GDP went down from 51% to 41%, while the ratio of imports value remained substantially stable (World Bank, 2010a).
- A relatively high level of foreign debt (57% of gross national income in 2008), but a decreasing trend (World Bank, 2010a).

- Limited, but improving, export diversification, both in terms of product and market diversification. The four main export markets (the Russian Federation, Ukraine, Romania and Italy) absorbed over 45% of total 2009 exports in the Republic of Moldova. The three main export product categories: agricultural products, wine, beverages and tobacco products and textiles and garments, accounted for over 60% of total exports in 2009. However, geographical and product diversification of exports was significantly lower in 2005 when the country's export mainly relied on wine and agricultural products shipped to the Russian Federation and other CIS countries. The Republic of Moldova has a high level of dependency on energy imports from the Russian Federation and other CIS countries and a very low level of energy efficiency (World Bank, 2010a).
- A limited stock of foreign direct investment (FDI), with a large share of FDI concentrated in the services, real estate and financial sectors, and very limited FDI in the manufacturing and export-oriented sectors according to data provided by the National Bureau of Statistics. Total FDI stock amounted to EUR 1 874 million in 2009 (UNCTAD, 2010).
- A high concentration of economic activity in the capital, Chisinau, and the surrounding region with marked differences in per capita income across regions.

All these elements have had a major impact on the structure and on the performance of the SME sector.

1.2. Size and structure of the SME sector

Definition and size of the SME sector

According to Law No. 206-XVI (2006) on Support to Small and Medium Sized Enterprises, SMEs are defined according to three parameters: the number of employees, turnover and balance sheet size. The law identifies four categories of enterprises: micro, small, medium and large enterprises. A company is included in a category if it meets the related headcount ceiling and either the turnover or the balance sheet ceilings. The parameters for each category are described in Table 1.2:

Table 1.2. **Definition of SMEs by size**

	Average number of employees	Average annual revenues from sales in MDL (EUR)	Average annual total assets
Micro	< 10	< MDL 3 million (EUR 182 000)	< MDL 3 million (EUR 182 000)
Small	< 50	< MDL 25 million (EUR 1.5 million)	< MDL 25 million (EUR 1.5 million)
Medium	< 250	< MDL 50 million (EUR 3 million)	< MDL 50 million (EUR 3 million)

Source: Law No. 206-VXI of 7 July 2006 on supporting the SME sector, Republic of Moldova.

SMEs can benefit from government support provided that no single large company holds more than 35% of the company and as long as they are not engaged in a number of specific activities including: imports of products subject to excise duties, investment funds, fiduciary and insurance companies, banks and other financial institutions and gambling organisations.

Before embarking on a detailed SME policy review it is important to estimate the size and structure of the enterprise population and its performance during the recent business cycle. It is in fact very difficult to design an effective policy for the SME sector without relying on good information about its size, composition and reaction to economic changes. However, collecting such information is often a difficult task. For instance, data on the size of the total SME population are difficult to assemble due to definition issues and incomplete data, but mainly due to the difficulty of separating active from non-active enterprises.

In fact, the estimate of the total number of SMEs results from the integration of data derived from three different enterprise registers. The first is the register of all legal entities managed by the State Chamber of Registration. This register covers all enterprises that have received an incorporation certificate. It includes active companies and non-active ones as long as no formal procedure to cancel registration from the enterprise register has been initiated. On 1 November 2010 the register included 156 940 entities: their ownership structures are presented in Table 1.3.

Table 1.3. **Number of entities by forms of ownership, 2010**

Form of ownership	Number of entities
Sole ownership	67 274
Limited liability	72 614
Joint stock companies	4 850
Co-operatives	4 061
Other types of legal entities	8 141
Total	**156 940**

Source: State Chamber of Registration, Republic of Moldova, 2010.

The second register, managed by the local tax offices, includes all patent holders.[1] There is no recently published information about the number of patent holders. According to press information, which gave the National Tax Inspectorate as a source, there were 17 500 patent holders in June 2008. Other sources estimated the number of patent holders in 2007 at 36 600. Their number is likely to fluctuate quite significantly, responding to seasonal, economic and regulatory requirements.

Finally the National Bureau of Statistics (NBS) maintains a company register, based on the returns of a mandatory company questionnaire. The NBS company register is built on information automatically provided by the State Chamber of Registration. However, only companies subject to the obligation to maintain double entry accounts[2] and that have recorded business transactions in the year covered by the survey have the obligation to report to the NBS. The number of enterprises monitored by the NBS amounted to 44 633 at the end of 2009 (+34.6% over 2005). Of those enterprises, only 975 are classified by the NBS as large (over 250 employees); all the others are SMEs (close to 98% of the total).

If patent holders are considered as individual entrepreneurs and included in the micro-enterprise category, the number of active SMEs is derived from the sum of all SMEs monitored by the NBS (43 658 at the end of 2009), plus the patent holders (no official figure for 2009, but likely to be, at the lowest estimate, at around 20 000 units), plus the micro-enterprises opting for single entry accounts – for which we have no figure. Based on those figures, the SME population is estimated between approximately 65 000 and 100 000 units.[3] The vast majority of the SME population is made up of individual entrepreneurs and micro-enterprises.

Box 1.1. **Estimating the number of active SMEs**

The Enterprise State Register includes active and non-active enterprises. In 2005 de-registration amounted to 1.2% of the total population of registered enterprises and increased to nearly 2% in 2009. These relatively low numbers can be attributed to the fact that most entrepreneurs complete company registration formalities before even considering activating company operations; de-registering inactive enterprises is not a regular occurrence. Deciding factors for these trends are the lack of yearly fees for holding a company registration certificate, the relatively easy and cheap registration procedures and the direct and indirect costs associated with company de-registration.

In addition, according to State Chamber of Registration officials, many patent holders often also hold a company registration certificate and shift from patent to company operations following changes to the regulatory and fiscal regimes.

As the data on the number of enterprises differs according to the different sources, it is only possible to estimate the active SME population. The approach used is the following:

As of 1 October 2010, 94 776 units out of 156 940 registered entities had received the unique company registration number which is a requirement to activate a company. This implies that approximately two out of five registered enterprises are inactive. However, not all enterprises holding the unique registration number are active as the number was automatically assigned to all entities registering after 2002. Assuming that 20% of all enterprises in the SME sector holding a unique identification number are non-active (a conservative hypothesis) and including patent holders,* one can derive the size of the SME population, ranging from a minimum of approximately 65 000 to a maximum of approximately 100 000 units. These figure are much higher than those mentioned in the 2009-11 State Programme for SME development; most of the difference is explained by the inclusion of patent holders. Those estimates exclude any enterprise operating under a regime of total informality, *i.e.* without any form of registration. There are no indications as to the number of totally informal enterprises, but given the possibility of registration as a patent holder, that the registration process is simple and inexpensive and that taxation of enterprise profits is very low or non existent, there is no strong incentive for operating under a regime of total informality, while partial informality is still widespread.

* Statistics on patent holders and sole entrepreneurs suffer from a partial overlap between the two categories.

Enterprise creation and population segmentation by turnover, employment and localisation

According to data provided by the State Chamber of Registration, between 2005 and 2009 the number of registered private enterprises increased by over 20%, which seems to indicate a healthy rate of new enterprise creation. Indeed, new registrations increased steadily between 2005 and 2007, from 7 292 to 11 083 units. Nearly half of the newly registered enterprises operate in the retail sector. The trend receded in 2008 and 2009, when only 7 477 new registrations took place. This is a possible indication of the impact of the economic crisis on the inclination towards engaging in entrepreneurial activities. Nearly 60% of new registrations resulted in the creation of new legal entities, usually a limited liability company. One third of the new registrations were made as sole ownership. The remaining new registrations include co-operative and professional cabinets, *e.g.* lawyers and doctors.

Data collected by the NBS and made available to the OECD allows for a detailed analysis of the SME population. NBS data has a high level of accuracy and is available for a number of years. Moreover, a considerable number of economic variables (number of enterprises, turnover, employment, profit) are available by sector, at 2 and 3-digit levels, according to the System of National Accounts, at national and at district (*raion*) level.

However, NBS data only covers enterprises that have adopted double-entry accounting. These enterprises are referred to as "reporting enterprises". This implies that although they successfully cover the large, medium and small enterprise section of the enterprise population, they tend to underestimate the size of the micro-enterprise sector and exclude entrepreneurs operating under the patent regime. This implies that a portion of the micro-enterprises is excluded from the analysis developed in the remainder of this section.

According to NBS data, at the end of 2009 there were 44 633 reporting enterprises. On average, during the 2005-09 period, SMEs accounted for 57.6% of total employment in the enterprise sector, but only for 41.6% of the enterprise sector turnover.

Table 1.4. **Employment and real turnover in the enterprise sector**

Average in 2005-09 period, by enterprise size

	Employment (%)	Real turnover (%)
Large	42.3	58.2
SMEs	57.7	41.8
of which:		
Medium	*23.6*	*15.2*
Small	*19.8*	*20.4*
Micro	*14.3*	*6.2*
Total	**100.0**	**100.0**

Source: Computation of statistics based on data provided by the National Bureau of Statistics, Republic of Moldova, 2010.

Despite contributing significantly to employment, the medium-sized enterprise segment provides a much lower contribution in terms of turnover. This is largely due to the fact that medium-sized enterprises are more present in labour intensive sectors such as agriculture (agrobusiness, and in particular wine-making and manufacturing). Overall, the SME sector is dominated by micro-enterprises (75.7% of the total). The average number of employees for the overall SME sector is 7.2 per company, while in the micro-enterprise sector it is 2.5. These indicators of SME population structure and density, computed on the basis of the NSB data, are broadly comparable to those of other economies with a similar per capita income level. Enterprise density, defined as a percentage of active enterprise per 1 000 inhabitants, is comparable with the level of enterprise density observed in a number of the Western Balkan countries, such as Albania, Bosnia-Herzegovina and the former Yugoslav Republic of Macedonia, but only once we take into consideration not only the reporting enterprises, but the total number of active enterprises, including sole entrepreneurs and patent holders (according to our estimation the total number is between 65 000 and 100 000).[4]

Both the net number of newly registered enterprises and the annual number of newly reporting enterprises increased relatively rapidly in the period from 2005 to 2007, reaching a peak in 2007. This boom period was followed by a significant drop in new enterprise

Table 1.5. **Distribution of the number of active enterprises and employment by size, 2009**

Size (by number of workers)	Number of enterprises	Share of enterprises (%)	Number of workers	Share of workers (%)	Average firm size
Micro (0-9)	33 805	75.7	84 085	15.6	2.5
Small (10-49)	8 264	18.5	117 104	21.7	14.2
Medium (50-249)	1 589	3.6	115 055	21.3	72.4
Subtotal	*43 658*	*97.8*	*316 244*	*58.7*	*7.2*
Large (250+)	975	2.2	222 951	41.3	228.7
Total	**44 633**	**100.0**	**539 195**	**100.0**	**12.1**
Micro-enterprise share of SME contribution		*77.4*		*26.6*	

Source: Computation of statistics based on data provided by the National Bureau of Statistics, Republic of Moldova, 2010.

registrations and in the rate of increase in the number of reporting enterprises during the following two years as economic growth slowed down and the country entered into recession in 2009.

The discrepancy between the number of newly registered enterprises and newly reporting enterprises is due to the fact that not all newly registered enterprises are active, and among those that are active only some of them choose to adopt double accounting. Moreover, the increase in reporting enterprises may result from new enterprise creation or from an increase in the adoption of double-entry accounting by existing micro-enterprises, making it difficult to know precisely how many enterprises are genuinely newly created in any given year.

Table 1.6. **Company registrations, de-registrations and net creation, 2005-09**

	2005	2006	2007	2008	2009
Annual number of enterprises created	7 292	8 430	11 083	9 630	7 477
Annual number of enterprises liquidated	1 581	1 677	1 854	2 956	3 191
Net number of newly created enterprises per year	5 711	6 753	9 229	6 674	4 286
Annual change % over the previous year	–	18.2	36.7	–27.7	–35.8
Annual number of new enterprises reporting to the NBS	–	3 017	3 829	2 134	2 512
Annual change % over the previous year	–	–	26.91	–44.27	17.71

Source: Computation of statistics based on data provided by the State Chamber of Registration, Republic of Moldova, 2010.

Economic activity in the Republic of Moldova is highly concentrated in the Chisinau area, which in 2009 hosted over 65% of SMEs among the country's active reporting enterprises. The enterprises located in Chisinau accounted for over 68% of total turnover and over 50% of total employment in the SME sector. However, during the 2005-08 expansion phase, SMEs located in the northern and central regions of the Republic of Moldova recorded faster growth in terms of turnover than SMEs located in the Chisinau area. Nevertheless, the expansion recorded in non-agricultural sectors was not enough to compensate for the job losses caused by the crisis in the wine sector and those regions suffered of a considerable loss of employment. The southern region benefitted far less from the expansion phase compared with other regions. SMEs located in the Chisinau area continued to generate new jobs until 2008. The construction and service sectors generated the highest number of new jobs, absorbing some of the workers who had left the agricultural and wine sectors in other regions.

Recent trends in the SME sector

The structural changes that took place in the economy of the Republic of Moldova over the last five years have had a profound impact on the SME sector. Understanding the evolution of the number of active enterprises, employment, turnover, profitability and geographical concentration of the SMEs can help to better understand the features of the current economic transformations, as well as indicate where policy responses may need to be developed to enhance performance.. For the purpose of our analysis, we have divided the 2005-09 period into two clearly distinct phases based on the country's overall economic performance.

The first period, between 2005 and 2008, is marked by strong economic growth. Credit expansion and capital inflows fuelled buoyant domestic demand. SMEs benefitted from the expansionary business environment, although not to the same degree as large enterprises. This has been clearly reflected in the NBS survey data. In 2009 the economy contracted sharply, and so did activity in the SME sector, reversing some of its previous expansion. It is too early to assess the impact that the 2009 recession will have on the structure and performance of the SME sector in terms of sector diversification, geographic concentration, employment and productivity. Preliminary evidence suggests, however, that domestic structural factors may lead to a slow economic recovery. At the time of writing, it is also too early to assess if the 2009 economic crisis signalled a break with previous trends and opened up a new phase of uncertain and slower economic growth, or if the economy will revert to its previous growth pattern once the external negative economic factors have receded.

Overall, between 2005 and 2009, the enterprise sector lost over 38 000 jobs (–6.7%). However the impact on the unemployment rate was mitigated by a reduction of the domestic labour force, due to emigration, and by a parallel expansion of employment in the public sector (+3.7% between 2005 and 2009).

SMEs in the 2005-08 expansion phase

Between 2005 and 2008, employment in the total enterprise sector, including both large companies and SMEs, remained stable at around 575 000 employees (the total number of employees in all sectors peaked at 1.35 millions in the third quarter of 2008 (NBS, 2010). During the expansion phase, employment grew significantly in the micro- and small enterprise segments (+8.2% and +4.1% respectively), while it contracted both in the large (–2%) and in the medium sized enterprise segments (–4.6%). In the SME sector, new jobs were mainly created in the service and construction sectors. Employment in the manufacturing sector remained stable, while employment in agriculture contracted considerably (–7.8%), in particular due to the crisis that affected the wine industry in 2007. Job losses in the agricultural and wine sectors were concentrated in the medium-sized enterprise segment.

Turnover data[5] gives an additional indication of the strength of the expansion phase and of the sectors that drove economic growth. Total turnover in the enterprise sector recorded a 79.0% increase in real terms between 2005 and 2008. Turnover in large enterprises increased significantly faster than in SMEs (+97.0% against +54.1%). This can be explained by the dominant presence of large enterprises in those sectors that benefited most from the expansion phase, such as banking and finance, telecommunications, construction, education, and energy and mining. In the SME sector, turnover grew faster in the small sized segment (+62.7%) than in the micro- and the medium-sized enterprise segment (+53.0% and +43.5% respectively). This reflects differences in distribution by

Table 1.7. **Composition of SME employment by sector, 2005-09**

In percentage

	2005	2006	2007	2008	2009
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Agriculture	21.9	20.2	17.5	16.6	16.2
Manufacturing	19.1	19.2	19.2	18.4	18.1
Energy	1.2	1.2	1.2	0.8	0.9
Construction	7.2	7.9	8.6	8.3	7.6
Trade and repairs	23.5	24.0	24.5	24.8	25.2
Hotels and restaurants	2.9	2.9	3.0	3.3	3.2
Transport and communications	7.5	7.4	7.6	7.4	7.6
Financial transactions	0.5	0.5	0.5	0.6	0.6
Real estate, rental and other business services	8.5	8.9	9.6	11.0	11.2
Other services	7.8	7.8	8.4	8.9	9.5

Source: Computation of statistics based on data provided by the National Bureau of Statistics, Republic of Moldova, 2010.

sectors. Indeed, small enterprises are more present in the high growth service sectors, while medium-sized enterprises are more active in agriculture and manufacturing. This growth can also reflect intra-segment dynamics as a number of micro-enterprises may have moved to the small enterprise segment during the expansion phase. Again, real turnover growth in SMEs was stronger in the broad service sector than in manufacturing or agriculture. Some sectors, such as finance and health care services, more than tripled their turnover in just four years.

Within the manufacturing industry, the most important sector is food and beverages. Although its relative weight within the manufacturing sector was significantly reduced over the last five years, food and beverages still accounted for over 50% of the total turnover of the manufacturing sector and close to 40% of total employment in 2009. Other relevant sectors, both in terms of turnover and employment, are garment production, the chemical industry, plastic production and metalworking. The garment sector is particularly significant in terms of employment, accounting for over 15% of total employment in manufacturing.

Over the last five years there has been a significant increase in the number enterprises operating in the manufacturing sector that are reporting (+21.7% between 2005 and 2009) due to the entry of a new set of small enterprises. During the same period the sector recorded a continuous loss of employment reduction (–14.8%), mostly related to job losses in large and medium-sized enterprises. This trend was particularly strong in the textile, garment, plastic and metalworking sectors, and led to a remarkable reduction in the average company size.

Total profits reported by SMEs, measured in real terms, grew strongly during the expansion phase, with an increase of more than 500% in the four-year period from 2005 to 2008. A similar evolution is seen in profit margins on turnover, which increased from 2.6% in 2005 to 8.4% in 2008. The largest increases in profit margins were recorded in finance, educational services and the retail sector.

Employment, new entry, turnover and profit data for the 2005-08 period are consistent with the view that during the expansionary phase there has been a structural shift in the economy of the Republic of Moldova from the trade sectors to non-tradable sectors. Value-added data for the SME sector is not available. However, by comparing trends in employment and turnover we can draw some initial observations about underlying productivity trends, using trends in turnover per employee as a proxy.[6] Data indicate that turnover per employee in the SME sector increased significantly during the expansion phase until 2008, but the trend was still not as strong as that recorded in the large enterprise segment. Within the SME sector, the largest gains in terms of turnover per employee were recorded in the medium enterprise segment, supported by large gains in the construction and finance sectors. Turnover per employee in the SME micro-enterprise segment increased until 2007.

In 2008 the trend was inverted as employment in micro-enterprises continued to expand while real turnover started to contract. Turnover per employee in the reporting micro-enterprise segment was just 41% of that of the small-sized enterprise segment, which recorded the highest level.

Enterprise creation data, considered together with turnover and employment data by enterprise segment show that, during the 2005-08 expansion phase, a dynamic was initiated whereby expectations of high returns, justified by an increase in profit margins and buoyant demand, led to the creation of a substantial number of new micro-enterprises, particularly in the service sectors. Within the service sector, new entries were higher in those activities with lower entry barriers, leading to overcrowding in some sectors, particularly in the Chisinau area. Employment in the micro-enterprise sector went up significantly, but fragmentation and efficiency decreased simultaneously, leaving new micro-enterprises potentially exposed to sudden changes in the economic environment.

SMEs in the 2009 economic recession

As mentioned above, the global financial and economic crisis put an end to the sustained expansion phase. Real turnover in the enterprise sector in 2009 (all segments) contracted by 21.8% compared with 2008. The contraction was more marked in the large enterprise sector (–24.5%) than in the SME sector (–17.3%). In general the crisis was felt significantly more strongly in the small (–19.0%) and medium sized segments (–18.5%) than in the micro-enterprise segment (–6.8%).

The same trend was observed in terms of employment. Total employment in the enterprise sector declined by 5.8% in 2009 compared with 2008. Job losses were higher in the large enterprise and medium enterprise segments, confirming and strengthening a trend already observed during the expansion phase. Job losses in the small-sized enterprise segment were markedly lower (–2.0%), while employment in the micro-enterprise sector continued to expand (+2.1%) despite the very difficult economic conditions, thus indicating a remarkable resilience.

During the 2008-09 period there was still a substantial increase in the number of reporting SMEs (+26.7%). Although all sectors saw an increase, there was a real surge of new market entrants in the real estate sector (+54.3%), the health service sector (+38.9%), construction (+36.2%), finance (+34%) and the retail sector (+22.9%).

The crisis has been felt strongly in some of the sectors that grew faster during the expansion phase. In construction, SMEs recorded a turnover contraction of more than one third between 2008 and 2009. Retail trade (–15.8% in turnover) and hotels and restaurant (–17.7%) were hit by a sharp drop in domestic demand and by the halt of credit expansion. Turnover contraction recorded by SMEs operating in the finance sector was less pronounced (–8.5%). Turnover in the agriculture and winery sectors also contracted significantly, with the highest impact on the medium-sized enterprise segment. The manufacturing sector, already underperforming during the expansion phase, recorded a drop in turnover in the SME sector close to 20%, hit by the combined drop in domestic and external demand.

In 2009, turnover per employee contracted by 14.3% in the SME sector and by –17.4% in the large enterprise sector. The profit margin on turnover contracted even more significantly (–53.5%). It appears that in 2009, SMEs, uncertain about the extent and the duration of the recession and constrained by employment regulations, tried to preserve their levels of employment, while temporarily cutting their profit margins.

Table 1.8. **Real turnover per employee by size, 2005-09**

% change compared with previous year

	2006	2007	2008	2009
Large	26.90	39.06	19.90	–17.36
Medium	25.18	34.08	–0.96	–11.19
Small	27.89	14.54	–2.76	–16.92
Micro	44.84	18.60	–27.91	–8.78
SME average	*27.47*	*21.80*	*–4.00*	*–14.29*
Total	**25.35**	**29.50**	**11.45**	**–17.09**

Source: Computation of statistics based on data provided by the National Statistical Office, Republic of Moldova, 2010.

Preliminary considerations on enterprise population structure and enterprise performance

Overall, the SME sector performed relatively well in the 2005-09 cycle. While the employment balance in the broad enterprise sector over the five-year period is negative, nearly all the job losses between 2005 and 2009 were recorded in the large enterprise sector (–14.5%). Employment levels in the SME sector substantially held on through the period, in spite of the 2009 recession (–0.2%).

Within the SME sector, the micro-enterprises have been the most dynamic. The number of active micro-enterprises increased by 38% over the 2005-09 period and employment, including self-employment, rose by 26.2%. A positive but less marked increase was recorded in the small-sized enterprises segment. Finally, data indicates that this strong dynamic in the small enterprise and micro-segments is partly balanced by an increased weakness in the medium-sized segment. Key performance indicators related to medium-sized enterprises recorded negative trends with the number of companies decreasing by 4.1% and employment decreasing by 20.8%.

Entrepreneur's profile

In order to define an effective policy towards the micro-enterprise segment and towards young enterprises, it is important to understand the dynamic factors and the incentives that trigger the decision to start a new business venture, and what are the assets and constraints that new companies are facing. Data on new entries and on micro-enterprises show that between 2005 and 2009 there was a considerable increase in the number of entrepreneurs and the number of new micro-enterprises increased rapidly during the expansion phase.

The opening of new business opportunities together with an improvement of the general investment climate, in particular elements of the regulatory climate, has probably contributed to promote entrepreneurship. However, the increasing number of micro-enterprises may reflect the lack of employment opportunities for employees who lost their previous job in large and medium-sized enterprises. This category of the labour force may have been forced to transform themselves into entrepreneurs. In this case, newly created firms are likely to be structurally fragile and with limited growth prospects.

The data available are too scarce to directly assess if the entry of new dynamic firms is motivated by increased business opportunities, or if it is a response to deteriorating labour market conditions. The motivations towards entrepreneurship are usually investigated through specialised surveys, such as the Global Entrepreneurship Monitor. Such surveys are not currently conducted in the Republic of Moldova. In the absence of a direct survey on entrepreneurship, the analysis of the LFS, conducted yearly by the NBS, can provide useful information on the profile of the average entrepreneur.[7]

Data availability

The LFS shows that in 2009 those who were self-employed accounted for 25.9% (307 100 individuals) of the total labour force (1 184 000). Employers counted for an additional 1% (10 400 individuals). The number of self-employed declined by 14.4% over 2008, during the same period the number of employees decreased by 5.3%.[8] A similar reduction was recorded for the number of employers. It appears, therefore, that during the 2008-09 recession a relatively large number of self-employed people and entrepreneurs stopped being active although, for the same period, NBS enterprise data shows a modest increase in the number of active and monitored enterprises.

However, LFS data must be interpreted with care, and evidence emerging from the LFS is not directly comparable to that emerging from the NBS enterprise survey data. For instance, according to LFS data, over 83% of those who are self-employed are resident in rural areas, while the NBS data shows that most SMEs, including micro-enterprises, are located in the urban area of Chisinau. The distortion is caused by the inclusion in the LFS classification of farmers working on their own plots, as self-employed entrepreneurs, while NBS enterprise data exclude individual farmers.

Main characteristics of entrepreneurs

Country wide LFS data on individual entrepreneurs are therefore “distorted” by the inclusion of individual farmers and they are not comparable with data from the NBS enterprise survey. However, data on the self-employed and on employers residing in urban areas do not suffer from this distortion and can help design the entrepreneur profile.

Over 56% of self-employed people are in the 25-44 age bracket and in particular 23% are in the 25-34 age bracket, pointing to the significant presence of a population of young entrepreneurs. Among employers, the largest group is in the 35-44 age bracket (39%), while the representation of young employers is minimal. The representation of self-employed women in urban areas (38.8%) is much lower than the representation of women as employees resident in urban areas (51.9%). Representation of women is even lower among employers (33%).

The educational qualifications of entrepreneurs appear to be limited. Fewer than 30% of self-employed people have attained high school qualifications or specialised technical education qualifications. In contrast, 47% of employers have obtained a university or postgraduate degree. Surprisingly, women entrepreneurs have attained higher education qualifications than men. This fact is even more pronounced in the self-employment segment, where 26.7% of men have attained high school or specialised technical qualifications compared to 33.6% of self-employed women.

The average profile emerging from the LFS data is one of a relatively young entrepreneurial population, predominantly represented by young men below the age of 44, with only basic qualifications. The data also indicate the presence of a relevant segment of relatively highly qualified entrepreneurs and employers, among them quite a large representation of young women. However, we cannot draw conclusions on how many entrepreneurs are motivated by necessity and how many are motivated by business opportunities.

Impact of the informal sector

One of the major issues in SME policy in transitional and developing countries is how to deal with informality and informal entrepreneurs. A number of enterprises, particularly the smaller ones, end up operating informally due to a combination of distorted incentives. Common distorted incentives are: the absence of effective sanctions, a complex and poorly targeted tax regime, poor tax administration and a burdensome regulatory framework. Informality has various degrees, ranging from operating totally outside the legal and tax system to non-compliance of a limited number of laws and regulations, particularly regarding taxation and employment.

The first observation coming out of the LFS is the presence of a significant informal sector in the Republic of Moldova. The employment data presented in the previous analysis refer to formal employment. However Labour Force Survey data show that informal employment plays a relevant role and the incidence of informal employment is the highest in the SME sector. In 2009, 11.7% of employees worked in the informal sector (non-registered enterprises), either as a main or secondary activity. In addition, 12.4% of total employees, including entrepreneurs, had an informal job, which is defined as being employed in formal or informal enterprises, but not contributing to social security, or benefitting from medical insurance or other labour protection schemes.

The number of employees working in informal enterprises does not appear to be particularly large, particularly if compared to the Eastern European Partnership economies. However, other estimates seem to point to the presence of a relatively large informal sector. For instance Schneider, Buehn and Montenegro (2010) estimated that the informal sector accounted for up to 44.3% of GDP in 2006.

In the enterprise sector the main drive towards informality, according to private sector views, appears to be the evasion of social contributions and, to a lesser extent, value-added tax (VAT) evasion. As noted previously, over the recent years significant progress has been made in simplifying and lowering the cost of registration procedures and company income tax is low and set at zero on re-invested profits. The patent system offers an opportunity to register small-scale business activities that otherwise would have been conducted in total informality.

These measures have contributed to reducing the incentives for operating under a regime of total informality (enterprises operating without any form of registration and therefore unknown to public authorities); this explains why the number of employees working for informal enterprises is relatively low.

However, there are still significant incentives for operating under a regime of partial informality. For instance, both employers and employees may find it convenient to under-declare salaries for the purpose of evading social security contributions. Employers and employees may thus share the direct benefit of social contribution evasion. Employees receive a marginally higher salary when part of their salary is paid in cash under the table and employers benefits from a partial reduction in labour costs. The resulting collusion between employees and employers makes it difficult to dismantle such practices.

1.3. The business climate

This section describes the development of the economic environment in the Republic of Moldova over recent years and is based in particular on conclusions from the OECD's Investment Reform Index (OECD, 2007 and 2010a), the World Bank's annual *Doing Business* reports (World Bank, 2009 and 2010b) and the European Bank for Reconstruction and Development (EBRD) Transition Indicators (EBRD, 2010). Supplementary information is provided by the Foreign Investors Association[9] of the Republic of Moldova (FIA), through its White Book (FIA, 2009), and from the joint World Bank-EBRD initiative, the Business Environment and Enterprise Performance Survey (BEEPS) (EBRD and World Bank, 2009).

The Investment Reform Index (IRI), produced by the OECD's Private Sector Development Division, reviews the business climate in ten economies in South East Europe (SEE), including the Republic of Moldova. As shown in Table 1.9; the IRI analyses each economy over seven policy areas and allows for direct cross-country comparison. The World Bank's *Doing Business* reports compare, on a yearly basis, the performances of 183 countries according to the time and cost dedicated to the key regulatory procedures that are conducted over the life cycle of a standard enterprise. The BEEPS, jointly conducted by the World Bank and the EBRD in all the transition countries, gives a good picture of the policy environment constraints faced by companies in the Republic of Moldova, in relation to the situation in comparable transition countries. The latest survey conducted between September 2008 and February 2009 – at the beginning of the recession phase – covered a sample of 363 companies, composed of 42 large companies and 321 SMEs. (EBRD and World Bank, 2009). The EBRD Transition Indicators provide a comprehensive picture of the status of structural reforms associated with moving towards a fully functioning market economy. The FIA's White Book identifies a number of specific investment policy issues selected by its member enterprises, and tracks progress on addressing those issues over time.

Table 1.9. **Investment Reform Index 2010: Final scores per policy area**

	Albania	Bosnia and Herzegovina	Bulgaria	Croatia	Kosovo under UNSCR 1244/99	Former Yugoslav Republic of Macedonia	Republic of Moldova	Montenegro	Romania	Serbia
Investment policy and promotion	3.5	3.3	3.8	3.8	2.6	3.7	2.9	3.8	3.9	3.7
Human capital development	2.7	2.2	3.5	3.0	2.3	3.5	3.0	2.9	4.0	2.8
Trade policy and facilitation	3.8	3.2		4.2	2.5	3.6	3.3	3.6		3.7
Access to finance	2.2	2.5	2.8	3.5	1.6	2.6	2.8	2.5	3.2	3.2
Regulatory reform and parliamentary processes	2.8	2.7		3.0	2.7	3.6	3.5	2.6	3.6	3.5
Tax policy analysis	2.5	3.5		2.6	2.8	2.4	2.5	2.5	3.1	2.2

Source: OECD (2010a).

Results from the various reviews consistently indicate that while there was progress in upgrading business legislation, in practice there was only limited improvement in the quality of the investment climate over the last few years. The positive changes were generated by the implementation of better regulations in some very specific areas, for instance, in the area of company registration or property registration. Action appears to have stalled on structural reforms, particularly in the area of infrastructure, public services and finance. The assessments of the business climate show that availability of finance, regulatory and structural reforms, restrictions on FDI, workforce education and corruption represent particularly important challenges for companies operating in the Republic of Moldova.

Access to finance remains one of the most important issues, identified as the main obstacle to conducting business by nearly 20% of small, medium and large firms. The Republic of Moldova is still in the early stage of reforming non-banking financial institutions, as enterprises rely nearly exclusively on bank financing. Availability of finance appears to be more of a constraint for large and medium-sized enterprises, than for smaller firms. This may be due to the fact that larger companies rely more exclusively on external financing – mainly bank loans – than smaller enterprises. At the time of the survey, commercial banks were raising credit standards and restricting access to credit. It should be noted, however, that according to the IRI, the Republic of Moldova scores similarly in terms of access to finance as the average scores for the SEE region. Whilst their regulatory and legal framework is largely in place, further reforms are essential to provide greater availability of finance. Additionally, conditions do not appear to have improved in the short term. According to the World Bank's *Doing Business 2011* report, the Republic of Moldova has moved from 87th position to 89th out of a ranking of 183 countries surveyed over the 2009-10 period in terms of access to finance.

The Republic of Moldova faces further challenges as it continues with regulatory and structural reform. Significant efforts have been made in the area of regulatory reform, with the OECD's Investment Reform Index showing that the Republic of Moldova is among those South Eastern European (SEE) economies where this area is most developed. However, while the Republic of Moldova has made considerable efforts in upgrading its business law, institutions remain weak and policy coordination is limited. One point to note, however, is that businesses in the Republic of Moldova rank extremely high in terms of "registering properties" and "enforcing contracts". According to the *Doing Business* ranking, the Republic of Moldova ranks 19th and 20th in these two dimensions, respectively, out of the 183 countries surveyed. These improvements in company registration have contributed, among other factors, to a significant increase in the number of new enterprises. However, as shown in Table 1.10, World Bank (2010b) highlights significant regulatory obstacles that still penalise companies, in particular those engaged in cross border trading, hiring new workers and building new warehouses. Those regulatory obstacles may contribute to slanting incentives towards domestic-oriented sectors with lower labour intensity. Transition Indicators also show a general stagnation in the

Table 1.10. **World Bank *Doing Business* scores, 2010-11**

	2011 ranking	2010 ranking	Change in ranking
Ease of doing business	90	87	–3
Starting a business	94	78	–16
Dealing with construction permits	159	163	+4
Registering property	18	17	–1
Getting credit	89	87	–2
Protecting investors	109	108	–1
Paying taxes	106	102	–4
Trading across borders	141	141	–
Enforcing contracts	20	20	–
Closing a business	92	91	–1

Source: World Bank (2010), *Doing Business 2011*, World Bank, Washington DC.

structural reform process for the 2005-09 period, stating that whilst there has been incremental progress in areas such as small-scale privatisation and in banking reform, for the four areas covered, no structural reforms have been implemented over the last three years.

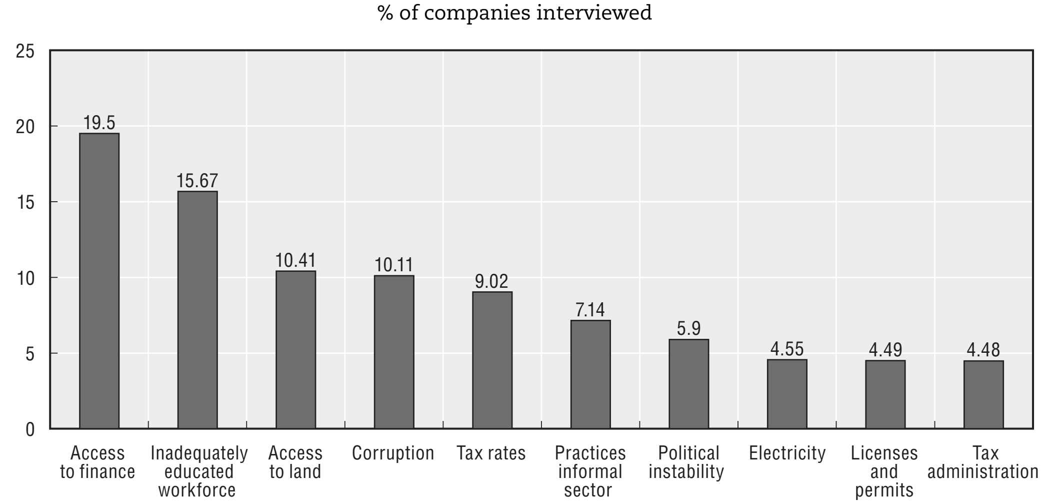
Although legislation related to investment policy is up to standard, and national treatment of foreign investors is embedded in the legislation, foreign investors still face heavy restrictions in specific areas such as the acquisition of agricultural land. In the three years to 2008, FDI flows increased from EUR 154 million to EUR 483 million according to the IRI (2010). FDI represents around one-third of the gross fixed capital formation, while the average for its SEE counterparts hovers around 20%. However, some restrictions to foreign investment exist. One of the key findings in the White Book 2009 (FIA, 2009) is the need to act on the removal of restrictions on the acquisition of agricultural land for foreign investors. Difficulties in acquiring agricultural land are reportedly the main obstacle for over 10% of operating firms. For an economy such as the Republic of Moldova, where agricultural trade is important, this may severely restrict FDI and subsequent growth.

Further efforts also need to be made to develop human capital. The IRI has recorded positive development in vocational education and training. However, due to the large-scale emigration of skilled workers, the country is experiencing a significant skills shortage. According to the *BEEPS 2009*, over 15% of businesses have indicated that an inadequately educated workforce is the main constraint to their operations (EBRD and World Bank, 2009). Further education reforms are needed in future years as the Republic of Moldova moves towards harmonising its laws with those of the EU in accordance with the 2005 Action Plan. Moreover, significant investment will be needed in order to strengthen infrastructure in the education system.

Finally, corruption remains a major issue in the Republic of Moldova. As Figure 1.2 shows, this is identified by the BEEPS as the main constraint within the business environment. The number of companies expected to pay a bribe to public officials in order to get things done, according to BEEPS data, remains high (33.4%), well above the Eastern and Central Europe average (23.5%). Also high is the number of companies identifying corruption as a major constraint to their operations (40.9%) against an average of 28.9% for Eastern and

Figure 1.2. **Top ten business constraints for firms in the Republic of Moldova**

% of companies interviewed



Source: IFC and World Bank (2010). *Moldova Country Profile 2009: Enterprise Surveys*, the World Bank Group.

Central Europe (EBRD and World Bank, 2009). The results of the 2010 Transparency International Corruption Perception Index seem to confirm this. The Republic of Moldova fell from a position of 89th out of a total of 178 countries surveyed to 105th.

1.4. Institutional framework for SMEs policy in the Republic of Moldova

The development of SME policy in the Republic of Moldova is at a relatively early stage. However, over the last five years the building blocks for an institutionalised SME policy framework have been established. The overall programme for the development of SMEs is included within the framework of the National Development Plan for the period 2008-11, adopted in December 2007 (see Box 1.2). The SME policy is built around two main institutions: the Ministry of Economy, in charge of policy elaboration, legislative drafting and policy coordination and the Organisation for the Development of the SME Sector of the Republic of Moldova (ODIMM) acting as an executive agency under the supervision of the Ministry of Economy. Moreover, in order to adopt a consistent approach, in February 2009 the Government of the Republic of Moldova adopted a State Programme for Supporting SME Development (hereinafter the "SME Programme") covering the 2009-11 period.

Within the Ministry of Economy, the tasks of SME policy elaboration, legislative drafting and policy co-ordination are assigned to the Directorate of SMEs and the Liberal Professions. There are no specific mechanisms for inter-ministerial co-ordination on SME policy issues, but SME policy forms a part of the government's overall economic strategy. The task of SME policy implementation is assigned to ODIMM, an agency founded in 2007, which acts as an executive agency under the supervision of the Ministry of Economy. ODIMM has a wide mandate which covers entrepreneurship promotion, service provision to SMEs and SME support in access to financing. Programmes developed by ODIMM include credit guarantees for micro and small entrepreneurs, matching grants for remittances invested in domestic companies, a number of business training programmes and the organisation of the annual SME Forum and International SME Conference as well as thematic workshops, seminars, and roundtables. It has receives funds from the state budget for the implementation of state programmes but is otherwise self-financed. It is a public non-profit, non-commercial institution and implements a number of business support activities. ODIMM works in close co-operation with its development partners: the Ministry of Economy, the 33 regional councils, the Moldovan Investment and Export Promotion Organization (MIEPO), the Chamber of Commerce and Industry (CCI), the Agency for Innovation and Technology Transfer (AITT), regional development agencies, and business-related non-governmental organisations (NGOs) and associations.

SME policy in the Republic of Moldova is defined by the SME Programme adopted in 2009. The legislative framework for SME policy is set by the Law No. 206-XVI/2007 which includes a comprehensive definition of SMEs, modelled on the EU definition, and provides guidelines for public policy in the area of SME development and support. The SME Programme details the priority measures to be set for SME policy. Acknowledging the difficulties met by the SME sector in the Republic of Moldova, the SME Programme envisages a number of measures structured along five pillars: *i)* legislative and normative framework; *ii)* access to finance; *iii)* entrepreneurial culture and managerial performance; *iv)* development of competitiveness and export performance; and *v)* public-private dialogue. These five pillars provide a comprehensive overview of the issues faced by SMEs and they happen to reflect the main policy orientation of the EU SME policy (European

Box 1.2. **National Development Strategy of the Republic of Moldova**

The National Development Strategy 2008-2011 was adopted by the Parliament of the Republic of Moldova in December 2007. It defines medium-term objectives for the country and pursues several objectives. It aims to provide a consistent framework to identify priorities and allocate resources across various instruments promoting economic and social development. It also aims to improve the coordination between the various initiatives conducted by the donor community. In particular, it integrates the action plan to achieve the Millennium Development Goals. Finally, it contributes to better aligning the policies in the Republic of Moldova with European standards. Five priorities are set in the National Development Strategy:

1. **Strengthen democracy based on the rule of law and respect for human rights principles:** As part of the transition process, the Republic of Moldova has established a legal framework in line with international practices. However, further efforts need to be made to fight abuses, in particular for vulnerable populations. The judiciary will be modernised, actions to prevent and combat corruption will be set up and state border management will be strengthened.
2. **Settle the Transnistrian conflict and re-integrate the country:** Solving the conflict linked to the status of Transnistria is a key priority for the Republic of Moldova. A settlement would include both a political and a socio-economical dimension. The possibility to define a specific juridical status will be explored and a consensus will be sought on a multilateral basis. Moreover, programmes to increase the social and economic integration of all citizens are planned.
3. **Raise the national economy's competitiveness:** In order to improve the competitiveness of firms in the Republic of Moldova, reforms will be made to improve the business environment. In particular, SME promotion measures are planned to facilitate their access to finance, develop skills and services and set up public-private dialogue. Efforts will be made to strengthen the research and innovation capacity. Finally, infrastructure will be developed to reduce production costs.
4. **Develop human resources, raise the employment level, and promote social inclusion:** In order for the economy to become more competitive, the labour force needs to be provided with a sufficient level of skills. Initiatives will be taken to improve the quality and the access to education services. Links between education and the labour market will be established and lifelong learning and employee training will be promoted. Social inclusion will be improved through measures to develop access to the labour market of vulnerable groups and through social insurance policies. Finally, health care services will be modernised.
5. **Regional development:** Important discrepancies exist between the municipalities of Chisinau and Balti on one hand, and the rest of the country. An institutional framework will be developed to promote better regional development. At the national level, a Council for the Coordination of Regional Development and a Regional Development Fund were set up. At the regional level, consultative structure and implementing agencies were established to promote development at the local level.

For each of these objectives, a number of programmes is set up and specific indicators are defined to monitor the implementation and the impact of the strategy. Assessments are conducted regularly and are presented to an inter-ministerial committee which evaluates progress and formulates recommendations to improve the strategy.

Commission, 2008a). A concrete action plan corresponding to the five pillars has been defined. This plan, however, is more a plan of action and co-ordination than a strategic document and it is not supported by an extensive analysis of the SME sector.

1.5. The role of the donor community

The Republic of Moldova receives support from various international financial institutions (IFIs) and from bilateral donors. Several programmes seek to grant larger access for SMEs to finance, in particular through dedicated credit lines. Furthermore, schemes have been developed, for example by the EBRD and USAID, to improve the skills and the capabilities of firms, in particular in the SME sector.

European Commission

The European Commission (EC) is among the major donors to the Republic of Moldova through the Eastern Neighbourhood and Partnership Instruments. Projects financed aim at consolidating institutions and also support construction of infrastructure. In 2009, the EC allocated EUR 57 million of which a budget of EUR 50 million was dedicated to a water sector support programme. In 2010, the EC contributed EUR 67 million, including EUR 45 million for a programme to support economic stimulation in rural areas. In 2011-13, the contribution of the EC is expected to increase to an average of EUR 91 million *per annum*. The EC has defined a detailed National Indicative Programme which sets the priorities for the 2011-13 period. Three main priority areas that will be focused on over the period: *i)* governance, rule of law and public administration reform; *ii)* social and human development; and *iii)* trade and sustainable development.

International Monetary Fund

The Republic of Moldova has been a member of the IMF since 1992. Since then, IMF's financing instruments have supported the transition process of the economy. Loans from the IMF particularly helped the Republic of Moldova face the difficulties induced by the wine and gas crisis of 2006. In January 2010, financing arrangements of about EUR 409 million were extended to the authorities, of which EUR 71 million were made available following the completion of the first review in July 2010 (IMF, 2010a; IMF, 2010c).

As part of IMF's programme, authorities will: *i)* develop a sustainable fiscal framework; *ii)* limit inflation through adapted monetary and exchange rate policies; *iii)* enhance the stability of the financial sector; and *iv)* conduct needed structural reforms to improve the business environment and raise the efficiency of the public sector.

World Bank Group

In 2008, the World Bank launched its Country Partnership Strategy for the period 2009-12. This strategy is closely aligned with the National Development Strategy adopted by the Government of the Republic of Moldova. The strategy seeks to lay the foundation of sustainable and inclusive economic growth through the development of economic competitiveness, the development of human capital and improvement of public sector governance. In 2010, the World Bank, through the International Development Association, committed EUR 52 million to projects in the Republic of Moldova, while the commitments of the International Finance Corporation (IFC) were EUR 23 million.

The work conducted by the World Bank Group in the Republic of Moldova consist both of lending and non-lending activities. The World Bank contributes to financing large projects, for example in infrastructure. Through the IFC, it also invests in individual companies, in particular in the finance sector and in agribusiness. It also conducts assessments of the business environment, for example through its yearly *Doing Business* report. Finally, the World Bank also implements specific projects, such as providing technical assistance to support the regulatory simplification process.

The Competitiveness Enhancement Project was started in 2006. It seeks to improve the business environment through recommendations to the government. It also contributes to improving access to finance, supporting the set up of a credit bureau and providing financial instruments such as matching grants and credit lines for enterprises. Finally, through this project, the World Bank helps modernise the metrology, standards, testing and quality infrastructure.

European Bank for Reconstruction and Development

In the Republic of Moldova, the EBRD provides funds to finance investments and also implement non-financial support to private enterprises, in particular through its Turn Around Management (TAM) and Business Advisory Services (BAS) programmes.

In 2009, the EBRD signed 12 projects for a total of EUR 57 million. The operations of the EBRD cover three main areas: support for the private sector, consolidation of the financial sector and rehabilitation of infrastructure. The EBRD provides direct financing to companies in all sectors of the economy. It is particularly active in the large agribusiness sector. In the financial sector, the EBRD offers credit lines to its partner banks and provides support for the development of microfinance institutions. The EBRD also offers loans to support the rehabilitation of infrastructure in the power sector, in transport and in information and communication technology (ICT), as well as in municipal infrastructure.

As part of its objective to support the private sector, the EBRD in the Republic of Moldova has been operating its Turn Around Management/Business Advisory Service (TAM/BAS) activities since 1997 and 2005, respectively; 24 turnaround projects have been completed since the inception of the programme. The BAS programme offers financial assistance to enterprises to access consultancy services. TAM/BAS use a number of internally accredited business services providers and the programme contributes to the development of business advisory and training services.

European Investment Bank

The European Investment Bank (EIB) is active in the Republic of Moldova through its Eastern Partners Facility. Since 2007, two projects have been financed by the EIB. In 2007, in partnership with the World Bank and the EBRD, the EIB lent EUR 30 million to finance the rehabilitation of roads linking Chisinau to the EU border. In 2008, the EIB lent EUR 20 million for the rehabilitation and expansion of Chisinau's airport.

United Nations Development Programme

In the Republic of Moldova, the United Nations Development Programme (UNDP) focuses on two main areas: strengthening governance structures and contributing to regional and local development. The activities of UNDP in the Republic of Moldova consist mainly of projects that support public authorities and their partners at the national and local level.

Bilateral donors

Several countries have developed bilateral support programmes in the Republic of Moldova. The United States, through USAID, supports a number of projects in the country. Countries in the European Union, and in particular new member states, have also developed projects to support the development of the private sector and to contribute to further capacity building.

United States Agency for International Development

USAID is particularly active in the Republic of Moldova. It runs a number of projects to assess particular aspects of the business environment and has also developed assistance programmes to help the government implement reforms and to provide support to the private sector. USAID's programme of work relies on two pillars: further establishing just and democratic institutions and promoting economic growth.

To develop governance, USAID has in particular set up programmes that monitor reforms and encourage co-operation between government, civil society organisations, the media and the public. The agency also provides assistance to the government to identify and remove potential obstacles to the implementation of reforms.

To promote economic growth, USAID has launched several projects that include elements of both the vertical and the horizontal approach. Among other initiatives, the Competitiveness Enhancement and Enterprise Development project focuses on four sectors (ICT, the wine industry, textile and apparel manufacturing and finance). It seeks to improve the competitiveness of companies in the Republic of Moldova through specific actions such as re-engineering of processes, workforce development and participation in trade fairs. The Business Regulatory and Tax Administration Reform Project (BIZTAR) supports the Government of the Republic of Moldova in its efforts to reduce the administrative burden on the private sector.

Other bilateral donors

Bilateral donors also develop a large range of programmes. In general, initiatives conducted by bi-lateral donors focus on private sector development and on capacity building.

The German development agency, the *Gesellschaft für Internationale Zusammenarbeit* (GIZ), provides technical support to companies in the agricultural sector and the food processing industries and contributes to modernising vocational training. The Norwegian research agency SINTEF provides support to the development of business incubators and provides support to various initiatives that aim at improving operations of SMEs. The Netherlands has set up a scheme which finances co-operation between companies in the Republic of Moldova and companies from the Netherlands, as well as providing loans for start-ups. The Japanese government has set up two schemes, the Japanese Non-Project Grant Aid (JPNGA) and the Moldovan-Japanese Grant Assistance for Underprivileged Farmers (2KR) that seek to develop leasing for industrial and agricultural investment and to support farmers in the Republic of Moldova.

A number of countries have engaged efforts to help the government of the Republic of Moldova through contributions to the general budget and initiatives to strengthen capacity. Central European states such as the Czech Republic, Hungary, Latvia, Lithuania, Poland, Slovakia and Romania have set up such initiatives. The Netherlands, which contributes EUR 250 million to the budget of the Government of the Republic of Moldova, the Department for International Development of the United Kingdom and the Swedish International Development Cooperation Agency (SIDA) also provide assistance to the Government to support capacity building and governance.

1.6. Conclusions

The Republic of Moldova recorded consistent, strong, positive growth between 2005 and 2008, followed by a sharp recession in 2009 that has significantly affected SME performance. In 2009, both employment and turnover contracted by 3.6% and 10.3%, respectively.

Today, the SME sector is increasingly made up of very small companies and by self-employed entrepreneurs operating in the broad service sector. This most likely reflects the opening of new business opportunities in the broad service sector, as well as the fact that service-related sectors generally have low entry barriers. For instance, over the last few years, the ICT sector recorded a rapid expansion, its contribution to GDP grew from 7.5% in 2004 to 9.5% in 2008 and total direct employment in the sector reached 20 500 in 2008 (USAID, 2010). The number of information technology (IT) companies has expanded rapidly over the last few years. USAID (2010) estimated that in 2008 there were 519 IT companies in operation, many of them operating as unregistered independent contractors, but a number of them are small and, in a few cases, medium-sized enterprises. Besides the broad services, small companies are also very dynamic in manufacturing, particularly in textiles and apparel and construction materials.

In contrast, the medium-sized enterprise segment has shown signs of increasing weakness, such as decreasing employment and low productivity. As previously mentioned, many medium-sized enterprises are operating in agrobusiness, including wine-making and in the manufacturing sector. The poor performance of the medium-sized enterprise segment largely reflects the difficulties experienced at the sector level. However, medium-sized enterprises rely more on export development and have greater needs for working capital and investment financing. This makes them more susceptible to suffer systemic operational constraints; among thesea are the high cost and the heavy collateral requirements associated with bank financing, poor and unstable access to export markets and low rates of adoption of technical, phytosanitary and quality standards. Furthermore, the recent appreciation of the Moldovan Lei against the euro also translated in an important loss of competitiveness of companies in the Republic of Moldova compared to their international competitors.

The recent evolution of the wine-making sector, in which the Republic of Moldova has developed a large production capacity and where there is a continuing tradition, is an indication of the predicament faced by this class of enterprise. The sector accounted for a large share of total country exports, with the Russian Federation being by far the largest export market, in 2005 absorbing 90% of total wine exports (USAID, 2010). A dispute over phytosanitary standards brought a sudden ban on imports of wine produced in the Republic of Moldova by the Russian Federation in March 2006, followed by a slow and limited re-opening of the Russian market starting in November 2007. The market access crisis was a major blow to the wine sector as companies were unable to re-orient their production towards alternative markets. Stuck with large unsold stocks and large exposure to bank loans, many of them went into a severe liquidity crisis and stopped servicing their debt. This move led to a deterioration of the quality of the banking sector's loan portfolio. Since 2007 the wine sector has gone through a process of restructuring. The number of operating companies has decreased from 120 in 2006 to around 50 in 2009. The sector still accounts for 10% of total exports. However, difficulties in accessing medium-term financing and limited support in introducing higher quality standards, developing new products adapted to non CIS markets, and upgrading phytosanitary standards in a highly globalised and competitive sector slow down the process of market differentiation and therefore the recovery of the wine sector.

The micro-enterprise segment (including micro-enterprises, patent holders and the self-employed but excluding farmers), has a mixed profile. Up to 2008, the positive business environment attracted a number of new and relatively well-educated entrepreneurs, interested in pursuing business opportunities in the fast-growing broad service sector. Such new enterprises traditionally rely on capital put together through the investor's own funds and contributions from family and friends. Bank financing plays a marginal role in the start-up phase, but becomes more relevant to support growth once the start-up phase is over.

Another very significant section of the micro-enterprise segment is made up of operations set up by entrepreneurs out of necessity. This section includes former employees made redundant by large and medium-sized enterprises, returning emigrants and all those involved in micro-scale operations, such as craftsmen, repairment and retail shops. This type of operation often only provides subsistence or near subsistence returns. The contribution to value-added generation is low, but the impact on job creation is significant, particularly in depressed areas, thus lowering the level of productivity (measured by the turnover per employed ratio) in the micro-enterprise segment. Both birth and death rates in the micro-enterprise segment are generally higher than in the other segments. As seen above, the economic and financial crisis led to a considerable slow down of the birth rate. Despite the lack of reliable data on closures, it is expected that a number of operations will be put out of business due to a combination of weak domestic demand – if the economic recovery does not pick-up and remittance inflow does not recover – and increased competition. On the other hand, micro-enterprises, far less exposed to bank lending, may prove quite resilient to temporary harsh economic conditions. The dynamic in the micro-enterprise segment will depend largely on how the revival of domestic demand for services and retail trade occurs. However, more difficult access to bank loans, together with fewer internally generated funds, may lead to a lower expansion rate for the micro-enterprises with most potential, despite recovery of internal demand.

Finally, since the SME population is highly concentrated in the Chisinau area, any policy of supporting SMEs, without addressing simultaneously the underlying issues that lead to such an unbalanced regional development, will only reinforce the current concentration trend.

Notes

1. According to the Law on the Business Patent (Law No. 93XIV, published in 1998 and amendment No. 121, published in 2008) goods liable to the patent-based marketing business are for example clothing, footwear, salt, mineral water and soft drinks.
2. The Accounting Law No. 113-XVI of 27 July 2007, stipulates that companies using single-entry accounting are exempted from presenting any financial reports. Companies meeting two of the following requirements for the previous accounting period are allowed to use single entry accounting:
   - The total income from sales is less or equal to MDL 3 million.
   - The accounting value of long term assets is maximum of MDL 1 million.
   - The average number of staff does not exceed nine.

3. Farmers are not included in the estimate of the SME population. Farmers register with local authorities and do not need to establish a formal enterprise to engage in their activity.
4. For instance according to data released by the Albanian National Institute of Statistics, at the end of 2009 Albania had 73 500 active enterprises for a population of 3.1 million; 92% of the registered active enterpises are micro-enterprises with less than 4 employees.
5. Real turnover data is calculated by deflating nominal turnover data with the GDP deflator.
6. Turnover is a poor proxy for productivity trends as it does not take into account the evolution of the cost structure.
7. National Bureau of Statistics of the Republic of Moldova, Labour Market in the Republic of Moldova 2010: Statistical compilation, Chisinau.
8. The data refers to the labour force, including those unemployed and in search of work and those employed in all sectors, not just the enterprise sector.
9. The FIA is an independent organisation created and supported by foreign-owned companies operating in the Republic of Moldova.

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Chapter 2

Review of SME Policy in the Republic of Moldova

This section reviews SME policy in the Republic of Moldova according to the ten principles of the Small business Act (SBA). The Small Business Act (SBA), which was developed by the European Commission and was adopted in June 2008, seeks to "guide the conception and implementation" of SME policy (EC, 2008a) for the European Commission as well as for the member states. Such a methodology allows benchmarking of the state of SME policy in the Republic of Moldova against reforms that have been made in the European Union. The OECD is currently conducting a number of regional reviews following a similar framework. Once the results of these assessments are available, comparison with the other economies in the region will also be possible.

The OECD has conducted a number of assessments of SME policy based on the framework developed in the European Union, using first the European Charter for Small and Medium-sized Enterprises and now the SBA principles (see Box 2.1). Moreover, as similar exercises are being developed in the Western Balkans, Turkey and Eastern Partnership countries,[1] it will be possible to compare the result of the current assessment with what has been achieved in other economies in the region.

Box 2.1. **Methodology of the assessment**

The methodology used to assess micro, small and medium-sized enterprise policy in the Republic of Moldova is part of a broader set of reports on SME policy conducted by the OECD Investment Compact. The assessment methodology was originally developed for the Western Balkan region (OECD, 2006b; OECD 2009a) and in the Middle East and North Africa region (OECD, 2008). These assessments were based on the European Charter for Small and Medium-sized Enterprises, a policy document adopted in the framework of the Lisbon Agenda to improve co-operation on enterprise policy issues within the EU and between EU member states. Building on these experiences and in preparation for the third regional Western Balkan assessment, analytical indicators were reviewed to reflect the ten principles covered by the European Small Business Act (SBA) endorsed by the European Union in December 2008.

The SBA consists of a set of ten principles that aim to guide the conception and implementation of EU and national policies concerning SMEs. The ten principles are as follows:

1. **Create an environment in which entrepreneurs and family businesses can thrive and entrepreneurship is rewarded:** Potential entrepreneurs may lack the skills to actually start a venture. In order to foster enterprise creation, measures need to be developed to foster entrepreneurial interest and talent, particularly among young people and women, and by simplifying the conditions for business transfers.
2. **Ensure that honest entrepreneurs who have faced bankruptcy quickly get a second chance:** Bankruptcy is among the main risks that entrepreneurs may have to face. Ensuring that the bankruptcy procedures are effective and balanced can foster entrepreneurship. Moreover, measures to limit the stigma attached to business failures may be needed to help re-starters.
3. **Design rules according to the "think small first" principle:** Complying with regulation can be a burdensome task for SMEs. Public authorities need to engage in a constant dialogue with SMEs in order to ensure that regulations are adapted to their situations.
4. **Make public administration responsible to SMEs:** SMEs dedicate significant resources to their interactions with public authorities. A number of procedures may need to be streamlined to ease access to SMEs. Efforts by governments to develop one-stop-shops and online procedures can have a strong positive impact on SMEs.
5. **Adapt public policy tools to SMEs' needs:** SMEs face obstacles when participating in public tenders. Public procurement agencies may need to introduce specific regulations in their procedures to promote the participation of SMEs.

Box 2.1. **Methodology of the assessment** *(cont.)*

6. **Facilitate SMEs' access to finance and develop a legal and business environment supportive of timely payments in commercial transactions:** Obtaining access to finance is among the key constraints for SMEs. SMEs have difficulties in obtaining the form of finance that is best suited for their needs. In particular, market failures are most prevalent for early-stage financing and adequate policy instruments can help SMEs in these critical phases of development.
7. **Help SMEs to benefit more from the opportunities offered by the single market:** In order to trade across borders, SMEs need to comply with a number of standards and technical regulations. SMEs have limited capacity to dedicate to the adoption of certification and standards which may represent significant obstacles to their ability to export their products. Governments have set up schemes to ensure that SMEs that would be willing to export are supported in their effort to do so.
8. **Promote the upgrading of skills and all forms of innovation:** Skills development and innovation capacity are essential aspect of the competitiveness of SMEs. In order to compensate for their difficulties in accessing training and innovative services, governments may set up schemes to help SMEs access the kind of training that they need and to foster innovation in the SME sector.
9. **Enable SMEs to turn environmental changes into opportunities:** As increasing emphasis is being put on environmental sustainability, SMEs may need to reform their business model. However, they rarely acknowledge the need to do so. Government can help SMEs adapt their business model and practices to adapt to the challenges linked to environmental changes.
10. **Encourage and support SMEs to benefit from the growth market:** SME have limited resources to allocate to finding potential export opportunities. To develop the export potential of SMEs, export promotion services can be developed. Furthermore, costs and delays associated with customs procedures can represent an impediment and these procedures may need to be streamlined.

The assessment further divides each policy dimension into sub-dimensions that capture critical features of policy development in each specific area. Sub-dimensions are then broken down into indicators. The policy development path for each indicator is structured around five levels ranging from one to five; where level one represents no structured policy intervention in place and level five represents policies which incorporate key elements of internationally recognised good practice. The results of the assessment are based on the reconciliation of the outcomes of two separate and independent assessment processes conducted by ODIMM and by the OECD, with the support of Business Intelligence Services (BIS), a consultancy company based in Chisinau.

For the purpose of this report the scores of the assessment have not been included as comparisons with other economies or time periods covered by the methodology cannot be made yet.

Source: EC (2008a).

2.1. Creating an environment in which entrepreneurs and family businesses can thrive and entrepreneurship is rewarded

Education systems in most OECD countries have undergone a change in orientation over the last few years. From being suppliers of theoretical knowledge, they have gradually incorporated the need to provide students with skills that can be used in the labour market. In the European Union, entrepreneurship is considered one of the key competences (EC, 2007a) that need to be promoted at every stage of the learning system. In particular, in higher education significant work has been achieved to increase employability of graduates as part of the Bologna Process. Ministers of education have identified employability as one of the key priorities to be achieved with the creation of the European Higher Education Area.

Employability relates to "the ability to gain initial employment, to maintain employment, and to be able to move around within the labour market" (Bologna Follow-up group on employability). Employers' surveys have shown that in addition to hard skills, a number of soft skills are needed. These skills, which include the ability to exploit potential business opportunities and more generally the capacity to perform well in a corporate environment, have been grouped under the concept of "entrepreneurial learning". The Entrepreneurial Learning Programme can be developed in particular to foster women and young entrepreneurship (EC, 2008a). Given the breadth of competences and skills it encompasses, an assessment of the development of entrepreneurial learning needs to review measures taken both during initial education and through continuous education and training.

This section gauges to what extent the concept of entrepreneurial learning is present in the education system of the Republic of Moldova. The policy framework for entrepreneurial learning and its application in the curriculum are reviewed. In particular, the development of entrepreneurial learning in tertiary education institutions is assessed. Schemes to develop entrepreneurial training through continuous education are also reviewed.

Policy framework for entrepreneurial learning

The policy and institutional framework for entrepreneurial learning in the Republic of Moldova is not clearly defined and dialogue between the various institutions appears limited. The National Development Strategy developed by the Government of Moldova for the period 2008-11 includes, among other objectives, the development of entrepreneurial knowledge and culture. However, this document defines the strategic orientation of reforms, but does not include practical measures. Responsibility for entrepreneurial learning policies is split between several institutions. The Ministry of Education is in charge of developing entrepreneurial learning in the education system while the Ministry of Economy, through the SME Programme, has programmes for young entrepreneurs and employees. Finally, as part of the active labour market policies, the National Employment Agency organises training which includes some forms of entrepreneurial learning.

Policy dialogue between these various institutions and with the private sector is needed to ensure that a consistent framework is developed and that schemes are in line with the needs of the private sector. However, consultation between the various institutions in charge of entrepreneurial learning in the Republic of Moldova appears to be limited. Despite a few attempts to foster public-private dialogue, in particular through the set up of a business-oriented Internet portal, consultation with private stakeholders seems minimal. Although the National Development Strategy should provide a common framework, there is little coordination between the various initiatives and no common understanding of the objectives of entrepreneurial learning. Furthermore, evaluation of the various existing schemes is done on an *ad hoc* basis and no comprehensive assessment exists.

Entrepreneurial learning in initial education

During initial education, entrepreneurial learning relates to the acquisition by students of a set of competences and skills, and in particular soft skills (*e.g.* communication skills, initiative, teamwork), that are valued on the labour market. Therefore, developing entrepreneurial learning requires that education institutions not only include new topics in the curriculum but also alter their teaching methods. As they are more directly preparing students for the labour market, tertiary education institutions can have an important role to play in the development of entrepreneurial learning.

There is no institutional commitment to include entrepreneurial learning in the education system of the Republic of Moldova. Initiatives are conducted by international organisations such as Junior Achievement or Winrock International and financed by the donor community, and in particular by the development agencies of Austria and Liechtenstein, which seek to bridge this gap. Since 1995, the international organisation, Junior Achievement, has been supporting education system reform through the development of a number of courses to foster entrepreneurial culture. Optional courses in several subjects related to entrepreneurship are available from primary to upper secondary school level. However, these courses tend to be mainly theoretical and may have limited applicability. Besides initiatives by the donor community, individual teachers, particularly in vocational schools, are developing alternative forms of teaching to engage students in more practical learning. The initiatives of the international community or of individual teachers have a positive impact and can demonstrate the benefit of entrepreneurial learning. However, their scope is necessarily limited and will remain so as long as entrepreneurial learning is not clearly included within the programme of the Ministry of Education.

Reform of the tertiary education system in the Republic of Moldova is driven by the adoption of the Bologna Process. In that respect, the need to develop entrepreneurial learning is acknowledged by policy makers and universities. Efforts have been made to develop more practical knowledge. In particular, many universities have included internship schemes within their curriculum, usually during the last year of study. However, curricula are still very oriented toward the acquisition of a theoretical compendium and significant efforts must be taken to change this legacy. Tertiary education institutions in the Republic of Moldova have a large degree of independence. Accordingly, the level of implementation of entrepreneurial learning varies across institutions and faculties. Entrepreneurial learning is often quite developed in economics faculties and much less so in technical faculties. This is similar to the situation in the European Union where efforts need to be made to develop entrepreneurship training within non-business studies (EC, 2008b). Raising the awareness of education institutions and helping them implement the concept of entrepreneurial learning for students in all subjects is needed to further develop the employability of graduates.

Entrepreneurial skills in continuing education and training (CET)

Throughout their professional life, employees may need to further develop their entrepreneurial skills.[2] As a consequence, entrepreneurial learning is a core element of continuing education and learning. In particular, entrepreneurial learning may be included within the range of active labour market policies. Unemployed people who choose to create their own company can therefore have the opportunity to obtain the skills necessary to do so.

In the Republic of Moldova, the main public programmes for continuing training and education are operated by ODIMM and by the National Employment Agency. ODIMM is implementing the National Youth Economic Empowerment Program 2008-2010. This programme targets young entrepreneurs, particularly in rural areas. It consists of 10 days of practical training in topics, such as business planning, and marketing or management, that are necessary to start up a business. In 2010, 405 people were trained. In November 2010, ODIMM also launched a programme to stimulate investments of remittances in business development which include the provision of training on entrepreneurship-related subjects.

In order to foster job creation, the National Employment Agency is also proposing training in entrepreneurship to unemployed people. These training courses last between two and nine months and help unemployed people develop the necessary skills to create a business. In 2009, more than 2 200 people attended these training courses. The success of this initiative is mixed. Participants seldom create their own company but instead they often find a job at the end of the training period. The budget dedicated to active labour market policies experienced a sharp reduction in 2010 due to the impact of the financial crisis. As a consequence, the scope of these measures is likely to be reduced in the next few months.

Finally, donor initiatives are also conducted which aim at developing entrepreneurial learning in CET. For example, Winrock International, as part or its Moldova Employment and Entrepreneurship Education, operates training courses for entrepreneurs with the support of the Liechtenstein Development Service.

Conclusions and recommendations

In spite of the overall framework provided by its inclusion in the National Development Strategy of the government, entrepreneurial learning in the Republic of Moldova suffers from a lack of coordination among the various stakeholders. While some forms of entrepreneurial learning are gradually being introduced within the initial education system, there is no common understanding of the objectives of entrepreneurial learning. Raising awareness in universities may be needed. Furthermore, consultation with the private sector on the skills needed appears minimal and should be reinforced.

Entrepreneurial learning is more developed within the framework of continuing education and training. In particular, public entities are operating programmes to foster entrepreneurial skills both for employed and unemployed workers. In particular, ODIMM has developed a training programme which targets the young entrepreneur in particular. No specific project has been developed to foster entrepreneurship among women. Due to resource constraints, these programmes only deal partially with the very important training needs of the workforce (European Training Foundation, 2010). Besides public agencies, private providers and NGOs offer programmes for entrepreneurial learning. These programmes should be supported. In particular, the government should consider establishing minimum monitoring of these institutions in order to ensure that the quality of training is adequate. Furthermore, in order to elicit investment in training, the government should consider developing adequate support for companies and individuals using the services of private training providers.

2.2. Ensuring that honest entrepreneurs who have faced bankruptcy quickly get a second chance

Bankruptcy procedures are an essential part of the development of a sound and active credit market. Because SMEs usually present a higher risk profile than larger firms, the effectiveness of the insolvency framework may have a particularly high impact on their access to finance. Banks are more likely to offer lending to companies if they have the guarantee that, in case of default, the bankruptcy procedures will allow them to regain their loans. Bankruptcy procedures need to strike the right balance between creditors' and debtors' rights. Djankov *et al.* (2007) find that various regimes need to be adopted according to the level of economic development. Indeed, income per capita appears to be a good indicator of the ability of the judiciary system to effectively conduct various forms of bankruptcy procedures, ranging from out-of-court work and foreclosure to reorganisation and liquidation.

In high-income countries, reorganisation of a company best allows the maintenance of activity of the bankrupt company and maximises the prospects of debt recovery. In medium-income countries, such as the Republic of Moldova, higher efficiency seems to be related to stronger creditors' rights. Indeed, in these countries foreclosure, which allows secured creditors to repossess their liens, is generally the procedure that is most likely to keep the company as a "going concern". In the Republic of Moldova, USAID (2010) indicates that foreclosure and liquidation are indeed the most common forms of bankruptcy, while reorganisation is much less usual.

This section starts with a review of the legal and institutional framework for insolvency. It then assesses the various steps linked to the insolvency procedure, reviewing in particular the various procedures that exist and their potential outcomes. Finally, the process governing the reorganisation of insolvent companies is detailed.

Legal and institutional framework

The legal framework for insolvency procedures consists mainly of the Insolvency Law (Law No. 632-XV), enacted in 2001, and its subsequent amendments. The law has been subject to a number of modifications since it entered into force and it is considered to be very much in line with international standards. The law distinguishes three forms of insolvency procedures: foreclosure, liquidation and reorganisation of insolvent companies. The possibility for the debtor to reach an out-of-court agreement with creditors is not recognised as a standard procedure.[3]

Once an insolvency case is open, the court nominates an administrator who will be in charge of conducting the process under the overview of the court. The competence and the reliability of the administrator are critical to the success of the insolvency procedure. Accordingly, a number of requirements have been set up in terms of experience and competence for an individual to operate as an insolvency administrator in the Republic of Moldova. In particular, initial training, offered by the Academy of Public Administration, is required. However, as USAID (2010) highlights, this training is short and no specific practical experience is included in the training. Although they need to be registered by the court, insolvency administrators require no licence. This lack of a formal system of licensing is considered by some practitioners as a limitation to the recognition and therefore the quality of administrators. The creation in 2008 of the Association of Liquidation Administrators of the Republic of Moldova (ALARM), which counts 27 members, is a positive sign that the level of professionalisation and self-discipline in the sector is improving.

The insolvency process is overviewed by the Economic Circuit Court, a specialised court with 12 judges established to administer economic cases. The Economic Court of Appeal deals with appeals on the decisions taken by the Economic Circuit Court. Although the framework for insolvency has been evolving rapidly over the last few years, practitioners have said that judges in the Economic Circuit Court were generally sufficiently knowledgeable about the legal framework for insolvency. USAID (2010) suggests that due to the very technical nature of insolvency laws, some additional continuing training should be considered to ensure good understanding of the financial documentation that is central to insolvency administration.

Insolvency procedure

The law on insolvency in the Republic of Moldova is mostly compliant with international standards. Indeed, an assessment of the insolvency framework conducted by the EBRD in 2009 concluded that compliance with international standards was medium (EBRD, 2009). The law clearly sets out the criteria for commencing proceedings and avoids pre-bankruptcy transactions. Once the insolvency procedure is initiated, a provisional administrator is nominated by the court who will overview the insolvency procedure and, if needed, liquidate the company. The qualifications of the administrator, as well as the scope of his role, are stated in the law. In particular, the administrator is to present monthly reports to the court in charge of the insolvency procedure. In practice, however, the situation appears to be more difficult. In *Doing Business 2011*, the World Bank (2010b) ranks the Republic of Moldova 92nd out of 183 economies on the "closing a business" dimension. This ranking is based on the recovery rate associated with the insolvency of a fictitious company. In the Republic of Moldova, when insolvency is launched, investors can expect that 28.2% of debt will be repaid. This is below the average of 30.2% in SEE but above the average of 26.4% in Eastern Partnership countries. In the Eastern Partnership, the performance of Belarus, Georgia and Ukraine is below that of the Republic of Moldova. The outcome of the assessment by *Doing Business* depends very much on the type of procedure that is considered most likely. In the Republic of Moldova, as in most transition economies with limited judiciary capacity, reorganisation generally yields a poorer outcome than liquidation and sale as a "going concern" (USAID, 2010). Data collected as part of the *Doing Business 2011* assessment shows that insolvency procedures tend to be lengthy in the Republic of Moldova. Indeed, a number of measures can be taken to slow down the process. In the case of a reorganisation, these measures can bring the duration to up to 34 months and for liquidation to up to 22 months (USAID, 2010). Given the time-critical dimension of insolvency procedures, these delays are an impediment to the effectiveness of the procedure.

Given the dominance of bank lending in the Republic of Moldova, the treatment of secured lenders in the insolvency process is of particular importance. Within the lending contract, secured lenders have the possibility to repossess their liens outside of the bankruptcy procedure if the debtor fails to comply with his obligations. Whenever a bankruptcy procedure is launched, an automatic stay on secured loans is pronounced that stops ongoing procedures to seize collateral by secured lenders and prevents future seizure. This stay is active until the termination of the bankruptcy procedure. Secured lenders however are treated with an absolute priority, meaning that they are to be repaid entirely before more junior lenders can be served. In practice, because the insolvency procedure tends to be lengthy and offers a less favourable treatment to secured lenders, banks are not keen to initiate bankruptcy cases. On the other hand, as the market value of collateral may be limited, in certain cases banks do not make particular efforts to seize the assets pledged. This may result in a *statu quo* situation where banks neither seize the assets nor initiate a bankruptcy procedure, although no repayment on the loan is made. In such a case, delinquent loans are carried forward in the portfolio of the banking institution, which is reluctant to take any action that would result in the materialisation of the associated loan loss.

Re-organisation

Insolvency procedures in the Republic of Moldova also allow for re-organisation of the company. Such a process grants an insolvent company permission to continue its operations and negotiate with its creditors. In order to enter re-organisation, management needs to submit a re-organisation plan to court within 90 days of the insolvency case being opened. This plan is then presented to an assembly of creditors who vote on the plan. Secured and unsecured creditors vote separately for the adoption of the plan. If creditors of a particular class are not disadvantaged by the plan, compared with the situation where no plan exists, it is deemed to be accepted. Otherwise within a class of creditors, the plan needs to be approved by at least 50% of creditors holding at least 50% of the liability to be considered adopted by that class. Once the re-organisation plan is adopted by all the classes of creditors, the court reviews it and, if the plan is confirmed, the insolvency procedure is terminated.

During the insolvency procedure, management is removed from operations and a number of restrictions apply. In particular, companies cannot participate in public procurement procedures while in insolvency. Furthermore, a specific procedure needs to be followed in order to lay off employees. Once the insolvency procedure is terminated, either because the company was sold as a going concern or because a re-organisation plan was approved, these restrictions are lifted. Within two weeks, the company is removed from the registry of insolvent firms. In the case of a re-organisation, although the management team may be re-instated, the plan can specify that oversight by an administrator is maintained until the full realisation of the plan.

The re-organisation process in the Republic of Moldova is formalised, as is the procedure to have a plan adopted by creditors. The assessment conducted by the EBRD in 2009 suggests potential improvements such as the provision of an independent analysis of the plan, the set-up of minimum protective requirements and restrictions on voting by connected parties. Although these measures may improve the re-organisation process, impact will be limited as re-organisation appears to be seldom used in the Republic of Moldova. One of the reasons for this may be that banking institutions, which have little to gain from a re-organisation procedure, usually represent a sufficient share of debts and thus block any initiative by the debtor or by other creditors to start a re-organisation procedure.

Conclusion

The Republic of Moldova has a well developed regulatory framework for insolvency. The law allows both for liquidation and re-organisation of insolvent companies. The liquidation procedures allow for the sale of an insolvent company as a "going-concern", an essential feature which allows the company to continue operations. No particular obstacles exist for re-starters. Although some improvements could be made, the various steps of the re-organisation procedures are well-defined. However, re-organisation of companies is seldom used. Only large public companies seem to have undergone a re-organisation procedure. Liquidation and foreclosure seem to be the preferred avenue to deal with insolvent firms.

In order to improve the efficiency of the insolvency process, which is currently considered among the lowest in the region, reforms should be taken to reduce delays in the procedure. Measures may also be taken to ensure that the officials in charge of administrating insolvency procedures have received sufficient training. In particular, ensuring that insolvency administrators have an adequate level of competence is central to the proper functioning of the insolvency framework. Furthermore, although no particular disposition prevents out-of-court settlement, formally acknowledging and regulating this type of agreement may help develop its use and foster cost-effective management of insolvency processes.

2.3. Designing rules according to the "think small first" principle

Compliance with administrative regulations is one of the main constraints faced by SMEs in Europe. Indeed, SMEs bear a disproportionate regulatory and administrative burden in comparison to larger businesses. It has been estimated that where a large company spends one euro per employee because of a regulatory duty, a small business might have to spend on average up to EUR 10 (EC, 2007c). Thirty-six per cent of SMEs in the European Union report that red tape has constrained their business activities over the past two years. There is a broad consensus amongst analysts that a positive correlation exists between high-quality legislation and regulation *and* enterprise growth and creation (Busse and Groizard, 2008; Djankov, McLiesh and Ramalho, 2006; Batra and Stone, 2008; OECD, 2002).

This section examines the extent to which the legislative and regulatory stock affecting SMEs has been reviewed and simplified and the extent to which an impact assessment is applied when legal instruments are drafted. It subsequently assesses the degree of public-private dialogue, focusing in particular on the representation of SMEs.

Regulatory impact analysis and simplification

In recent years, the Republic of Moldova has made important progress in implementing regulatory reform programmes. It is one of the most advanced economies in the region in the application of regulatory impact analysis (RIA) to draft legislation.

Regarding regulatory simplification, three reviews of existing regulation, refered to as regulatory guillotine initiatives, were conducted: in 2005, 2008 and in 2010. As part of these initiatives an independent working group was set up including representative from the public and private sector: the Guillotine Working Group. The three projects were funded by the World Bank and USAID and involved consultation with public authorities and the private sector (FIA, CCI, National Confederation of Employers, Association of Sugar Producers, etc.). The first review focused on government decrees and by-laws; 192 acts were abolished and 26 government decisions amended. The second phase focused on laws and regulation related to entrepreneurial activity; 82 laws were amended and two laws were abolished. In 2010, a third review, called Guillotine 2+, was conducted; it focused on regulation related to permits and authorisations required by companies and it is expected to result in the abolishment of close to 100 acts. Furthermore, regulatory simplification is also mentioned in the 2009-13 Government Program, which includes in particular an action plan to remove administrative constraints for SMEs. To be effective, regulatory simplification needs to be conducted consistently at the national and at the local levels. Measuring the administrative burden on companies incurred by local regulation is beyond the scope of this assessment. Evidence provided by the BEEPS, which collects information stratified by geographic areas,[4] does not show very large differences in the perception of administrative burden according to location (EBRD and World Bank, 2009). However, further enquiries would be needed to assess the potential differences in the effectiveness of regulatory simplification at the local level.

RIA has for several years been entrenched in policy making and there is a legal framework in place that makes RIA mandatory on legislative proposals related to entrepreneurial activity. RIAs are created by the authority proposing the normative act draft. In practice, RIAs are conducted by a division in each ministry whose employees are trained in conducting RIA and follow specific RIA guidelines set by the government. The "Guillotine Working Group", which has been made a permanent body, verifies the validity of every RIA. The Working Group is composed of key representatives of the Government and of the private sector. It includes an equal number of public and private sector representatives. It has two co-chairs, from the public and the private sector respectively. The SME community is represented through the president of the Small Business Association, as well as by sector-specific associations. The Working Group meets weekly, is open for attendance to non-Working Group members, but does not have the power to block a legislative proposal. Furthermore, a recent study by the Directorate for Regulatory Reform (Ministry of Economy) concluded that many civil servants are not appropriately trained to conduct RIA.

Public-private dialogue

The Guillotine Working Group, which meets weekly, is the main platform for public private consultation in the Republic of Moldova. It reviews all the legislations that have an impact on business activities. Its primary function is to verify RIAs on draft legislation from the line Ministries. Half of the 22 members are from the private sector, including a representative of the SME sector, and half are from the government. The Working Group votes on every legislative proposal to determine whether it should go to parliament based on the attached RIA. Only if a majority supports the legislative draft, is it endorsed. Whether the draft does go to parliament, however, is ultimately determined by ministers during a government meeting. Although general operation of the Working Group is deemed satisfactory, participants highlighted that documents were sometimes communicated to stakeholders without enough time to ensure effective review by members. Delays do not allow representatives of the private sector to submit legislative proposals to their members and therefore limit potential feedback.

In addition to this Working Group, there are several informal mechanisms. A yearly SME forum, with a somewhat consultative role, invites SMEs to present their experiences and exchange views with the government at thematic roundtables, workshops, and seminars. A public-private consultation function was also added to the SME online portal recently: *www.businessportal.md* offers the possibility for SMEs to present their questions to the government. The site does not, however, give an indication on when and how the questions will be answered nor a guarantee that they will be answered at all. Another website, *www.particip.gov.md* was also created by the government to elicit public opinion on draft laws, normative acts, strategies and other initiatives. Apart from these forums, anecdotal evidence indicates that, as a rule, consultation is seldom conducted. In particular, although feedback from the private sector is critical to ensure the relevance of some regulations, there seems to be limited dialogue at the drafting stage of regulation.

The current fragmentation of the private and SME sectors in particular seems to be the main obstacle to the development of a more systematic and effective public-private dialogue. Several institutions represent the views of the private sector, with the CCI of the Republic of Moldova, to whom membership is mandatory for large companies,[5] being the largest one. However, no horizontal association exists to specifically represent the SME sector. SMEs generally set up sector-specific associations to discuss specific issues. However, in order to allow adequate representation, these vertical associations need to be grouped under a horizontal umbrella organisation. Indeed, in the Republic of Moldova, several sector-specific organisations exist, for example in the ICT and in the textile sectors. However, they have only limited access to policy makers. Conversely, strictly horizontal organisations may be considered as having limited relevance by companies which often favour a sector-specific approach. For example, the horizontal association representing SMEs in the RIA committee is mainly composed of patent holders and micro-companies. In that respect, its position does not fully reflect the concerns of the overall SME sector.

Conclusion

The Republic of Moldova has made considerable progress in the area of regulatory reform through the implementation of sound regulatory simplification processes and the application of RIA to draft legislation. A Guillotine Working Group has been set up, which has many characteristics of a regulatory oversight body. A clear framework for public-private consultation is in place, which is structured around the 11 private sector representatives of the Guillotine Working Group.

However, international best practice suggests that the Guillotine Working Group could be granted the power to block legislative proposals if the RIA carried out is deemed to be incomplete or inconclusive. This would ensure that the opinion of the working group is taken into account. Furthermore, in order for the RIA to be effective a recent study of the Ministry of Economy suggests that additional training courses for civil servants conducting RIA could also be considered.

Public-private consultation with SMEs in particular appears to be limited. This is partly due to the difficulties that public institutions have in identifying and engaging in a dialogue with an organisation that would represent the whole SME sector. This is particularly detrimental for SMEs outside Chisinau as they have little opportunity to participate in public-private dialogue. Adding further consultation platforms to the policy-making process, including at the local level, should be considered.

Finally, in order to ensure that the process of administrative simplification is consistently implemented, local authorities need to be closely involved. Further study may be needed to identify and remove potential administrative barriers to the operation of companies at the local level.

2.4. Make public administration responsive to SMEs

In order to limit the cost attached to complying with administrative regulations, two complementary approaches can be adopted. The first approach, assessed in the previous section, aims to simplify the regulation to reduce the number of procedures that SMEs need to conduct. This section, and the corresponding principle of the SBA, aims at assessing the extent to which public administrations have developed instruments to ensure that dialogue with SMEs was more effective. Examples of such instruments include e-government and one-stop-shop solutions. Because they have a particularly strong impact on company creation and on the operations of SMEs, registration and taxation procedures deserve particular attention. Accordingly, this section contains three main sub-areas: the company registration process, online interaction with government services and taxation.

Company registration

A cumbersome and costly start-up process can be a key entry barrier for new businesses. Such barriers may translate into a lower degree of competition and thus lower efficiency and innovation. An efficient start-up process consists of simple and streamlined procedures, with overall low charges for the new entrepreneur and low processing costs for the public administration, while securing compliance with legal and regulatory requirements. Until a few years ago, starting up a business was a complex and costly process in most of the EU and OECD countries. However, over the last decade, the application of new ICT solutions, together with new approaches to regulatory issues have led to substantial gains in terms of efficiency. According to the World Bank's *Doing Business 2011* data (World Bank, 2010b), the average time to complete the overall start-up business process in OECD countries was cut by over 60% over the past few years, while the average cost for the entrepreneur was reduced by nearly 50%.

The Republic of Moldova has already achieved positive results in improving the efficiency and quality of the business start-up process (particularly in the registration and notification phase), while obstacles still remain in the compliance phase. Regarding the length of time required to obtain a company registration certificate, Article 5 of Law No. 220-XVI states that companies are registered within five working days of submitting the required documentation. Moreover, for an additional fee, companies can obtain registration certificates within 24 hours or even within 4 hours. In practice, although this process is rapid by regional standards, the actual duration is significantly longer. The World Bank's *Doing Business 2011* report (2010b) states that the duration is 10 days. Such a delay is close to the OECD average.

The standard fee for obtaining a company registration certificate is different for limited liability companies and joint stock companies. For the former, the fee is MDL 718 (EUR 44), for the latter, MDL 916 (EUR 56). The registration fee for a 24-hour procedure is slightly higher: MDL 1 189 (EUR 72.5) and MDL 1 585 (EUR 97) (for limited liability and joint stock companies, respectively. These fees represent a higher portion of GDP per capita than in the EU. Thus, they may represent a significant entry barrier for new companies.

Progress on notification has been less marked than on company registration. The State Registration Chamber has set up an information technology network shared with the various public institutions that interact with companies. However, according to the *Doing Business 2011* report, start-ups in the Republic of Moldova still have to register with the following administrative authorities:

- the State Chamber of Registration;
- the Ministry of Information Development (this procedure is included in the registration with the State Chamber of Registration);
- the local Fiscal Inspectorate of the Ministry of Finance;
- the National Bureau of Statistics;
- the National Social Security Fund; and
- the National Medical Insurance Company.

The State Chamber of Registration has indicated that a one-stop-shop has been set up. This system allows entrepreneurs to conduct all the necessary registration in one of the ten regional offices of the State Chamber of Registration. Online services have also been developed. However, limited adoption of the Internet by companies limits the potential demand for online services. The Republic of Moldova's legislation has no provisions on the "silence-is-consent" principle. This principle stipulates that a certificate and authorisation are deemed granted if administrations fail to decide within a certain delay. It switches the burden of action to the administration and provides a clear signal to companies that procedures will be conducted within a reasonable timeframe. The "silent-is-consent" principle has been adopted by administrations in some SEE economies such as Serbia and the former Yugoslav Republic of Macedonia. In the Republic of Moldova, it is not formulated as a principle in any domestic legislative acts and it cannot be used as a result of interpretation of any legal stipulations, including company registration.

Interaction with government services

Encouraging enterprises to adopt ICT solutions is critical for building a competitive knowledge-based economy. As SMEs adopt ICT solutions, they will be able to establish electronic links with other businesses, engage in e-business activities, and access new and richer information sources in order to enhance innovation and competitiveness. Moreover, governments that adopt ICT approaches to provide services to small enterprises will be able to improve their services, while reducing their own costs and enabling enterprises to reduce the costs of meeting legal requirements. Online access to e-government is of particular importance to micro and small companies where entrepreneurs cannot carry out their core business (*i.e.* running their company) during time spent on administrative matters in the offices of public officials.

The Republic of Moldova has only recently started to implement an electronic signature for businesses, which is key to the interaction with government services online. E-government services, therefore, remain relatively undeveloped. The Republic of Moldova has an SME-dedicated online portal which is managed by ODIMM. Its key features include information on business services, training programmes, public-private partnerships and the registration process. The website is currently mainly in Romanian with only part of the content also available in English. Plans exist to expand the information available and to include a translation of the content into English and Russian.

Taxation

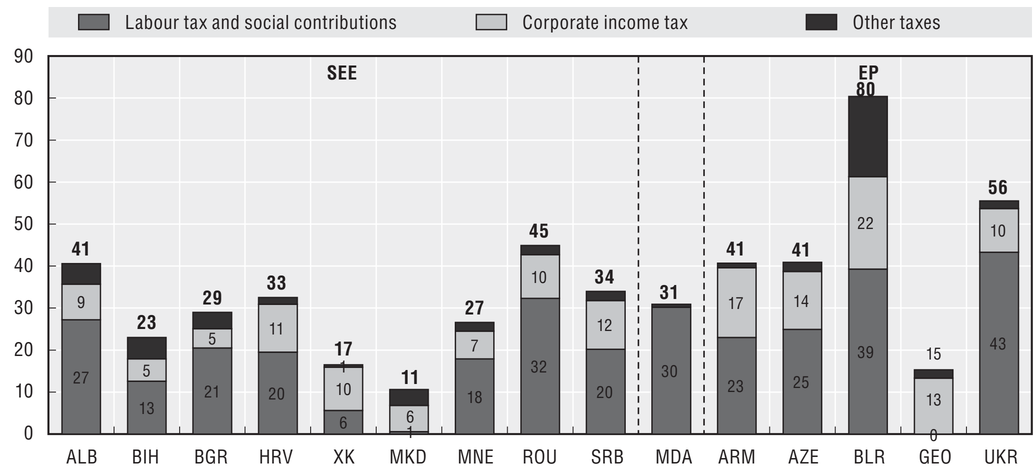
Tax policy is one of the main instruments that government can use to support specific activities. When assessing taxation, both the overall level and the structure of incentives that derives from the various taxes need to be taken into account. Furthermore, as SMEs have limited resources that they can dedicate to dialogue with the tax authorities, tax administration can represent a significant obstacle. Accordingly, this section assesses the tax policy in the Republic of Moldova and the measures taken to facilitate tax administration.

Tax policy

The fiscal burden on companies in the Republic of Moldova is low on an international scale and has been decreasing steadily in the past few years. The World Bank's *Doing Business 2011* report (2010b) estimated that total tax payable for an industrial medium-sized company in the Republic of Moldova represents 30.9% of gross profits.[6] As shown in Figure 2.1, this ratio is slightly above the average for other SEE economies but significantly below the average of EP countries, which stand at 28.6% and 46.6% of profits respectively. In particular, the total tax rate is lower in the Republic of Moldova than in neighbouring Romania and Ukraine. The tax burden decreased marginally from its 2010 level of 31.1% of profits. In the past few years however, the tax level reported by the World Bank has decreased significantly. As a result, 49% of companies in the Republic of Moldova identified the tax rate as a major constraint in 2009, compared to 73% in 2003 (EBRD and World Bank, 2009).

Figure 2.1. **Total level of tax in the SEE and EP regions, 2001**

As a % of total profit



Source: World Bank (2010b), *Doing Business 2011*.

The majority of companies in the Republic of Moldova consider the level of taxation to be generally satisfactory. However, the structure of the tax system represents a distorted incentive procedure that may have a detrimental impact on the development of companies. Indeed, the tax regime in the Republic of Moldova is characterised by a zero per cent tax on corporate profit. This fiscal policy was enacted to foster foreign investment and support competitiveness. Based on cross-country analysis, Piatkowski and Jarmuzek (2008) question the effectiveness of tax competition in attracting FDI. Indeed, international evidence indicates that FDI is only marginally impacted by changes in corporate income tax alone. Other elements, such as the quality of governance or the business environment can also have an impact and may also need to be reformed. Furthermore, on a more microeconomic level, a zero per cent corporate income tax significantly reduces the possibility of developing tax incentives. While lower expenditure may reduce wasteful public expenditures, it is also a strong limitation to potentially beneficial horizontal public intervention on private sector activities. Reflecting the debate on the benefit of a zero corporate income tax, the fiscal inspectorate of the Republic of Moldova has proposed to increase corporate income tax to 10 per cent by 2012. Companies with fewer than 19 employees and fewer than MDL 3 000 000 (EUR 180 000) annual turnover would remain exempted from this tax.

Additionally, as a consequence of the low corporate income tax, taxes paid by corporations are almost exclusively on salaries. According to *Doing Business 2011*, labour tax and social contribution represent 30.2% of profits. In SEE, the average is at 18.7% and in the Eastern Partnership countries, the average stands at 26.1%. Only in Romania, Belarus and Ukraine is the tax on labour higher. Setting a relatively high level of tax on labour in a country where taxes for companies are otherwise low, represents a strong incentive toward informality. Anecdotal evidence suggests that employers formally pay a minimum wage to their employees that they complement in cash in order to avoid paying social contributions. Measures should therefore be considered to reduce the share of taxation that relies on salaries so as to adopt a more balanced tax regime.

Tax administration

Significant efforts are being made to improve the cost of complying with fiscal requirements. Accordingly, the satisfaction of companies with the tax administration process has improved. According to the BEEPS, in 2009, 30.4% of companies identified tax administration as a major constraint, compared to 64.7% in 2003 (EBRD and World Bank, 2009). To be more specific, in the World Bank's *Doing Business 2011* report estimated that reporting duties required 48 payments a year and 228 hours compared to 52 payments and 234 hours in 2009. These statistics put the performance of tax administration in the Republic of Moldova within the highest in the region. However, additional progress has not been made and, in particular, VAT reimbursements seem to remain difficult. International experience in reducing the cost of tax compliance may serve as a guide to further reform of the tax administration.

Despite clear delays set by the administration, there appears to be a gap between the official and the actual reimbursement time for VAT. Officially, VAT reimbursements take only 45 days. The fiscal inspection closely monitors delays associated with the procedures and ensures that all reimbursements take place within the official timeframe. However, the delay monitored by the fiscal authorities does not take into account the additional time that companies spend collecting the various documents required to obtain reimbursement. Such documents are quite extensive, so collecting the required documentation takes them a significant amount of time and labour. Taking into account this delay, anecdotal evidence suggests that actual VAT reimbursement takes closer to three months.

In order to further reduce the cost of compliance, international experience shows a number of measures that have been developed (see for example OECD, 2010). In particular, the set up of a simplified system for SMEs, the development of an effective tax reconciliation system and online services can prove beneficial. For entrepreneurs and SMEs, complying with the tax system requirements represents a heavier burden than for larger companies. Accordingly, a number of countries have set up simplified tax compliance systems for SMEs. The European Commission (2007b) and OECD (2009b) provide illustrations of the best practice developed in this domain. In the Republic of Moldova, SMEs do not benefit from a simplified tax collection system. Setting up a specific system that would more effectively take into account SME needs would lower compliance costs, increasing efficiency and encouraging SMEs to operate in the "formal" economy. Moreover, in the Republic of Moldova, there seems to be no system for tax reconciliation. Such mechanisms allow payment to be made only for the net balance of tax rather than for the gross amounts. This helps to decrease the number of payments that are needed as well as the complexity and delay associated with the overall tax payment. Online services for the payment of tax are also used by government to limit paperwork and the costs associated with tax collection. In the Republic of Moldova, fiscal authorities recently developed an online service to submit filing and reports online. As of January 2010, the service counted 65 registered users. In addition, in 2010 the National Office of Social Insurance, in collaboration with USAID, launched a project which aims to develop online social security returns.

Conclusion

The assessment shows that the Republic of Moldova performs relatively well in promoting faster and cheaper start-ups. Implementation is more advanced in the registration phase. The cost for obtaining a registration certificate is relatively high and is likely to form a significant barrier to start-ups: lowering the fee should be considered. The notification phase is still cumbersome and streamlining this process should also be considered. The Republic of Moldova has taken important steps to establish an online registration system.

The Republic of Moldova is beginning to introduce e-government services to business operations. The progress already achieved in this field should be extended to other government services, such as social security returns and enterprise statistics. The Republic of Moldova has a functioning and regularly updated online portal for SMEs. It could be improved by providing more of its content in English, thus making it more accessible to foreign companies.

In the area of taxation, the Republic of Moldova has made a significant effort to improve both the level of tax and the burden associated with tax administration. The total level of tax appears similar to that of other transition economies. However, taxes are primarily based on salaries, which may introduce distortion and promote informality. Further measures to simplify reporting duties are desired. In particular, simplified compliance mechanisms for SMEs could be considered. The effort to introduce online services for VAT should also be sustained and possibly extended to other types of taxes.

2.5. Adapting public policy tools to SME needs

Public procurement can represent a significant source of revenue for SMEs. However, in many cases, complex regulations and cumbersome procedures makes it difficult for SMEs to respond effectively to public tenders. Some restrictions may also exist for foreign companies, thus limiting the willingness of foreign investors to participate. These obstacles not only hinder the potential for SMEs to use public procurement to foster their development, they also reduce the level of competition for public tenders and limit the effectiveness of the procurement process. This section assesses the efforts made by the government to ensure that access to public procurement is available to the widest range of economic actors.

Public procurement process

Public procurement in the Republic of Moldova is governed by the Law on Public Procurement No. 96-XVI enacted in 2007. The law states the procedure that needs to be followed as well as the role that the Public Procurement Agency plays in monitoring the various tenders. The contracting agencies have a duty to send the request for tender to the Agency as long as the contract exceeds MDL 100 000 (EUR 6 100) for goods and MDL 500 000 (EUR 30 500) for services. The agency reviews the tender documents and ensures that they are in conformity with the law on public procurement and then publishes the tender on the Public Procurement Bulletin and on its website. The selection is conducted by the contracting agency which sends a report to the Public Procurement Agency. If the selection process is compliant with the law and no complaint is filed by applicants, then the Public Procurement Agency approves the selection process. Otherwise, the Public Procurement Agency can require additional information from the contracting authority and, if necessary, revoke the initial decision and launch a new tender.

Role of the Public Procurement Agency

The Public Procurement Agency is the institution that centralises the monitoring of public procurement procedures in the Republic of Moldova. The law on public procurement defines the various roles of the agency. It plays a central role in ensuring that access to public tenders is fair and effective. Besides the overview of the selection process, the agency collects statistical information on public procurement and provides support and training to the various contracting agencies. It also has the duty to develop and submit regulations related to public procurement and to suggest potential amendments to the legislative framework. Currently, the agency has 24 employees, including technical staff. A current plan to introduce e-procurement is also under way and two additional employees will be hired to support the implementation of this tool. Outside Chisinau, the agency does not have representative offices. However, in the various regions of the Republic of Moldova, the agency is in contact with public procurement specialists.

With approximately 20 000 contracts handled in 2009 and a large number of missions, the capacity of the Public Procurement Agency is placed under significant stress. As there are plans to lower the financial threshold above which public procurement contracts are handled by the agency, there is an increasing risk that the workload may represent a significant limitation to the level of oversight by the Public Procurement Agency in the Republic of Moldova. Besides improving the capacity of the agency, a measure that may be difficult to implement in time of budgetary restrictions, additional reforms could include differentiating monitoring according to the value of the contract and further centralising purchasing processes for certain categories of goods and services.

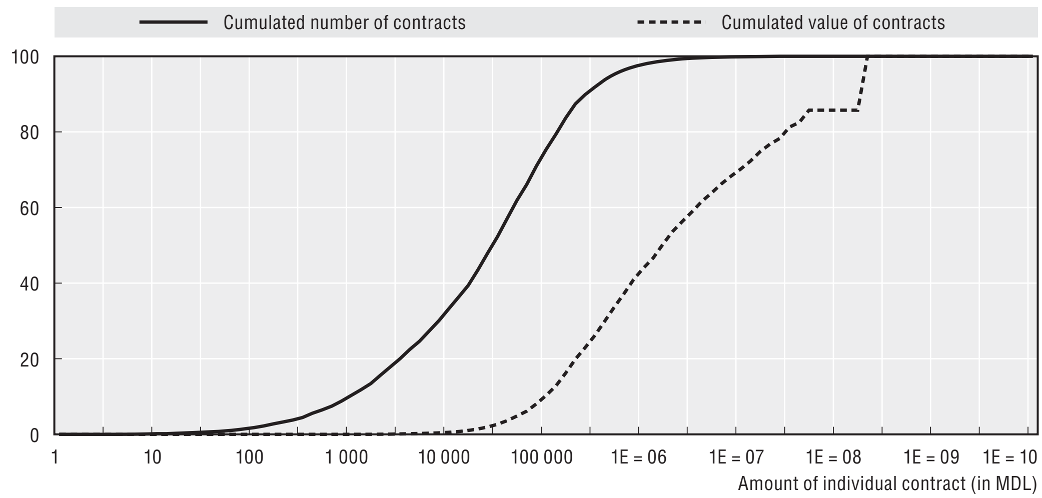
Access of SMEs to public procurement

A number of measures exist to ensure that SMEs can participate in public procurement. In order to better disseminate information, public procurement tenders are published online on the homepage of the Public Procurement Agency. Additional e-procurement measures are currently being considered. In addition, in order to foster participation of SMEs, public tenders are systematically cut into lots and evaluated by lots. The Public Procurement Agency reviews the tenders in order to ensure that the qualifications and financial requirements are adequate and do not represent undue barriers for certain types of bidders. In order to allow for SMEs to respond to larger contracts, the grouping of operators is possible for all types of contracts. Although this procedure is routinely used in specific areas, such as construction, it is seldom used in other domains.

Even though there are certain measures to grant SMEs access to public procurement contracts, analysis of those contracts allocated in 2009 indicates that SME participation may be limited. Indeed, Figure 2.2 shows the cumulative share of contracts, both in number and value, which are below a certain threshold. In 2009, a total of 15 582 contracts were allocated[7] for a total expenditure of MDL 15.5 billion (EUR 1 billion). As shown in this figure, in 2009, 75% of public contracts allocated were for less than MDL 100 000 (EUR 6 480). However, these contracts represented only 10% of total public procurement expenditures in 2009. In contrast, although contracts for more than MDL 1 million (EUR 64 800) represented only 2% of contracts, they amounted to 44% of total expenditure. Two contracts, allocated respectively for the reconstruction and refurbishment of the parliament and the president's office, were allocated for amounts above MDL 250 million (EUR 16.2 million), representing together 15% of total expenditures. The high concentration of public expenditure on large contracts suggests that although SMEs theoretically have access to public procurement, they only represent a marginal share of total expenditure. Companies that are awarded large contracts may use SMEs as sub-contractors. As a consequence, although they cannot be selected as a prime contractor, SMEs may be

Figure 2.2. **Cumulated public procurement contracts by amount, 2009**

Total number and value of contracts (%)



Source: Public Procurement Agency, OECD analysis.

involved in the actual realisation of the work. However, although the law states that a preference may be granted to companies that support SMEs, there is no systematic mechanism to ensure that SMEs are indeed involved.

Both foreign and domestic companies can participate in public tenders. However, a national preference system is still in operation in the Republic of Moldova which limits competition. In particular, all things being equal, foreign suppliers need to be 15% cheaper than domestic competitors in order to be awarded a public contract. The Republic of Moldova has signed a number of international trade agreements, in particular the Central European Free Trade Agreement (CEFTA), which explicitly bans this type of measure. The current political agenda has not allowed the government to change the law on public procurement. However, discriminatory measures must be removed in the short term in order for the Republic of Moldova to comply with its international obligations.

Conclusion

The regulatory and institutional framework for public procurement in the Republic of Moldova is well defined. In particular, the process required and the role of the Public Procurement Agency are clearly set up. Several projects have been led by international donors to support the reform of public procurement.[8] These projects will help the Republic of Moldova further improve its public procurement processes. In particular, the discrepancy between the large number of contracts that need to be approved each year and the limited capacity of the Public Procurement Agency requires particular attention.

The access of various types of companies to public procurement seems adequate. In particular, the Public Procurement Agency ensures that SMEs do not face particular barriers. However, in practice, public procurement expenditure is concentrated on a relatively small number of large contracts. Further efforts may be needed to improve the access of SMEs to public procurement. Furthermore, regulations on national preference are still prevalent in the Republic of Moldova and will need to be modified for the country to comply with its international obligations.

2.6. Facilitating access of SMEs to finance and developing a legal and business environment supportive of timely payments in commercial transactions

According to the BEEPs survey, Access to finance is the main concern for firms in the Republic of Moldova. Thirty nine per cent of companies interviewed as part of the BEEPS consider access to finance to be a major constraint. With only 30.8% of companies using banks to finance investment, companies in the Republic of Moldova are among the least likely to appeal to banks in the Eastern Europe and Central Asia area. In particular, only 27.0% of small companies use banks to finance investment, compared to 40.3% of large companies (EBRD and World Bank, 2009). The Government of the Republic of Moldova is extremely aware of the difficulties faced by companies that need to access finance. Accordingly, and with the support of the international community, a number of measures have been taken to improve this situation. Measures have been taken to improve the credit conditions in the country and efforts have also been made to improve the legal system and to develop creditors' information and guarantee schemes.

Legal and institutional framework

The legal system for access to finance in the Republic of Moldova is comprehensive and does not represent an obstacle for companies. The various types of financial products are well defined in the legal framework. The framework for bankruptcy and lated issues of collateral registration play a particularly important role for access to finance. Lenders need to have the certainty that, in the case of delinquency, they will be able to seize assets and that the bankruptcy process is adequate.

Registering collateral, in particular real estate, and obtaining precise information on pledges is critical for lenders. In the Republic of Moldova, cadastre registration is among the best in South East Europe. The territory is fully registered and available online. A central collateral registry is also available which includes both fixed and moveable assets. This system is not available online and, although a maximum delay of 30 days is set to obtain an answer from the registry, this delay may represent an impediment for lenders, particularly in rural areas.

The bankruptcy law, a particularly important element of the legal framework for access to finance, is in line with international standards. The detailed settings of bankruptcy law are reviewed in Section 2.2. The insolvency framework includes clear commencement criteria and allows for settlement out-of-court. Moreover, both liquidation and re-organisation of the company are allowed and processes are well structured. Some elements of the bankruptcy legislation can still be improved upon. For example, a regional assessment by the EBRD concluded that specific issues such as independent analysis of the proposed re-organisation plan, the protective requirements and the vote for the re-organisation plan should be examined.

In order to monitor the evolution of bank finance throughout the financial crisis, some governments, in particular in France and Belgium, have set up credit mediation services. The role of this service is to monitor the actual difficulties SMEs have in their efforts to obtain bank loans. When necessary, the mediator can act as an intermediary between the company and the banking institution to propose a solution or suggest alternative sources of funds. Such a service can be used in particular to ensure that public funds supporting commercial banks are effectively channelled to SMEs.

Credit information

The link between the availability of credit information and access to finance is well documented. Indeed, studies such as Kallberg and Udell (2003) show that by incorporating data on credit history, credit institutions are better able to predict the default rates of borrowers. Credit bureaus help reduce the information asymmetry between lenders and borrowers. This results in lower risks of adverse selection and moral hazard and, ultimately, in an increased penetration of credit. Pagano and Jappelli (1999) find that countries in which information-sharing services are more firmly established experience a higher rate of bank lending to the private sector. In the Republic of Moldova, measures have been taken to develop information that should contribute to improving access to finance in the long run.

The Law on Credit History Bureaus of March 2009 established a private credit bureau – the only credit bureau so far. It only has a limited number of partners and its main partners are still in the process of collecting authorisation from their customers to share information with the credit bureau. The credit bureau will only distribute negative data on borrowers.[9] International evidence, collected for example in Turner and Varghese (2010), suggests that including positive data in the credit bureau database improve performance and access to credit. Such a measure, the feasibility of which depends on the legal framework on data protection, could be considered. Given the current situation of the banking system, banks have limited capacity to increase the size of their loan portfolio in the short term. Therefore, the positive impact of the credit bureau will only be felt in the medium to long term. However, by allowing financial institutions to screen their prospective customers more effectively, the credit bureau should reduce the collateral requirements of lenders and increase access to credit for smaller companies.

Besides the existence of a credit bureau, evidence suggests that financial statements maintained by companies in the Republic of Moldova represent a limitation to access to finance. Currently, companies in the Republic of Moldova use national accounting standards that are derived from International Accounting Standards (IAS). Specific rules have been designed for SMEs to reduce the administrative burden linked to book-keeping. However, in a recent study, USAID (2010) said that the financial statements currently submitted by borrowers do not allow lenders to effectively assess the creditworthiness of their company. The Republic of Moldova is currently moving towards adoption of International Financial Reporting Standards (IFRS). The deadline for IFRS adoption was initially set for 2011 for all companies but has been postponed. Large and publicly listed companies are now obliged to adopt the standards by the end of 2011 while the remaining companies will follow. Adopting new standards may prove difficult for smaller companies and authorities should consider taking actions to ensure that financial statements maintained by companies are adequate and, if needed, provide them support in helping them maintain the required quality.

Credit guarantee schemes

Credit guarantee schemes are insurance mechanisms that ensure a lender against credit default for a fee. They contribute by granting borrowers with limited collateral and credit history access to credit. In the Republic of Moldova there are two credit guarantee schemes. One is private, Garantinvest, while the other is operated by ODIMM. Garantinvest, which was set up in 2006, receives funds from eight partnering banking institutions and, in 2009, had a capital of MDL 4 million (EUR 260 000). The guarantee fund operated by

ODIMM was initiated in 2004 and later integrated within the scope of activities of ODIMM. On 31 December 2010, it had a capital of MDL 7.3 million (EUR 450 000) and actively co-operated with four banks. The guarantee schemes offered by the two institutions cover a share of the capital against credit default. Guarantinvest covers a maximum of 50% of the amount of the loan. For existing companies, ODIMM also guarantees 50% of the loan amount while, for start-ups, this rate goes up to 70%. The fees required are between 1.5% and 3% of the outstanding capital. ODIMM currently offers guarantees for loans with a limit of MDL 700 000 (EUR 43 000) for existing companies, MDL 300 000 (EUR 18 000) for start-ups. The two credit guarantee schemes do not directly address the borrowers. Instead, they work with the banking institutions that have customers with insufficient guarantees, despite a project that would otherwise be funded. The initial assessment of the quality of the project is conducted by the banking institutions. The credit guarantee schemes then assess applications to decide whether or not to grant a guarantee. This two-step process limits the risk of using the credit guarantee scheme to support failing companies.[10]

The two-credit guarantee schemes are allowed to guarantee up to three times the amount of their capital. Therefore, they collectively cover a total amount of approximately MDL 35 million (EUR 2.3 million), representing 0.15% of domestic credit to the private sector in 2009. However, despite their modest size, the credit guarantee schemes are underutilised. Several reasons may explain the limited effectiveness of the current schemes. First, the funds operations have started quite recently and their design is still in an early stage of development. Features such as the ceiling on the amount of the loan that can be covered or the details of the criteria for activating the insurance[11] have proved to limit the effectiveness of the schemes so far. Second, best practice in the OECD suggests that the rate of coverage needs to be above 70% of the loan amount to represent a sufficient incentive for banks to address a riskier range of customers (Levistky, 1997). Finally, in a credit environment that is characterised by rationing, the effectiveness of a credit guarantee scheme is limited by the behaviour of banks. As the solvable demand for loans is not fully served, banks will be unwilling to serve riskier clients, even though a guarantee is offered. In such a context, there are risks that the credit guarantee contributes marginally to increase the credit of the most fragile companies. In such a context, establishing clearer links between the credit guarantee schemes and the credit lines provided by an international financial organisation may prove beneficial. Indeed, a number of IFIs distribute credit lines to domestic banking institutions in the Republic of Moldova to contribute to improving access to finance for SMEs. As these credit lines are distributed by banking institutions, the selection of lenders by banking institutions may limit their effectiveness. Credit guarantee schemes make it easier for commercial banks to address SMEs with limited collateral or a credit history. Therefore, the conjunction of dedicated credit lines and credit guarantee schemes, both seeking to reduce the cost of lending to SMEs, will help banking institutions distribute loans to the SMEs that need them most.

In order to complement the operations of credit guarantee schemes, international experience shows that private companies can group together to form a mutual credit guarantee scheme. According to these schemes, companies (in the same sector, for example), form an association that selects and present projects to banking institutions with a guarantee issued by the association. Such schemes have been developed in France, Italy Lithuania and Portugal, among others. Based on data from the Italian market, Columa, Gambacorta and Mistrulli (2010) show that mutual guarantee schemes can reduce the cost of lending for small firms. In South East Europe, although several feasibility studies have been conducted, mutual guarantee schemes are scarce. Only in Croatia is there a scheme, operated at the regional level with the support of the regional development agencies, which issues guarantees from a consortium of private companies (OECD, 2010). In the Republic of Moldova, there is neither a mutual guarantee scheme nor signs of particular initiatives to set up one. In order for such a scheme to operate in the Republic of Moldova, private companies would need to be strongly involved in the set up and in the operations of the scheme.

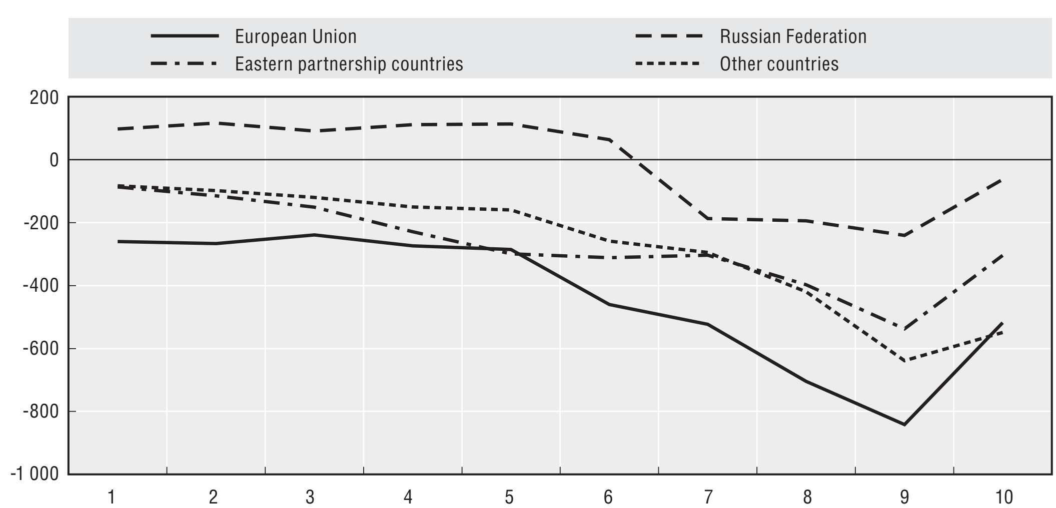
The development of credit guarantee schemes in the Republic of Moldova is recent and has been fuelled in particular by public support for these initiatives. Plans exist to further develop the existing schemes. However, the effectiveness of the credit guarantee schemes may be limited by the adverse conditions in the banking market and by certain elements of their design. Efforts should be made to ensure that the public funds allocated to the credit guarantee schemes are actually serving lenders who otherwise would not have access to bank lending. In particular, an increase of the rate of coverage, together with stronger conditionality should be envisaged. This would ensure that the activities of the public guarantee scheme would complement potential private initiatives and that a broader range of SMEs would be able to access the loan market.

2.7. Helping SMEs to benefit more from the opportunities offered by the single market

Since 2000, the Republic of Moldova has experienced a deterioration of its trade balance. As shown in Figure 2.3, this erosion was progressive until 2003 but then suffered a sharp worsening of the trade balance between 2005 and 2008. In 2009, due to the effects of the global financial crisis on domestic demand, the level of imports continued to decrease with a modest, albeit positive, impact on the trade balance. This evolution has been driven in particular by increasing net imports of energy on the one hand and by the increasing difficulties encountered by local producers to find export opportunities for their products, in particular in the agricultural sector, on the other hand.

Figure 2.3. **Trade balance of the Republic of Moldova with its main partners, 2000-09**

In EUR million



Source: UN Comtrade.

The trade pattern in the Republic of Moldova is characterised by a double specialisation: by geography and by sector. The two main trading partners are the European Union, and in particular Romania, on one side and the Russian Federation and Ukraine on the other side. Other trade partners, and in particular within CEFTA, play a relatively minor role in trade. Each partner also receive exports in distinct categories. The Russian Federation and Ukraine mainly import vegetables and wine from the Republic of Moldova while the European Union predominantly imports clothing and, to a lesser extent, vegetables.

This double-pronged specialisation derives partly from historical links, such as the strong market share of Moldovan wine in countries of the former USSR. However, trade regulations have recently taken on prime importance in the evolution of trade between the Republic of Moldova and its main partners. In 2006, exports of wine to the Russian Federation where banned and trade fell by 75% compared to the previous year. This followed a claim by Russian authorities that wine imports from the Republic of Moldova did not live up to Russian standards. Although the ban was lifted in November 2006, wine exports to the Russian Federation never recovered and remain close to their 2006 levels. With respect to the European Union, difficulties for some producers, in particular in the agricultural sector, in abiding by the technical regulations of the European Union have resulted in increasing specialisation in trade. Since Romania joined the EU in 2007, exports from the Republic of Moldova to Romania have become increasingly concentrated just to a few items. For example, between 2004-06 and 2007-09, exports of textiles to Romania increased by 178%. In parallel, the average volume of wine and vegetables exports decreased by 20%.

These two particular cases of the Russian Federation and Romania illustrate the crucial role that technical regulations can have on the volume and composition of trade. In order to sustain the competitiveness of its economy, notwithstanding the sometimes political dimensions of trade disputes, the Republic of Moldova needs to ensure that products comply with technical regulations and standards set in main export markets. This section, which is mainly based on the assessment of trade policy and facilitation in SEE economies conducted by OECD (2010), examines the efforts made by the government to facilitate SMEs' access to export markets.

Trade policy formulation

Since 2000, trade policy formulation has experienced two parallel evolutions that have made policy making increasingly complex. Trade liberalisation has become a prerequisite to enter the international trading system. Multilateral organisations such as the World Trade Organization (WTO) have helped define national trade policy agendas. Mirroring this internationalisation of trade policy, policy makers have increasingly involved stakeholders representing civil society in the policy formulation process, so as to better take into account the various impacts of trade policy.

The Republic of Moldova participates in the major multilateral trading systems. It has been a member of the WTO since July 2001 and was granted autonomous trade preferences by the European Union in March 2008. Furthermore, the Republic of Moldova is a member of the CIS and has established free trade agreements with all CIS members except for Tajikistan. However, it only has an observatory role in the Eurasian Economic Community which aims at creating a common market between CIS members.[12] The Republic of Moldova is also a member of CEFTA 2006.

Efforts have been made in the Republic of Moldova to develop the inclusiveness of the trade policy-making process. Within the government, policy formulation is carried out by the Ministry of Economy. Line ministries (*e.g.* Ministry of Agriculture) have the right to amend regulations related to trade policy in their remit. Furthermore, formal consultation with the Anti-Corruption Centre is required to amend trade-related laws. Besides this institutional dialogue, consultation with specific agencies and with the private sector takes place through a number of channels. Although no formal consultation with private sector and civil society representatives is required in the drafting stage, some *ad hoc* consultation does occur. Once regulation is drafted, trade measures, as other economic regulations, are reviewed by the RIA committee.

Non-tariff barriers

Although the Republic of Moldova has engaged in trade liberalisation, a number of obstacles remain for exporting companies. While the various trade agreements limit the quotas and tariffs faced by exporting companies, technical barriers and sanitary and phytosanitary measures represent an impediment to the export potential of SMEs in the Republic of Moldova.

Technical regulation and standards

The system governing technical regulations and standards in the Republic of Moldova is making a transition from the GOST system (*gosudarstvennyy standart* or state standard), a legacy from the communist period to adopting internationally recognised standards. In countries where they apply, GOST standards are mandatory. However, the law on standardisation enacted in 1995 made standards voluntary, in accordance with international practices. The Republic of Moldova has now started to adopt EU technical regulations and standards. In the sectors where EU technical regulations have not been adopted, the GOST still applies. Due to resource constraints, transition is slow and GOST still represents 90% of standards currently applicable. The National Institute for Standardization and Metrology (NISM) is responsible for implementing standards in the Republic of Moldova. The NISM is a member of the European Committee for Standardization (CEN) and plans to apply to the European Committee for Electrotechnical Standardization (CENELEC) for membership. Besides its regulatory role, the NISM also provides standard-related services to companies (*e.g.* certification). The standards and technical regulations are implemented by a large network of laboratories and 35 certification bodies for standards and regulations located throughout the Republic of Moldova.

Although the legal and institutional framework for the implementation of standards is largely in place, limited capacity has resulted in a slow adoption of international and European standards. GOST and EU standards currently co-exist in the Republic of Moldova, making the environment difficult to assess for potential investors.

Accreditation system

In order for companies to be able to apply standards, an accreditation system, including a certification infrastructure, needs to be developed. In the Republic of Moldova, the legal framework for certification was been established in 2003. The national accreditation body of the Republic of Moldova, Accreditation Center in the Field of Products Conformity Assessment (CAECP), which is operating according to the ISO/CEI 17011 standard, is the government agency in charge of accreditation. The CAECP is responsible for the accreditation of testing laboratories, certification and inspection bodies. It participates in the work of the International Laboratory Accreditation Cooperation (ILAC) and has signed a contract of co-operation with the European co-operation for Accreditation (EA). CAECP has granted certification to about 120 laboratories and to 35 certification bodies in the Republic of Moldova, a number of which are state-owned. A number of conformity assessment bodies, which are assessed by the CAECP, also operate in the Republic of Moldova. Although some private international certification companies operate in the Republic of Moldova, certification capacity is still insufficient.

Sanitary and phytosanitary standards (SPS)

SPS are a particularly important issue in the Republic of Moldova as they particularly govern trade in agricultural products. Ensuring that international SPS are adopted and implemented by producers is a necessary condition to permit exportation. The collapse of fruit and vegetable trade with Romania following its EU accession illustrates the difficulties that stem from limited SPS adoption. In the Republic of Moldova, SPS are governed separately from other standards. The transposition process, which started in 2005, is led by the Ministry of Agriculture and Food Industry which has set up specific agencies. Because responsibility is split across a number of relevant public bodies that need to be consulted, the adoption of new standards can be a lengthy process.

Impact on SMEs

Non-tariff barriers to trade have a deep impact on SMEs' ability to export their products. When limited certification is available on the domestic market, exporting companies have little alternative. Using foreign certification services entails costs that are prohibitive for SMEs. In cases where the product is tested by the authorities of the importing country, exporting companies bear a high compliance risk. Local recognised certification capabilities are therefore required to allow SMEs to access export markets. In the Republic of Moldova, international organisations are very active in providing certification services to companies. In particular, the EBRD, through the TAM-BAS programme, and the World Bank, through its competitiveness programme, help companies obtain the certification required to exports. Besides these actions by the donor community, no specific approach for SMEs has been designed. International experience, conducted for example by the European Committee for Standardisation, suggests strategies to further engage with SMEs (see Box 2.2). The NISM and the CAECP should assess the potential to replicate these strategies to ensure that SMEs can access export markets at reasonable costs.

2.8. Promoting the upgrading of skills and all forms of innovation

In order to increase their productivity and to be competitive, SMEs need to constantly improve the skills of their employees and their innovation capability. In both areas, only medium to long-term benefits can be expected. In an environment where credit constraints are pervasive, under-investment will be widespread. Therefore, public authorities have a role to play in designing schemes to help companies develop employee training programmes and support their efforts to be more innovative.

This section assesses the existing schemes that have been put in place to help firms develop skills and innovation capability. It is composed of two sub-sections. The sub-section on availability of skills reviews the various instruments that have been put in

Box 2.2. **The SME approach of the European Committee for Standardisation**

The EC has conducted extensive work to ensure that SMEs are included in the standardisation process. A number of instruments have been developed both at the European and at the national level to support standardisation and SMEs. These best practices respond to the three main difficulties identified for SMEs in the field of standardisation: their difficulties in accessing relevant information, problems in understanding and applying standards, and limited participation in standardisation work.

Access to information

Accessing and understanding information on standards can prove difficult for SMEs. At the European level, the Euro Info centres network, which includes 283 centres in 46 countries, aims at providing information to SMEs in specific domains. In the area of standards, they help raise awareness, answer specific questions that SMEs may have and organise workshops on the standardisation process. At the national level a number of initiatives have been developed. For example, in the Czech Republic, a network of information points assures that enterprises can find information on standardisation locally. A number of initiatives have also been conducted at the national level to raise awareness of SMEs. For example, Hungary has developed specific training, in the Netherlands the links between trade organisations and standardisation institutions were strengthened and a specific web portal was designed to offer more information.

Support in standards implementation

The cost of adopting a standard can prove prohibitive for SMEs. To support the further adoption of standards, some governments in the European Union have developed schemes to help SMEs implement standards. These instruments are particularly developed in countries that are recent members of the European Union. In Slovakia, the government offers direct support for SMEs in the industry and services sectors. The Ministry of Economy provides grants that cover up to 65% of the costs related to standardisation. In Croatia, the Ministry of Economy, Labour and Entrepreneurship has set up a similar programme to foster business system certification. Malta has adopted a slightly different approach where the national standards authority offers standards for a reduced price for SMEs, and in particular for those tendering for a public procurement bid that makes reference to a specific standard.

Participation in standardisation work

Although the standardisation process generally formally invites all stakeholders to participate in the work, SMEs and craft enterprises are often not aware of this possibility. They may not realise the importance of the work conducted and its potential impact on their activities. Moreover, they lack the capacity to participate in the work. As a result, the specific interests of SMEs risk not being properly taken into account in establishing the standards. The European Office of Crafts, Trades and SMEs for Standardisation (NORMRAPME) was created to increase the influence of SMEs in standard-writing. It receives financial support from the EC and has gradually become an active stakeholder in the standardisation process. At the national level, many SME organisations have set up fora where members can be involved in the standardisation process. Examples of such organisations can be found in particular in Germany, Norway and in the United Kingdom. In Sweden and in Finland, schemes offers travel allowance to SMEs to attend standardisation meetings.

Source: Enterprise Information Management (2006).

place to ensure that training is accessible to a large range of companies and that the quality of the training provided is adequate. The sub-section on innovation reviews the measures that can help to foster innovation and the absorption of existing technologies.

Availability of skills

Ensuring that SMEs can access the training they need throughout the business cycle is an important aspect of SME policy. SMEs face a number of specific constraints when trying to provide training compared to larger firms. These may be linked to the fixed costs involved in gathering information on training needs and training providers, to difficulties in financing training and lower potential return from training investments (Bassanini *et al.*, 2005). Using cross-country analysis, Almeida and Aterido (2010) found that, due to lower expected returns, investment by SMEs was bound to be lower than for larger firms. However, they also found that improving the financial resources available to SMEs and the level of information on training contributed significantly to increasing training uptake by SMEs. Accordingly, this section assesses the support provided to SMEs to help them identify their training needs and to support employee training.

Monitoring of needs

In order to be able to effectively design measures to support the training needs of companies, government needs to monitor both the demand and the supply of training. On the demand side, the development of training needs analysis (TNA) allows stakeholders to monitor the evolution of the needs of employees. This information is necessary for government to efficiently allocate resources dedicated to training support. On the supply side, government, in collaboration with stakeholders, can assess if the quality of the training is adequate. Such an assessment can also help companies identify potential providers of training and limit the uncertainty over the quality of service they will obtain.

Training needs analysis can be performed both at the firm and at the aggregate level. At the firm level, the objective of TNA is to help companies assess the potential needs of their employees and identify relevant suppliers of training. Because SMEs have limited capacity to perform such an analysis, the government could provide a scheme such as the one offered in the United Kingdom by Business Link (see Box 2.3). At the aggregate level, TNA are important policy tools that monitor the evolution of needs by the private sector and support the development of relevant capacities. This type of analysis, which relies on strong co-operation between private and public stakeholders, makes it possible to identify and reduce the gap between the demand and supply of skills. Throughout South East Europe, several initiatives have been carried out to assess skill gaps, in particular with the support of the European Training Foundation (ETF) and USAID. In the Republic of Moldova, no comprehensive scheme exists either to assess the skills gap or to help SMEs identify their training needs. There are some *ad hoc* initiatives. In particular, as part of its training programmes, ODIMM has distributed surveys to SME managers in order to design the curriculum of its training. ODIMM also seeks feedback on an ongoing basis from participants in the various training courses and seminars that are organised. This initiative allows ODIMM to constantly update the curriculum of the training it provides. However, this is still done on a relatively small scale and no consolidation of training needs or communication of the results of these surveys is available.

Box 2.3. **United Kingdom – Business services provided by Business Link**

Under the auspices of the Department for Business Innovation and Skills and the Regional Development Agencies, the government of the United Kingdom set up a system of business support services called Business Link. This network, covering the entire country, provides free business services online and through local consultants. Business Link operates as a brokerage agency and tries to match the needs of clients and available business services.

In March 2010, the department for Business Innovation and Skills was reported to provide EUR 166 million a year to the regions for the development of Business Link services. Regional Development Agencies may also seek additional financial sources, including EU funds in some cases. This explains why there are regional variations in the supply of business services. A rationale for providing public funding for the development of Business Link is based on market failures in the market for business information and advice. On the supply side, duplication of services may occur due to a lack of co-ordination and co-operation among business service providers. On the other hand, SMEs struggle with information asymmetry and confusion as to where to access business support. Business Link is a policy instrument which has the potential to correct both market failures by providing an overview of services available and by helping SMEs to navigate through the support services available.

Information about these services is disseminated through a single national website. The website includes a list of links to all relevant institutions and a search function by postcode which provides more specific regional information. Requests for support and assistance can be filled in and submitted online. A national telephone line which connects you through the regional Business Link provider is also in operation. At the moment a review of online government information is being conducted. The goal is to make business-facing content and transactions from 170 government websites available on the Business Link portal by April 2011. This will result in one single online government service for businesses of all sizes.

In 2009-10, the national Business Link website received over 19.4 million visits, of which 7 million were returning visitors. The network received over 111 000 new registrations in this time period, an increase of 2 000 compared to new registrations in the previous period. Customer satisfaction of the web portal also increased to 93% compared with 88% in the previous period. In March 2010, the overall impact on the economy of Business Link interventions was estimated to generate approximately EUR 885 million of additional value added *per annum*.

Source: OECD (2010b) and *www.businesslink.gov.uk*.

Access to training

Besides helping SMEs identify the training needs of their employees, governments can develop measures to ensure that SMEs have sufficient access to training providers. In particular, initiatives can be developed to improve the level of information on training providers. Such initiatives can help decrease the cost of gathering information on the potential training providers and lower uncertainty concerning the quality of training.

Private sector expenditures dedicated to training have increased significantly in the Republic of Moldova over the last few years (ETF, 2010). However, with only 33.1% of companies offering formal training to their employees (EBRD and World Bank, 2009), considerable efforts must still be made. In order to support employee training, ODIMM organises a number of training programmes. The "Efficient Business Management" training courses include eight targeted training modules that have been developed through consultation with private partners. Courses are proposed free of charge to employees and entrepreneurs. In 2010, 1 480 people participated in this training. Moreover, through its "Simple Accounting" programme, ODIMM provided training in accounting to 761 entrepreneurs in 2009.

A number of private providers and NGOS also offer professional training courses. In particular, the CCI has created a Vocational Training Centre which organises a number of training courses and seminars. These cover a wide range of topics and are targeted at entrepreneurs, managers and craftsmen. Besides training on legislation, communication and financial skills, CCI has developed specific training for welders with the co-operation of the Chamber of Skilled Crafts Koblenz in Germany. The CCI has also developed a train-the-trainer programme in order to help private training providers fulfil the required training needs.

The market for training is known to experience significant market failures. As a consequence, although a more educated workforce is more productive, employers may under-invest in continuous education and training. In particular, there is significant asymmetry of information between providers of training and their clients, and companies and employees may limit investment in training in the absence of quality certification. Public policy has a role in overcoming these two barriers to the development of CET. although training programmes provided by public institutions such as ODIMM and the National Employment Agency contribute to improving this situation, most of the training is provided by private organisations operating on a commercial basis. Little is done to help SMEs navigate this training market and there is no comprehensive listing of providers. ODIMM has set up an online database of providers which focuses on urban areas and MIEPO has a complementary database which focuses on providers outside urban areas. These databases can allow SMEs to better identify potential providers corresponding to their current skill needs and they should be advertised to SMEs.

Uncertainty about the returns of training is an important barrier for companies and employees who consider purchasing training services. Developing quality certification schemes has positive impacts both on the quality and on the quantity of training that will be conducted. In particular, developing a quality certification for training would provide greater recognition of training by employers. A quality certification scheme can be complemented by advertising the training available. For example, as part of the TAM/BAS programme, the EBRD uses an internal system of accreditation of business service providers that is available to SMEs participating in the programme. However, no national accreditation scheme for private training providers exists in the Republic of Moldova. Some initiatives have nevertheless been developed to improve the quality of the services provided. In particular, the Chamber of Commerce and Industry, together with international partners, has developed seminars and training modules for trainers. Although these initiatives can be instrumental in bringing training providers closer to international standards, they can only address part of the issue and should be complemented with a more global approach.

Conclusion

The Government of the Republic of Moldova acknowledges the critical role that the acquisition of adequate skills plays in developing SMEs. Accordingly, budget-funded programmes targeting SMEs and entrepreneurs have been developed by ODIMM and the

National Employment Agency. Training in various aspects of SME activities are provided free-of-charge. NGOs and private training providers also operate in the Republic of Moldova.

However, despite initiatives by ODIMM and MIEPO, no single instrument exists that would allow companies to identify the potential providers of a specific type of training. Moreover, the government does not monitor the quality of training providers. This may limit the confidence of companies in using potential providers. Developing measures to help SMEs identify relevant training providers would support the development of the training market. Public organisations could identify and monitor training providers while continuing to offer training for which only limited expertise exists or that are intended for specific audiences. Finally, measures to encourage SMEs to invest more on employee training could be considered. ODIMM is currently considering the potential to develop voucher schemes. Such schemes would provide incentives to private companies and would also further stress the importance of employee training.

Innovation

According to the definition provided by the OECD *Oslo Manual* (OECD, 2005a), innovation relates to the introduction of new products, processes, marketing and organisational methods or external relations. Innovations are not solely defined as "new to the world". Innovative activities can also result in outcomes that are new to the firm or new to the country. Innovation policy, while promoting the development of entirely new products and processes, needs to foster the adoption by companies of technologies and standards that may be available in other parts of the world. This second role of policy is particularly relevant in transition economies such as the Republic of Moldova. Linkages need to be established to promote the development of flows of knowledge between producers of innovative ideas, products or processes and their users.

According to the Code on Science and Innovation, the AITT is responsible for the implementation of state policy in the fields of innovation and technology transfer. In 2009 its budget amounted MDL 14 million (EUR 907 128). The agency is in charge of developing a link between the public research institutions and the private sector.

Its two main areas of activity are the organisation of tenders for the exploitation of innovation developed by public institutions and the management of science and technology parks and incubators. Besides the implementation of these two policies, SMEs in the Republic of Moldova could also benefit from a more consistent framework for the provision of technological professional services.

Technology transfer schemes

The primary role of the AITT is to assist the scientific community in the Republic of Moldova in identifying potential partners to help develop the outcomes of research. Once or twice a year, it publishes tenders for companies to compete for a licence to develop products based on research conducted by the public research institutions. Fifty per cent of the expenses associated with developing the innovation are covered by the AITT, while the remaining costs must be met by the company. These direct subsidies to research projects are the main expense of the AITT. In 2009, they represented MDL 9.5 million (EUR 616 000), approximately 70% of the budget of the agency. These subsidies are only available to companies developing research outcomes created in public research centres. Importantly, companies that are willing to adapt a technology developed outside the country cannot benefit from support from public research institutions or the innovation policy funds.

In a few cases, private companies have approached public research institutions to request their services. An example is the development of a specific anti-freeze for the city of Chisinau. However, it is not within the general policy of the agency to promote such contacts. Companies requesting services from a researcher or university staff are not allowed to establish a contract with the institutions but would need to contract with the person directly. This makes the innovation system fully driven by the research agenda of the Academy of Science and provides little room for private partners to influence the direction of research.

Science and technology parks and business incubators

Three science and technology parks operate in the Republic of Moldova. "Academica" which is generalist, "INAGRO" which focuses on agriculture and the park "Micronanotech" which focuses on nanotechnology. These parks have been entirely created through public efforts. The government is providing the building, has designed a number of financial incentives and has launched a competition for the selection of companies to be located in these science and technology parks. These companies will then benefit from: *i)* an exemption from payment of VAT (20%) on goods and services; *ii)* exemption from payment of customs taxes (5%) on imported goods and services; *iii)* exemption from income tax for a period of three years; and *iv)* preferential rental rates. The "Academica" park, the first to be established, now hosts 27 companies. "INAGRO" hosts 15 resident companies and the selection process for the residents of "Micronanotech" is now taking place.

A number of business incubators have been set up in the Republic of Moldova. For example, a business incubator operates within the Academy of Economic Sciences. Another was created with the support of the European Union's TACIS programme[13] in Ungheni. In order to provide support to start-ups, the government has also launched two business incubators: Innovatorul and the business incubator in Soroca which was launched in 2009 with the financial and operational support of SINTEF, an independent research organisation in Scandinavia. The Innovatorul business incubator, which focuses on nascent firms, offers tax incentives similar to those offered in science and technology parks. Innovatorul hosts ten companies which have been selected based on the innovation content of their activity. In Soroca, companies can establish themselves in this business incubator for three years and benefit from reduced leasing terms and free consulting services from experts. So far, 17 companies have benefited from this scheme.

Technological services

SMEs may lack internal capabilities to conduct innovative activities. In order to develop their innovation potential, they often appeal to external services providers such as engineering firms, process quality management specialists and management consultants. Government intervention can support both the supply and demand for professional services.

On the demand side, governments in the OECD countries have set up schemes to help SMEs take advantage of consultancy services. In particular, a number of them have set up innovation voucher schemes. For example, following pilots in 2004 and 2005, the Netherlands developed an extensive programme of innovation vouchers. According to that programme, the Netherland innovation agency SenterNovem distributes a limited number of vouchers to applying SMEs. Each SME can obtain a voucher of up to EUR 2 500 and, provided that they contribute one third of the amount, can receive a EUR 7 500 voucher. These vouchers can be used to purchase intellectual services from public research institutions or research subsidiaries of large companies. A new "private" voucher scheme was recently introduced that is co-financed by companies and allows them to appeal to a wider range of knowledge providers. The success of the initiative, which is confirmed by the high level of adoption, relies on, among other things, the low administrative costs of application for SMEs. In the Republic of Moldova, no similar scheme exists and there is a wide gap between public research institutions and SMEs. The AITT could consider setting up an innovation scheme to elicit stronger co-operation between knowledge providers and knowledge users.

On the supply side, the knowledge providers include a mix of private and public organisations. For them, various sets of policy interventions could be designed. For the public organisations, international experience shows that public research organisations have been encouraged to further liaise with the private companies that are users of knowledge. Thus, changing the criteria for allocating budgets to institutions or reforming the evaluation criteria of researchers are avenues to be considered by authorities in the Republic of Moldova. However, such measures cannot be performed in isolation and should be considered within an overall reform of the science, technology and innovation system. To foster the development of private knowledge providers, government could ensure that sufficient information is made available. In particular, brokerage services could be developed to assist SMEs in identifying specific knowledge providers. When a specific service is not available domestically, SMEs could then appeal to foreign providers. Quality insurance mechanisms could also be developed. Accreditation of knowledge providers often arises through the private initiative of professional associations. However, policy makers may be willing to foster the development of quality standards for knowledge providers.

Inter-firm networks

In order to foster exchanges of knowledge, private companies develop a web of relationships with suppliers, customers and other partners. These contacts are most often informal and allow companies to exchange ideas and share tacit knowledge. In specific cases, firms enter into formal co-operation and define a networking agreement. Networks can serve many purposes: they facilitate identification of business opportunities, help raise finance or pool resources to reach a common goal (OECD, 2003). As firms focus on a limited scope of activities, inter-firm networks are playing an important role in the innovation process. Improving the efficiency of innovation networks should be one of the main concerns of innovation policy.

Although inter-firms networks often arise through private initiatives, public policy can help networks develop. In order to overcome potential resistance by firms, public authorities can help create informed demand through awareness campaigns on the benefits of inter-firms networks. Moreover, public brokerage services help companies identify the most relevant partners for potential co-operation. Seminars and other networking events can also be important catalysts for the formation of networks. Finally, public policy may provide financial instruments to support the early stages of co-operation. For example, governments can finance feasibility studies for potential alliances, and the cost of brokerage services. Alternatively, governments can make innovation-related subsidies conditional on a degree of co-operation between stakeholders. For example, research projects funded by the EC's CORDIS Framework Programmes need to explicitly include research bodies from several countries.

FDI by multinational enterprises (MNE) establishes a particular form of linkage. FDI is an important channel for technology transfer at the international level (OECD, 2002). Provided that the absorption capacity of local SMEs is sufficient, investment by MNEs can translate into knowledge spill-over to the local economy. However, international experience shows that technology transfer does not automatically stem from openness to foreign trade and foreign capital inflows. Instead, policy makers have a role in ensuring that foreign investments generate benefits for the domestic economy. Policies to attract FDI need to be coupled with measures that aim at developing linkages with local SMEs. Furthermore, strategies to strengthen the absorption capacities of SMEs may be needed.

2.9. Enabling SMEs to turn environmental changes into opportunities

The rationale for governmental involvement in the environment originates in the numerous market failures in this area. In particular, externalities are very common. An example of an externality is provided by the cost of cleaning water polluted by industrial activities. The cost of cleaning the water is paid by society at large, and is external to the costs of the company which may have caused the pollution in the first place.

This section aims at measuring the extent to which an environmental policy is in place and is being implemented. More specifically it aims at assessing the degree to which environmental standards are promoted and implemented in the operations of SMEs.

No overarching strategy exists and the competencies are divided between the Ministry of Ecology, the Ministry of Agriculture and the Institute for Ecology and Geography. Co-ordination between these three institutions is largely lacking.

The introduction of environmental standards is in its infancy in the Republic of Moldova and is limited to the agribusiness sector. The Institute for Ecology and Geography includes four working groups that are formed to implement the following types of standards: soil/ground, water, air standards, waste.

A national strategy is in place for the agribusiness sector and aims at ensuring its sustainable development, including environmental sustainability. Its timeframe is 2008-15 and it is structured around four pillars: *i)* natural potential and environment conditions; *ii)* aligning national standards to EU standards and ensuring food harmlessness; *iii)* subsidising/supporting policy for agricultural producers; and *iv)* land market development and agricultural land consolidation policy. The most notable features of this strategy include a programme for promoting ecological agricultural practices, which includes a register of SMEs that develop their business in ecological agribusiness and a system of subsidies for these businesses.

Conclusion

Environmental policy has not yet been prioritised by the government of the Republic of Moldova. Nevertheless, preliminary steps have been taken to implement environmental standards in the operations of SMEs. In order to progress in this area an overarching environmental strategy should be considered that establishes a system of co-operation between the three institutions involved.

2.10. Encouraging and supporting SMEs to benefit from growth markets

In some cases it might be difficult for a country to launch new exports, even in an area where it has a comparative advantage. Hence, it is important to design and implement proactive export promotion policies (OECD, 2005). In order for such policies to be effective, custom measures should also be streamlined so as not to represent a barrier for exporting companies.

This section aims at evaluating the support that is provided to companies that are engaged in international trade and reviews the custom procedures, the presence of an effective export promotion agency and the number and characteristics of export promotion programmes.

Custom procedures

Custom procedures currently represent a significant impediment to the ability of firms in the Republic of Moldova to engage in import and export activities. According to the *Doing Business 2011* report, the Republic of Moldova ranked 141th out of 183 economies in this area; its performance in this dimension is below that of the other SEE economies. Among EP countries, only Azerbaijan obtained a lower ranking. Although the number of documents needed is similar to what other customs offices in the region require, the time and costs associated with the procedure clearly exceed the level of those in other economies in the region.

Since 2006, a number of measures have been introduced. A one-stop-shop has been set up which integrates the Border Guard Service, the National Automobile Transporter's Association, the Sanitary, Veterinary and Food of Animal Origine Safety agency, the General Inspectorate of Phytosanitary Supervision and Seeds Control and commercial banks. ICT tools have also been introduced that ensure automated processing of customs documents. However, companies still consider customs procedures cumbersome. In particular, anecdotal evidence suggests that although the new IT services have made handling documents for customs officers easier, they have only had a marginal impact on the difficulties encountered by companies in dealing with customs.

Export promotion agency

The presence of an effective export promotion agency can be instrumental in improving the penetration of local companies into foreign markets. While there are major methodological challenges in attributing increased export earnings to spending on such agencies, some research suggests a positive and sizeable relationship (Ledermann, Olarreaga and Payton, 2006).

In 1999, the Moldovan Investment of Export Promotion Organisation (MIEPO) was established by the Ministry of Economy. It is responsible for attracting and promoting investment. MIEPO is considered to be the focal point for companies and international donors. It provides information services to Moldovan companies wishing to enter international markets, as well as to international companies seeking entrance into the Moldovan market. MIEPO also helps domestic companies to attract foreign investors. Other services provided are business visits, supplier and partner searches, and investment preparation and property/site identification. MIEPO's services are confidential and free of charge.

Currently, the organisation appears to have limited capacity, both in terms of staff and budget, to conduct the various tasks that it has been allocated. MIEPO currently employs ten people and its funds are mainly taken up by the organisation of large promotional events, leaving little for other activities relating to export promotion. In 2010, MIEPO received an annual budget of EUR 500 000 of which EUR 350 000 was designated for participation in the Shanghai World Exhibition. In order to realistically provide investment and export promotion services, the agency would need to be restructured so as to accommodate a higher level of human resources and additional funding.

Export promotion programmes

Export promotion services and programmes can be grouped into four broad categories: country image-building, including promotional events and policy advocacy; expert support services, including training and providing information on trade finance and customs; marketing, including trade fairs and exporter missions; and market research and publications (Ledermann, Olarreaga and Payton, 2006). The Republic of Moldova adopted a new Export Promotion Strategy for the period 2006-15 in November 2006. This programme has an annual budget and action plan which are created in co-ordination with ministries and MIEPO.

Export promotion programmes in Moldova are focused on promotional events and marketing. Several exhibits are organised, ranging from the Made in Moldova exhibition in January to the Christmas Fair in December. SMEs are reported to participate in all the exhibitions in the exhibition calendar. MIEPO also organises several bilateral promotional events and seminars, such as the Fashion Trends for the year 2010-11 event with the support of the Netherlands, or the Export of fruit and vegetables to German markets seminar. MIEPO also participates in several international exhibitions, such as the Shanghai World Exhibition and the International TEXTILLEGPROM-2010 in Moscow, focusing on the textile and garment industries.

Another import annual event is the National SME forum organised by ODIMM. This comprises of four components and lasts 3-4 days. A first component of the event is the SME fair, which gives SMEs the opportunity to promote their products and services to other companies, business associations and potential investors. A SME Conference presents a forum for public-private dialogue in which more than 250 private and public stakeholders participate. The forum also includes a SME competition. Finally, a series of seminars and roundtables throughout the event include elements of public-private dialogue.

Financial instruments for foreign trade participation are not currently included in the state budget. However, several donors are active in this area, such as the Netherlands with the Private Sector Investment Programme, and the World Bank Competitiveness Enhancement Project. However, it is important that MIEPO receives sufficient funds to set up its own financial instruments. Donor financing should be temporary and gradually replaced by adequate domestic resources (De Wulf, 2001).

Conclusion

The Republic of Moldova has set up its export promotion agency, MIEPO, in order to develop a proactive approach to export promotion. This agency organises several promotional events to attract foreign investors and foreign companies and participates in international events. However the capacities of MIEPO, both in terms of human resources and in terms of budget, seem to be too limited to fulfil its various missions effectively. A consolidation of MIEPO should therefore be envisaged. Such a step could open the way for a broadening of export promotion programmes. In particular, financial instruments to promote foreign trade operations would be useful. However, the current resources of MIEPO make it difficult for the agency to take on these additional activities.

Notes

1. Eastern Partnership economies include Armenia, Azerbaijan, Belarus, Georgia, the Republic of Moldova and Ukraine.
2. A review of programmes to support employee training in general is presented in Section 2.8: "Promoting the upgrading of skills and all forms of innovation".
3. Out-of-court settlements allow creditors and debtors to reach an agreement on debt restructuring without opening an insolvency case. If all creditors agree to the plan, the courts need not be involved. This allows a cost-effective management of the insolvency. Alternatively, the plan defined can be used as a basis for a restructuring agreement under minimal supervision by the court.
4. For sampling purposes, the BEEPS distinguishes 4 areas for the Republic of Moldova: South, Centre, North and South-East (EBRD and World Bank, 2009).
5. According to Law No. 393-XIV enacted on 13 May 1999 "Regarding the Chamber of Commerce and Industry", membership in the Chamber of Commerce and Industry is mandatory except for representatives of small companies, individual entrepreneurs and companies in the agricultural and forestry sectors.
6. Taxes considered by the World Bank *Doing Business* survey include corporate income tax, land tax, tax on immovable property and road and fuel tax as well as health insurance contribution and social security contributions made for employees.
7. This does not take into account annexes to existing contracts which represented an additional 3 401 contracts in 2009.
8. In October 2008, the UNDP funded a comprehensive assessment of the national procurement system and acted as an implementing agency for a mission of European Union High Level Policy Advisers which focused in particular on public procurement reform.
9. Negative information on credit refers to information related only to payment incidents such as late payment, delinquencies and default. Credit information services can also include positive information, for example on credit limits, credit utilisation, balance, etc.
10. This risk is particularly acute for public guarantee schemes. When assessment is carried out directly by the guarantee scheme, the government may be tempted to use them to support specific sectors. The lack of rigorous risk assessment may then lead to a significant level of failure and an inflation of the related costs.
11. Initially, the insurance offered by Garantinvest was only available provided that the fee was paid. In case the borrower defaulted on his loans and stopped paying insurance, the insurance could not be activated.
12. Members of the Eurasian Economic Community include Belarus, Kazakhstan, Kyrgyzstan, the Russian Federation and Tajikistan while Armenia, Moldova and Ukraine are observers.
13. TACIS is a technical assistance programme of the European Union directed at countries of the Commonwealth of Independent States.

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Fostering SME Development

Chapter 3

Focus on Access to Finance and Innovation Policy

This chapter focuses on two specific issues that particularly affect SME development in the Republic of Moldova: access to finance and innovation policy. The objectives of this detailed review are to further assess the situation, to better understand the structural causes that may affect the performance of SMEs and, where relevant, makes suggestions for reform.

As highlighted in Chapter 2, access to finance is particularly difficult for SMEs in the Republic of Moldova. Interest rates and collateral requirements represent significant obstacles while alternatives to bank financing are scarce. Section 2.6 reviewed the various policy instruments that have been put in place by the government to support access to finance for SMEs. This section seeks to better identify the root causes of the difficulties encountered by SMEs, looking in particular at the structure of the financial sector and at the constraints faced by banking institutions.

In order to further realise their export potential, SMEs in the Republic of Moldova need to be able to integrate innovations developed abroad and to develop their own innovative ideas. Because of their limited capacities (*i.e.* financing, human resources, access to information and technology), SMEs may face difficulties in independently sustaining the investments needed to maintain a high level of innovative activity. Therefore, in a highly competitive trade environment, the government has an important and critical role to play in fostering innovation. Moreover, following examples set in OECD economies, the distribution of roles between the government and the private sector needs to move from a linear supplier-user of knowledge paradigm to a more multi-faceted innovation partnership. This section assesses the performance of the innovation system in the Republic of Moldova and its institutional setting and reviews best practice in the OECD area to identify potential reforms.

3.1. Access to finance

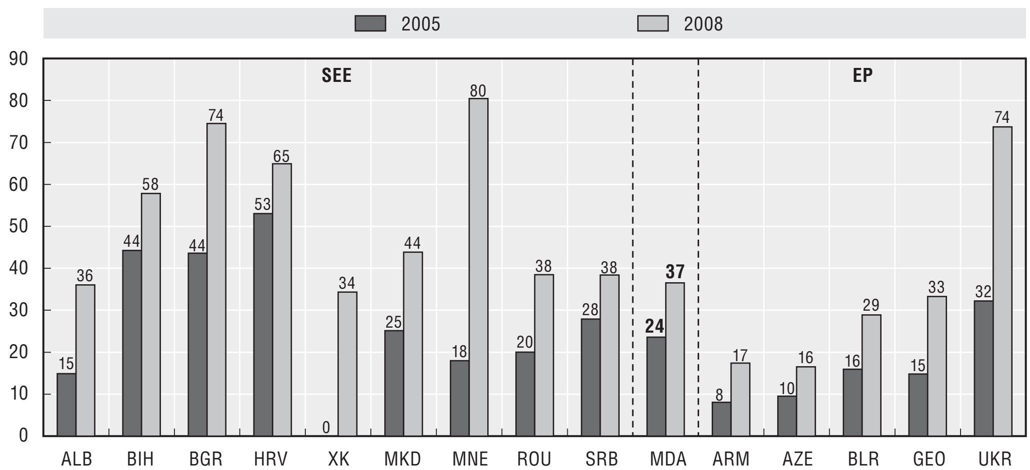
Overview of credit conditions

Penetration of credit in the Republic of Moldova is very modest. Private sector credit represented only 37% of GDP in 2008. As shown in Figure 3.1, this ratio is far below the average of 52% observed in SEE countries. Among SEE countries, only Albania and Kosovo under UNSCR 1244/99 have a lower penetration of credit. In the EP countries, all the economies, with the exception of Ukraine, have lower credit penetration than the Republic of Moldova. This gap in credit market conditions between countries has increased in the last few years. The penetration rate of domestic credit in the Republic of Moldova increased by 13 points between 2005 and 2008. This is significantly below the growth observed in SEE countries where, on average, penetration increased by 21 points between 2005 and 2008. Except in Georgia and Ukraine, EP countries experienced a more modest growth in the penetration rate. At the end of 2008, credit growth came to an end with the impact of the global financial crisis. Indeed, new loans extended by banks in the Republic of Moldova decreased from MDL 3.3 billion (EUR 199 000) in December 2007 to MDL 1.7 billion (EUR 110 000) in December 2009. In the first few months of 2010, credit growth has resumed with MDL 2.0 billion (EUR 124 000) worth of new credit in May 2010.

Credit penetration in the Republic of Moldova is limited by the difficulties that companies have in obtaining loans from banks on acceptable terms. Interest rates in the Republic of Moldova have remained at a very high level since 2003. Nominal interest rates on

Figure 3.1. **Penetration of credit to the private sector in SEE and EP countries, 2005-08**

As a % of GDP



Source: World Development Indicators, World Bank.

loans in Moldovan lei have remained within the 18% to 21% range, reaching 20.3% at the end of 2009. Similarly, for loans in foreign currencies, interest rates have remained within the 10% to 13% range. Until 2008, inflation was stable at around 12%. In 2009, as a result of the recession that hit the Republic of Moldova, inflation fell sharply, a trend that was not mirrored by the evolution of the nominal interest rate. This dramatically increased the cost of credit for companies at a moment when the capacity to export was lowered by a decrease in global demand. In addition to high real interest rates, companies also face high collateral requirements. According to the BEEPS, banks require collateral of 139% of the loan amount (EBRD and World Bank, 2009). This ratio, while within the average of the values observed in SEE and EP economies, represents an impediment, particularly for smaller companies and for companies with a large share of intangible assets.

In such a context, access to finance is the prime constraint to the development of companies. In 2009, according to the BEEPS, 39% of firms considered access to finance a major or severe obstacle to their development; 19.5% of companies rated access to finance as the most important issue for their firm, ahead of human capital and access to land (EBRD and World Bank, 2009). Given the very difficult credit conditions, most companies finance new assets through internal funds and owner contributions. In 2009, bank finance represented 22% of investment undertaken by firms in the Republic of Moldova. Such a situation translates into under-investment and represents a major difficulty for improving productivity. As the information available on these companies is more limited, SMEs are particularly likely to suffer from difficult access to bank lending.

Structure of providers of finance

Access to finance in the Republic of Moldova is largely dominated by the banking system. However, given the high level of interest rates and prevalence of rural areas, microfinance institutions (MFI) and Savings and Credit Associations (SCA) have developed as an alternative to the banking sector. Besides these forms of lending, few alternatives exist; equity finance in particular is mostly absent in the Republic of Moldova.

Banking institutions

The banking system in the Republic of Moldova represents total assets of MDL 40.0 billion (EUR 2.6 billion) in 2009. Fifteen commercial banks operate in the Republic of Moldova. They have a presence mainly in urban areas with representative offices for basic operations based in the countryside. The banking market in the Republic of Moldova is fairly concentrated with the five largest banks holding 63% of the total assets of the banking sector, a ratio that is in line with SEE economies. The largest institutions are Moldova Agroind Bank and Victoria Bank SA. However, in contrast with other SEE economies, the banking sector in the Republic of Moldova is characterised by a limited presence of foreign financial institutions. International experience suggests that entry of foreign banks into transition economies is linked to an increased level of competition and to higher efficiency (*i.e.* Levine, 1996; Classens *et al.*, 2001). Foreign banks in the Republic of Moldova hold 31.6% of the total assets of the banking sector, compared to an average of 88.0% in SEE and 44.4% in EP economies, with the exception of Azerbaijan and Belarus where the penetration of foreign banking institutions is lower.

Commercial banks in the Republic of Moldova are mostly targeted towards the corporate market. Credit to households represented only 19% of domestic credit. This ratio of household credit represented 12% of domestic credit in 2005 and has increased significantly since then, although it is still small compared to other economies in the region. This may be related to the relatively higher level of gross savings in the Republic of Moldova compared to SEE economies, which is in turn related to the high level of remittances sent by emigrants. Although deposits in financial institutions may capture only part of the savings available in the economy, the large level of deposits combined with unfavourable credit conditions results in high liquidity in the banking system.

Non-bank financial institutions

Given the credit rationing that occurs in the banking sector, a number of non-bank financial institutions have developed in the Republic of Moldova. These institutions serve customers who do not present sufficiently secure guarantees to obtain finance from the banking system or live in areas where banking services are not available. Two types of financial actors are operating in the market: microfinance institutions (MFI), which represented total assets of MDL 2.0 billion (EUR 130 million) and the savings and credit associations (SCA), which represented assets of MDL 386 million (EUR 25 million).

MFIs grant loans while requiring limited or no collateral. They have no particular restrictions on the type of customers that they serve. In some areas, such as consumer finance, MFIs come into direct competition with the banking sector. However, they are not allowed to collect savings. In 2009, 35 MFIs operated in the Republic of Moldova, out of which 29 submitted financial records to the National Commission on Financial Markets (CNPF), the government body in charge of monitoring non-bank financial institutions. The level of concentration is very high with the four largest institutions representing 75% of total assets recorded (CNPF, 2010a). Besides the largest institutions, and in particular Microinvest and Corporatia de Finantare Rurala, which address the corporate market, MFIs mostly serve the consumer and mortgage credit market.

In response to a project by the World Bank, SCAs were set up in the Republic of Moldova in an effort to increase the level of financial intermediation in rural areas. SCAs are associations of individuals at the local level and they lend only to members of their associations. To limit credit-risk, firms are not allowed membership in a SCA. There were 395 SCAs active in the Republic of Moldova in December 2009 (CNPF, 2010a). In order to further regulate the sector, the CNPF has set up two types of licences. SCAs which obtain an A licence are only allowed to make loans based on their capital and are not allowed to collect savings, while those with a B licence can collect savings. So far, 68 B licences were issued (CNPF, 2010a).

There is a strong link between MFIs and SCAs. Indeed, Microinvest and the Corporatia de Finantare Rurala have established two-way relationships with a network of SCAs. The two MFIs are owned by SCAs. They also use their capital, and additional funds from IFIs, to refinance SCAs. Those MFIs are acting as refinancing instruments for a set of SCAs. Such a structure creates complex governance issues. Because each SCA has a relatively limited participation in the MFI, there is only a small risk that some SCAs can benefit more from the funds than others. The management of the MFIs has a good level of independence. Furthermore, each SCA has an interest in ensuring that the other SCAs make proper use of the funds provided by the MFI. As a consequence, mechanisms for monitoring have been set up to ensure peer discipline among SCAs that are part of the same group. This monitoring is conducted by the MFIs which assess the operations of the SCAs to which they lend funds on a regular basis.

Alternative sources of finance

Lending, be it by banks or by non-bank financial institutions, is the dominant form of external finance for companies in the Republic of Moldova. However, some alternative sources of finance exist that can complement traditional lending and may be more suited to specific situations of SMEs. In particular, the development of leasing, factoring and equity finance can play a critical role in improving the finance situation of SMEs.

The leasing market in the Republic of Moldova is regulated according to the Law on Leasing which was approved in 2005. The law clearly defines the various aspects of leasing contracts as well as the obligations of the parties. As a consequence, 27 leasing companies operate in the Republic of Moldova (CNPF, 2010b). However, the volume is still limited and car leasing represents the bulk of activity. Two projects financed by the Government of Japan, JNPGA and 2KR, aim at further developing leasing for industrial projects. At the end of 2009, the programmes offering leasing on preferential terms had resulted in 121 leasing contracts for a total amount of EUR 8.1 million. Monitoring of the leasing market is performed by the CNPF. However, the capacities of the agency are not sufficient and, in practice, the market is poorly monitored.

Besides financing investments, many companies face difficulties financing their working capital. In order to support these companies, financial institutions have developed a number of trade finance instruments, in particular for exporting companies. In the Republic of Moldova, the most common trade finance instrument available is the letter of credit through which an importer's bank guarantees to the exporter the payment of the goods upon delivery. Although banks can also offer credit to their customers, together with the letter of credit, they offer this possibility mostly to their larger clients. Besides the letter of credit, factoring services have also been introduced in the Republic of Moldova. Factoring services help companies face cash-flow constraints and are widely used in developing economies where it can represent up to 7% of GDP. Factoring services in the Republic of Moldova is defined as a form of credit which may limit the ability of the factor to collect the account receivables from its customer in case of bankruptcy. Such an impediment may contribute to the limited development of the sector in the country.

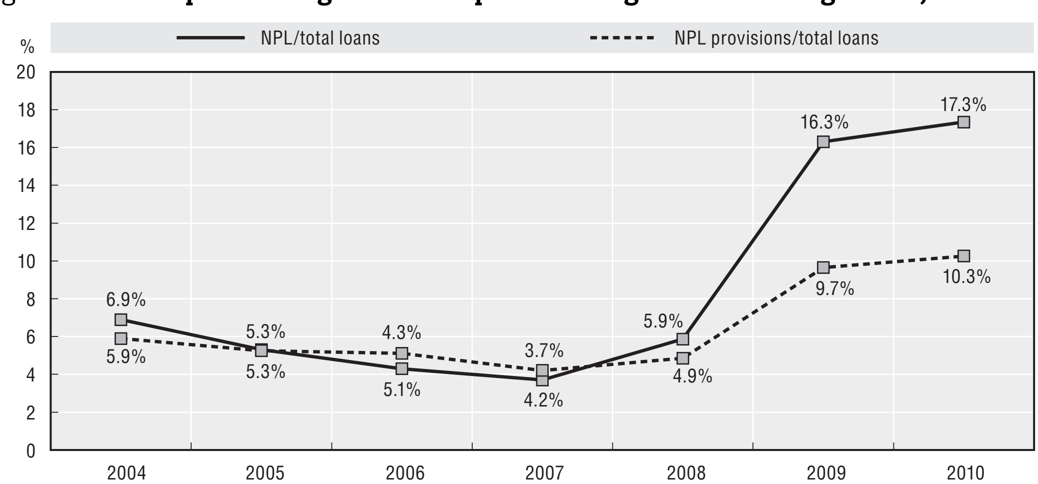
In order to be innovative, SMEs need to be able to make long-term investments. Because they often do not have sufficient guarantees for bank lending and because their time-horizon is long, SMEs need to access equity finance. In particular, venture capital and business angel networks can contribute to bridging the financing gaps of growing SMEs. The IRI 2010 (OECD, 2010a) showed that, in South East Europe in general, equity finance is under-developed. This is particularly the case in the Republic of Moldova. Some foreign venture capital funds operate in the Republic of Moldova but no national fund exists. Given the transaction costs, a significant deal flow is necessary for a domestic industry to emerge. These conditions have not yet been met in the Republic of Moldova. Despite some civil society initiatives to draft a law on venture capital, the legal framework for these instruments does not exist. Moreover, no business angel networks operate in the Republic of Moldova.

Constraints in the banking market

Banks are often perceived as the source of difficulties faced by the private sector in obtaining loans. Indeed, due to their dominance in providing access to finance, there is a close connection between the unavailability of finance for companies and banks' inability to lend to companies, and in particular to SMEs. As the failure of Investprivatbank SA in 2009 shows, the banking sector in the Republic of Moldova is actually facing serious internal and external constraints. These issues impede the ability of banks to extend credit to the economy.

Between 2004 and 2008, the assets of the banking system grew at a very rapid pace, from MDL 13.3 billion (EUR 869 million) in 2004 to MDL 39.1 billion (EUR 2.6 billion) in 2008. Although high levels of inflation partially explain this evolution, this rapid increase was also fuelled by an important expansion in lending. The agricultural sector, and in particular the wine industry, have benefited from this. As exports contracted in the wake of the financial crisis, companies faced difficulties in repaying their loans. These difficulties were intensified by very high interest rates charged on loans. As shown in Figure 3.2, this evolution brought the rate of non-performing loans in the banking sector from 5.9% of the total loans portfolio at the end of 2008 to 16.3% at the end of 2009. However, the level of capitalisation of the banking sector remains very high. The average capital adequacy ratio of banking institutions

Figure 3.2. **Non-performing loans and provisioning in the banking sector, 2004-09**



Source: National Bank of Moldova.

in the Republic of Moldova was at 32% in December 2009, slightly higher than its December 2008 level. As a consequence, the stability of the banking system as a whole is not a pressing concern. However, a closer evaluation on a bank-by-bank basis shows that, while the largest banks have maintained a ratio of non-performing loans below 15%, in smaller institutions non-performing loans can represent more than half of the gross loan portfolio. The discrepancies between the situations of individual banks suggest that, besides global issues, some institutions have engaged in a strategy of credit expansion while disregarding credit risk management. Some institutions have or are planning to increase their capital base in order to face the requirements of future provisioning.

Such a rapid evolution represents a major impediment to the ability of banks to provide additional loans. The banking system has been unable to reduce the ratio of non-performing loans (NPL), a task that the financial crisis has only made more difficult. In order to maintain their stability despite the rise in NPLs, banks have had to dramatically increase their level of provisioning. This rapid increase had a deep impact on the profitability of the sector, which posted negative returns in 2009. As the level of NPLs and provisioning stabilised in the first few months of 2010, the profitability of banks has been restored. However, the ratio of uncovered NPLs could translate into important loan losses should delinquency materialise. In such a context, banks have very few incentives to further extend loans as this would increase their level of risk in a context where their sustainability is already in question. Moreover, as profitability in the banking sector was severely hit in 2009, the willingness of the banking sector to further ease the conditions of access to credit will remain limited. The level of collateral required, in particular as the evolution of asset prices is uncertain, and interest rates are likely to remain high.

Companies that have access to loans often have difficulty in obtaining lending terms with appropriate maturity. Indeed, maturity of new loans in the Republic of Moldova rarely exceeds one year. Such a short period is significantly below the payback period that can be expected from companies seeking to modernise their production facilities or launch expansion projects. This prevalence of short-term lending is a big constraint for companies as they may not be able to finance the potentially long-term investment necessary to improve productivity. However, this issue is rooted in the balance sheet structure of the banking system. Deposits represent 75% of the total liabilities of the banking system, far above the ratio observed in OECD countries. Although the level of short-term liability in the banking system is high, the liquidity ratio is significantly above the levels observed in other economies. Banks keep a significant precautionary cushion to prevent liquidity crises. This behaviour limits the potential for monetary intermediation and is a sign of lack of trust in the stability of the banking system. However, these practices protected the banking system during the rapid decrease in deposits held by the banking sector that occurred in the first few months of 2009. Between December 2008 and April 2009, the level of deposits decreased by 7.3%. However, during the same period, the ratio of liquid assets over total assets, a measure of the liquidity of the banking system, remained higher than 29%, compared to a threshold of 20% set by the regulator.

In a context where the banking system is facing an important set of constraints, the ability of regulators, and in particular of the central bank to improve the situation in the short term is limited. Although the central bank repeatedly lowered its base rate in 2009, the impact on the effective lending rate by commercial bank was limited. The widening gap between lending rate and base rate suggest that the effectiveness of monetary policy on bank lending is limited. In order to further strengthen the financial sector, solutions should be found to improve the maturity of banks' sources of funding and to limit the potential detrimental impact of bad loans. Currently, credit lines by international finance institutions are playing a critical role in providing longer-term finance to banks. However, further diversification of long-term finance should be sought. In order to restructure the non-performing loans portfolio, international experience shows that restructuring of the assets of troubled banks can be performed either through a decentralised approach, through the set up of a good and a bad bank within individual institutions or through the set up of a central programme for the management of troubled asset (BIS, 1999). The cost of these measures can be extremely high which limits the ability of the government to implement such programmes on its own. However, the various schemes that have been developed in similar contexts should be assessed and their potential applicability should be reviewed.

Development of microfinance

The microfinance system in the Republic of Moldova is split between two types of institutions: SCAs and MFIs. The development of these two types of institutions has occurred in parallel over the last few years. The links between the two types of institutions are numerous although they do not serve the same customer segments. The development of SCAs and MFIs is constrained by their difficulty in accessing additional funds to finance the potential growth of their loan portfolio. In that respect, the monitoring framework for the sector is critical in order to build the confidence of potential investors.

Given the difficulty in accessing credit within the banking sector, MFIs and SCAs, which grant loans without necessarily requiring guarantees and a long credit history, play a critical role in the financing of the economy. Indeed, although lending by MFIs and SCAs represents only 2.3% and 0.5% of GDP in 2009, respectively, together they address 5.8% of the population. This penetration rate is significantly above the 4.4% rate observed for MFIs in Central and Eastern Europe (CNPF, 2010a). In terms of customer segmentation, SCAs can only provide loans to individuals and predominantly target agricultural loans, which represent 68% of their loan portfolio. MFIs are allowed to distribute loans to both individuals and legal entities. Their customer mix is therefore much more diversified. SMEs represent 44% of the loan portfolio of MFIs. SCAs, which channel the funds to their customers, receive 24% of the loans. The rest of the portfolio consists of loans to individuals to purchase real estate and consumer goods. These two categories represent 25% and 17% of the loan portfolio of MFIs, respectively (CNPF, 2010a). While SCAs are mainly committed to financing agriculture, MFIs are generalist financial institutions which, on the lending side, differentiate from the banking sector by addressing a client base which does not have access to the guarantees that bank financing in the Republic of Moldova demands.

In order to further expand their activities, microfinance providers need to be able to raise additional funds. Currently, the potential sources of funds that MFIs and SCA can appeal to are limited. Only 68 SCAs that have obtained a B licence can collect deposits. Other institutions, and in particular all MFIs, rely solely on their own capital and on inter-bank lending to develop. In such a context, the credit lines that are offered by international donors are a major source of financing. These are by nature limited and current allocation mechanisms may place restrictions on the use of credit lines by MFIs. As a consequence, the growth of MFIs is constrained by difficulties in raising savings. The two largest organisations, Microinvest and the Rural Finance Corporation, which have constituted co-operatives of SCAs, have indirect access to savings. However, these cases are exceptional and most of the other MFIs face important financing issues. Given the importance of microfinance at the local level, in particular in rural areas, measures to improve MFI's access to funding should be considered. However, increasing the scope of actions of microfinance institutions, and in particular allowing the collection of savings, should not be considered unless a proper monitoring mechanism is put in place to ensure proper management of the funds obtained.

Non-bank financial corporations are regulated by the CNPF, a government body that reports directly to parliament. Besides the monitoring of MFIs and SCAs, the CNPF also has a supervisory role over the development of the security markets and over the various institutions active in this market. It also monitors insurance companies and pension funds. The CNPF currently has 119 employees, 15 of whom are dedicated to supervising MFIs and SCAs. Due to limited resources, monitoring is limited to a review of financial information sent by the various institutions to ensure that they abide by the minimal capital and liquidity requirements set by the CNPF. As they are allowed to collect savings, B-licenced SCAs are subject to more in-depth inspections. In particular, the CNPF has initiated on-site inspections of these institutions. Although a number of irregularities have been identified, the level of monitoring, even for the B-type SCAs remains quite limited. Developing further monitoring, in particular for MFIs, is currently being considered. However, given the current capacity of the CNPF, increasing the workload of the agency could indeed be counter-productive for the effectiveness of control.

Conclusion

Providing support to SMEs that need access to finance is clearly among the key challenges for SME policy in the Republic of Moldova. Credit penetration is limited compared to similar economies and a large number of companies consider the lack of access to credit as a very significant obstacle to their development. Difficulties in accessing bank lending result in limited investment potential of companies and hamper related gains in productivity. In order to develop access to finance, the government has taken a number of initiatives (see Chapter 2, Section 2.6). Although considerable progress remains to be made, the legal and institutional framework has been adapted. Moreover, credit information services and credit guarantee schemes are currently being developed. Although these reforms represent positive steps, their effectiveness is currently limited by the difficulties that lending institutions encounter.

Banking institutions, the predominant providers of finance for companies, face considerable challenges which are linked to the high level of delinquency in their loan portfolio. Although the stability of the banking system as a whole seems to be adequate, the ability of banking institutions to further develop credit is being reduced. Restructuring the portfolio of the banking system must be carried out before significant credit expansion can be expected.

Microfinance institutions and SCAs, which provide an alternative to more traditional bank lending, make it possible for companies with limited collateral or a poor credit history to access credit. However, the development of these institutions is impeded by the difficulties they themselves face in accessing external funds. Measures should be developed to help those institutions that are well-managed and performing to access finance and foster their development. Developing a consistent and comprehensive monitoring framework would contribute to building the confidence of investors in MFIs and SCAs.

Other sources of finance, such as leasing, private equity finance and venture capital still represent an insufficient volume to be an alternative to lending by commercial banks and MFIs. Efforts have been made to channel funds from remittances towards productive investments. Such an initiative can represent a useful source of funds for companies. Additional schemes, such as business angels networks and venture capital funds could also be promoted (OECD, 2010e).

3.2. Innovation policy

Innovation is defined by the OECD *Oslo Manual* (OECD, 2005a) as "the implementation of a new or significantly improved product (good or service), or process, a new marketing method, or a new organisational method in business practices, workplace organisation or external relations". This definition encompasses a broad spectrum of activities. Innovation, be it in products, processes, marketing or organisation has a direct impact on firm productivity and on income at the aggregate level. Empirical studies on the determinant of innovation have found that innovation propensity in firms was lower for smaller firms than for larger ones. As such, innovation practices in SMEs may be more fragile than in larger firms and may benefit even more from an adapted set of supporting policies and institutions by the public authorities.

Measuring innovation

Links between innovation and economic growth have long been established. In order to assess innovation activity in the Republic of Moldova, it is necessary to consider several aspects of the innovation process. Data at the firm level is not readily available in the Republic of Moldova and assessment is based mainly on aggregate indicators. Nevertheless, assessing inputs and outputs of innovation allows a clearer consideration of the potential role that policy makers could play in improving the innovation system.

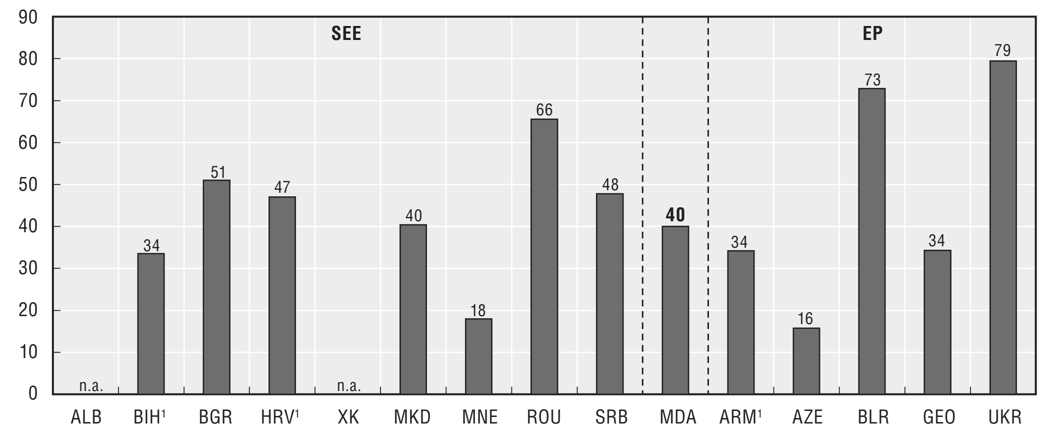
Innovation input

In order to assess the effectiveness of the innovation system, one needs first to consider the level of resources that are available to develop innovation in the Republic of Moldova. Inputs into innovation can be segmented in three categories: human resources, financial resources dedicated to research and the infrastructure available.

Innovative economies rely on a highly-skilled workforce. Education therefore plays a broad role in supporting innovation. Enrolment rates in tertiary education are important indicators of the ability of a country to develop a highly skilled workforce (OECD, 2010a). Figure 3.3 shows the gross enrolment rate in tertiary education for South East Europe and Eastern Partnership countries. In 2008, the last year when comparative statistics are available, students in tertiary education in the Republic of Moldova represented 40.0% of the relevant class age. This is significantly below the average for the SEE and EP regions that are 43.5% and 47.3% respectively. In particular, the enrolment rates in tertiary education are far below those of the two countries that are bordering Moldova: Ukraine and Romania. Although enrolment provides only a partial picture (and does not take into account the quality and relevance of the education provided), it shows that the Republic of Moldova is developing fewer tertiary-educated workers than similar countries, especially its neighbouring countries. The Republic of Moldova has also experienced large-scale emigration of its skilled workers, a problem that is complemented by internal migration from the countryside to Chisinau. As a result, finding workers with the relevant level of skills is a

Figure 3.3. **Gross tertiary education enrolment rate, 2008**

SEE and EP countries, in %



1. 2006.

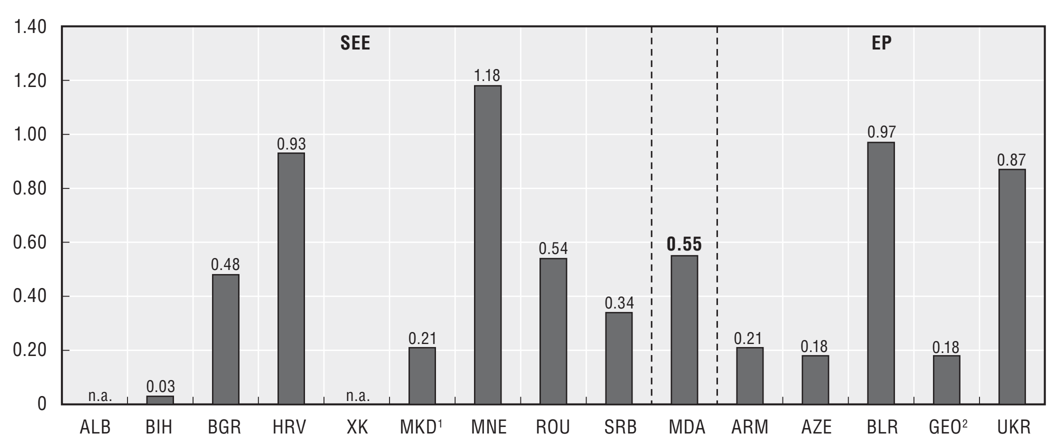
Source: World Development Indicators.

particularly challenging task for employers. According to the BEEP survey, in 2009, 15.7% of companies considered an inadequately educated workforce as a prime constraint for their development, the second most important issue following access to finance (EBRD and World Bank, 2009). This lack of skills has a deep impact on the innovation potential of firms.

Besides a highly skilled workforce, companies and the government need to commit significant financial resources to fostering research and development (R&D). At the aggregate level, the World Bank collects statistics on public and private expenditure in R&D. Figure 3.4 compares the situation in the Republic of Moldova with economies in SEE and EP. With 0.55% of GDP dedicated to research and development, the Republic of Moldova appears in line with similar economies in the region. However, this ratio is significantly below the average in the OECD where R&D expenditures represent 2.5% of GDP. Furthermore, in 2007, there were 723 researchers per million inhabitants in the Republic of Moldova. Although few

Figure 3.4. **Research and development expenditures, 2007**

As a % of GDP



1. 2006 data.
2. 2005 data.

Source: World Development Indicators.

countries in the region provide such a statistics, comparison with Romania and Ukraine, where these ratios reach 877 and 1 458 respectively, suggest that the Republic of Moldova has a limited research workforce, despite significant expenditures in this field.

Evidence collected at the micro-level has shown that access to ICT significantly increases the probability of innovation (OECD, 2010e). Investment in ICT is therefore important for a country's economic growth. The development of an ICT infrastructure can be assessed both in terms of access to and use of ICT technologies. With only 23.4 users of the Internet per 100 people, the Republic of Moldova appears among the countries where Internet penetration is the lowest. Similarly, and although data is not available for most countries in the region, with only 11.4 personal computers per 100 inhabitants in 2006, the Republic of Moldova shows a low level of adoption of ICT technology.

Innovation output

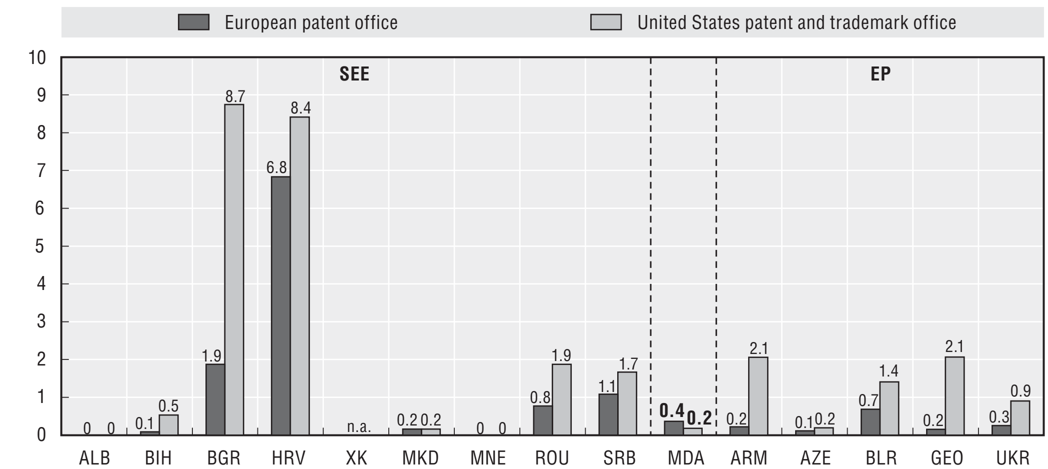
The primary impact of innovation at the aggregate level is an improvement in productivity. The analysis of factors productivity, although it is subject to criticism (see for example Hulten, 2000), can provide an overall picture of the growth pattern of an economy. In the Republic of Moldova, analysis of potential output conducted by the IMF (2010b) shows that as a consequence of emigration, between 2001 and 2009, the contribution of labour to potential growth was negative, while growth of capital stock and productivity contributed to maintaining the potential growth rate at around 4%. Most of this growth can be attributed to productivity growth and the shift of the labour force to higher productivity sectors following the transition process. In addition, 54% of companies interviewed by the BEEPS in the Republic of Moldova state that they have introduced a new product or services within the last three years (EBRD and World Bank, 2009). This shows that significant innovation activities are indeed recorded in the Republic of Moldova. To complement this analysis, more direct outputs of the research and innovation process should be taken into account.

A more direct measure of the outputs of the innovation process is provided by patents and trademarks filed by companies and research institutes in the Republic of Moldova. Trademarks and patents are subject to home bias as organisations are more likely to protect their innovation in their home market. Moreover, because different countries may have different institutional settings for patents and trademarks, international comparison often relies on patents and trademarks filed in the European Union, in the United States and in Japan. Accordingly, Figures 3.5 and 3.6 show the number of patents filed in the European Union and in the United States by inventors from SEE and EP countries.[1] This allows comparison of innovation activities in countries at the forefront of international innovation. In order to take into account the relative sizes of the economies in the region, these amounts are normalised by the population size.

The patent intensity in the Republic of Moldova, with regard both to the European Patent Office (EPO) and the United States Patent and Trademarks Office (USPTO) is at the low end of what can be seen in the region. As Figure 3.5 shows, among SEE economies, only Montenegro and Albania show less intensive innovative activity than the Republic of Moldova. Romania, Serbia, Bulgaria and Croatia are the economies where research intensity is the highest. This is consistent with the fact, observed in the previous section, that the effort made in these countries in terms of education and research investment is greater than in the Republic of Moldova. In EP countries, innovation intensity seems to be lower than in SEE, although a regional bias may contribute to the lower number of patents

Figure 3.5. **Average number of EPO and USTPO patent applications**

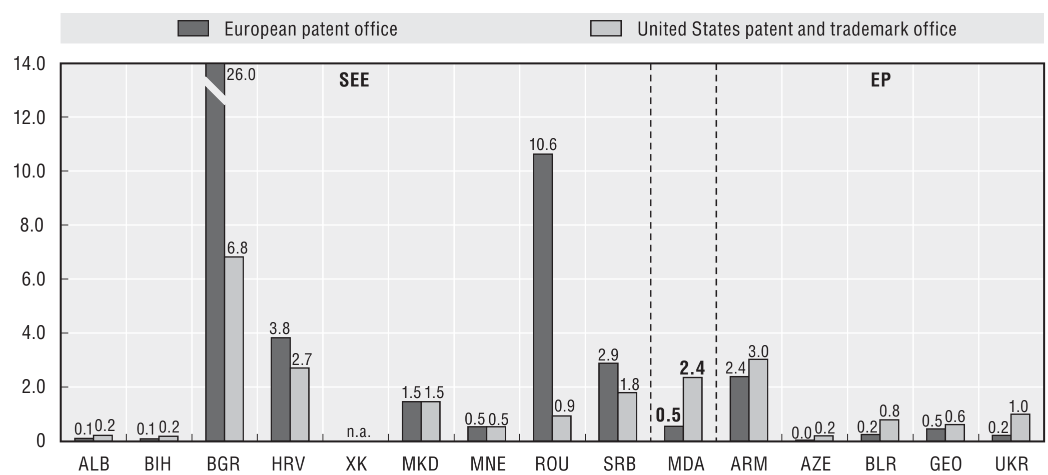
2006-08 average, in number of patents per million inhabitants



Source: WIPO, WDI.

Figure 3.6. **Average number of cross-border trademarks**

2006-08 average, in number of trademarks per million inhabitants



Source: WIPO, WDI.

filed at the EPO. Taking into account this limitation, only Azerbaijan shows an innovation intensity that is lower than that in the Republic of Moldova. In particular, although Armenia and Georgia invest less in R&D and have lower tertiary education enrolment, innovation intensity seems comparable to that of the Republic of Moldova.

Trademarks can also be used to measure innovation. Trademarks are filed for companies who want to signal some form of novelty to customers. They do not focus on technical innovation but rather on specific designs and marketing innovation. In that sense trademarks can measure to what extent new services and competition for product design is actually occurring in a country. Trademarks are also correlated with innovation indicators and are a good predictor of economic cycles (OECD, 2010). As shown in Figure 3.6, Bulgaria and Romania are clearly the economies where trademark intensity is the highest. This phenomenon is quite recent and can be linked to the entry of these economies into the EU. Trademark intensity in the Republic of Moldova is higher than in Albania, Bosnia and Herzegovina, Montenegro and all EP countries, except Armenia. This relatively better position of the Republic of Moldova may be a sign that despite limited technical innovations, companies in the Republic of Moldova are actually developing non-technical innovations that they signal through a relatively high share of trademarks.

Policy framework

Innovation policy in the Republic of Moldova is determined by the Code on Science and Innovation that was adopted in 2004. This regulation delegated the competences of the government in the fields of science and innovation to the Academy of Science.

Institutional settings

Responsibility for innovation policy is mainly split between the government and the Academy of Sciences. This partnership regulates the respective missions of the two institutions. Specific state agencies exist independently from the Academy of Sciences. In particular, the State Agency on Intellectual Property of the Republic of Moldova (AGEPI) and the National Council for Accreditation and Attestation (CNAA) play an important role.

Based on the Code on Science and Innovation, the Government has delegated to the Academy of Sciences the implementation of innovation policy. This institutional setting is formalised through a partnership agreement signed both by the Government and the Academy of Sciences. The first partnership agreement was signed in 2004, after the Law on Science and Innovation was adopted. The agreement is set for a period of four years and is revised annually. It sets the terms of the delegation of authorities to the Academy of Sciences in the field of research and innovation.

- The Government has responsibility over the strategic orientation and the budget allocated to innovation. It defines strategic orientations in consultation with the scientific community and the programmes to be developed. These programmes are then included in the partnership agreement. The government, as part of its budgetary procedures, decides on the budget allocated to the Academy of Sciences. It also designs the incentive schemes for innovative activities. Finally, it is responsible for supporting infrastructure to support innovation, including, in particular, the science and technological parks.
- The Academy of Sciences is responsible for the implementation of the science and innovation programmes designed by the government. As such, the Academy of Sciences has a responsibility for the public research institutions and the research activities of universities. It distributes funds allocated by the state budget and selects participants in the state programmes. In particular, the Academy is responsible for the development of innovation and technology transfer. The Academy of Sciences has established the Agency for Innovation and Technological Transfer (AITT) to conduct this task.

In addition to the Academy of Sciences, two state-agencies have an important role in the innovation system. The AGEPI which was set up in 2004 is the public institution responsible for issuing patents and trademarks. AGEPI also supports the government in monitoring the intellectual property system and provides proposals to improve the current system. The AGEPI publishes an annual report summarising its activities and the status of intellectual property rights (IPRs) implementation in the Republic of Moldova. It is a member of the World Intellectual Property Organisation (WIPO). The CNAA also plays a critical role in the innovation system. The CNAA is responsible for the accreditation of scientific personnel and of research institutions. For organisations, obtaining an accreditation is necessary to participate in the competitive allocation of state-funded innovation programmes. For institutions financed by the state, budget accreditations are provided based on regular inspection, while the other institutions require an application.

Organisation of the Academy of Sciences

The Moldovan Academy of Sciences (ASM) was established in 1961 as the focus point of all research activities in the Soviet Socialist Republic (SSR) of Moldova. From 1961 until the independence of the Republic of Moldova in 1991, the ASM was subordinated both to the Presidium of the Academy of Sciences of the USSR and the Council of Ministries of the Moldovan SSR. During the transition period, the ASM remained the main body for innovation and scientific activities. However, the emigration of large numbers of researchers, as well as important financial constraints limited its activities. In 2004, the decision by the Government of the Republic of Moldova to delegate the implementation of science and innovation policy to the ASM and the gradual increase in the state budget allocated to research and innovation has permitted modernisation and expansion of the ASM.

In terms of governance, the ASM has a prominent role in the implementation of science and innovation policies and is also a research and education institution. It includes both institutions whose primary target is to design and implement policies and instances that focus on steering the public research institution system.

The main steering body of the ASM is the Assembly. The Assembly has 103 full and corresponding members who are elected for life and 78 habilitated members who represent the scientific community and are elected for a period of four years. The Assembly elects the President of the ASM, approves the programme of work set up by the partnership, and determines strategic directions in the fields of science and innovation. The Supreme Council, which is chaired by the president of the Assembly, is the executive body of the ASM. It is responsible for the design of policies that are approved by the Assembly. It also distributes the state budget that is allocated to innovation, approves the research programmes of the various institutions and monitors their performance. Finally, it decides on the organisation of graduate studies.

In terms of structure, the ASM is composed of three scientific departments and also includes transversal services. The scientific department has a responsibility for public research institutions and the transversal services administer the academy and its auxiliary institutions.

Scientific departments are split according to field of knowledge: natural and life sciences; exact sciences and economics; and social sciences and humanities. Within each field, research institutions are grouped according to their statute in relation to the ASM. Institutional members are fully financed by the state budget. There are 19 institutions with a statute of institutional members. In 2010 institutional members had a budget of MDL 113 million (EUR 6.9 million), split evenly between basic and applied research. Thirty six research and tertiary education institutions are "profile members". They receive full financing of fundamental research and partial financing of applied research. According to the law, funding of applied research for profile members must be complemented with additional sources of finance. In 2010, profile members received a total of MDL 86 million (EUR 5.2 million), of which MDL 69 million (EUR 4.2 million) was dedicated to applied research. Three affiliated members, all research departments of universities, can participate in competition for specific projects. Besides pure research institutions, some universities are also members of the Academy of Sciences for their research activities. In order to benefit from higher integration with research institutions and to complement their activities, the Academy of Sciences has set up a high school and a university: the Lyceum of the ASM and the University of the ASM.

Auxiliary organisations of the ASM fulfil specific transversal tasks related to innovation. The AITT is responsible for setting up a link between the private sector and public research organisations. In particular, it is responsible for the organisation of tenders to market innovations developed in research institutions. The Information Society Development Institute (IDSI), established in 2008 in co-ordination with the Ministry of Information Technology and Communication, aims at developing ICT in particular for research and innovation. Activities include the organisation of international conferences, development of a network for academics and research institutions and participation in international projects. The Centre for Graduate and Post-graduate Education and Advanced Training is responsible for organising continuing training for researchers. These training courses focus on innovation strategy but can also address specific issues, such as public procurement procedures, that are relevant to the employees of research institutions. The ASM is also responsible for the Central Scientific Library and for other small state enterprises.

Experience in the OECD

Public policy intervention in the field of research and development is justified by the need to bridge market failures in the innovation process. Because of spill-over effects, companies are unable to capture the full benefits of innovations. Moreover, because research outcomes are uncertain, firms have difficulty funding research. For SMEs, which experience more difficulties than larger firms in accessing long-term funding, financing research activities can prove particularly challenging. Numerous empirical studies have shown that investment in research and development by the private sector is lower than the social optimum (see for example OECD, 2006a). However, the form that public support to innovation should take has been subject to controversy. Innovation policy in OECD economies has experienced a radical shift in the last few years. The emergence of the innovation system concept has lead policy makers to focus on systemic failures that limit the innovation process rather than on strict financial support for research and development. In parallel to this shift, the importance of the private sector contribution to the innovative process has increasingly been recognised by policy makers. These two policy trends have led governments in OECD countries to modify their approach in the steering of innovation systems and to increasingly develop linkages between firms and public institutions.

Steering of the innovation system

The prevalence of market failures in the financing of research projects provides a role to public authorities in the innovation system. Although the justification for public intervention has remained, the practice of innovation policy has evolved under the double constraint of increasing international competition and more complex innovation processes. Governments in the OECD countries have adopted new models of innovation policy that insist on versatility and on co-operation between the various stakeholders in the innovation system.

In a review of public research governance structure (OECD, 2003), the OECD defines three archetypes that can help describe the characteristics of a country innovation governance structure: the "centralised" system which relies on a strong top-down approach; the "decentralised system" which focuses on co-ordination and programme-based funding of independent research institutions; and the "dual" system which combines elements of top-down and bottom-up approaches and relies on several types of research institutions. These three systems do not intend to provide a typology of the various innovation systems in the OECD. Instead, in each economy, the structure of innovation governance includes aspects of the three systems. In the Republic of Moldova, the structure of the ASM and its links with the research institutions and with the AITT correspond to a highly centralised system. Priorities are set by the ASM that decides on the distribution of funding, which is mainly institutional. Research is primarily conducted by public research institutions that fully depend on the ASM. Such a system ensures the continuity of the funding stream and provides stable priorities that allow the pursuit of long-term research. On the other hand, there is a risk that such an innovation system may be slow to respond to emerging topics. Furthermore, co-operation between public and private research institutions depends fully on the academy's actions.

The process of setting priorities for research in the Republic of Moldova is primarily driven by the Academy of Sciences through its Assembly. These priorities are then implemented by the various research institutions. This process allows for limited consultation and dialogue. In OECD countries, this top-down approach has given way to a more collaborative process, better able to reflect the various dimensions of the innovation process. Co-ordination of innovation strategy across ministerial boundaries is one particular aspect of this trend. Indeed, innovation policy is at the frontier between research, economic development and sector-specific policies. Therefore, inter-ministerial dialogue is necessary to avoid duplication and inconsistencies. Also, reflecting the growing importance of the private sector and civil society in the innovation process, priority-setting processes have been adjusted to increase inclusiveness. Although governments retain the leading role in designing the strategy, private sector representatives are included in advisory boards and peer review and participate in foresight exercises. Companies have a more direct appraisal of the innovation needs and can support the public institutions in increasing the relevance of research orientation. Countries in the OECD complement the traditional top-down approach with a bottom-up consultation on the needs of the private sectors (OECD, 2003).

Besides its role in policy design and priority settings for research and innovation, the Academy of Sciences also provides funding to the various research institutions, deciding in particular the allocation of funds between the various institutions and projects. Such a setting, where the government allocates funds directly to the research institutions, is seldom seen in OECD countries. Most countries have established institutions that are administratively independent from the government and that receive a state budget to be allocated. Research councils in Australia, Belgium, the Czech Republic, Denmark, Germany, Iceland, the Netherlands, Norway, Sweden, the United Kingdom and the United States have this most common form of structure. These institutions have proved more responsive to a changing research environment. Besides the establishment of these institutions, countries in the OECD have increasingly promoted project finance over budget support to research institutions. In the United Kingdom, grants and contracts represented 65% of research funding for universities. The share of contract-based finance in the United Kingdom, the highest in the OECD, may be an extreme case.[2] However, in applied sciences, such schemes help increase accountability of the research institutions and, through projects with interdisciplinary objectives, contribute to developing linkages between institutions.

Developing links between public research and the private sector

In 2008, investment in research and development by private sector companies in the OECD countries was on average 1.65% of GDP (OECD, 2010a). Statistics available for 28 OECD member countries show that, on average, private expenditure by companies represented 55.4% of the gross domestic expenditure on research and development. The involvement of the private sector varies according to the type of research conducted. While important for long-term growth, basic research does not generally, and should not seek to, yield commercial applications and innovations in the short term. Firms have therefore limited incentives, and limited resources, to invest in basic research. Statistics collected by the OECD in 31 countries have shown that in 17 of them, public authorities covered more than 80% of the total cost of national basic research (OECD, 2010a). In contrast, in the area of applied research, because the commercial potential is among the objectives of innovative activities, private sector involvement is central. Governments need to ensure that they design measures to fully exploit the potential that private sector investment represents. In OECD countries, public support of innovation in the private sector particularly aims to increase the quality and quantity of innovation conducted by the private sector and to develop linkages between private and public research institutions.

The primary instrument developed to help the private returns of research of firms match social returns is the development of IPR. IPR regulations provide, for a limited time, a monopoly to innovative firms. By increasing the potential profit from innovation, IPR provide a potent incentive for innovative firms. By establishing protection against copy, IPR also support innovation diffusion through licensing and joint ventures (OECD, 2006a). Therefore, as described in OECD (2010), IPR are considered to have a positive impact on innovation and FDI flows. In developing economies however, the impact of IPR on economic growth appears more limited. Indeed, in order to be fully effective, IPR enforcement needs enabling conditions such as strong human capital and an adequate business environment to translate into economic growth. In the Republic of Moldova, the government has made significant efforts to enact and implement IPR laws. The Republic of Moldova has ratified the major international agreements related to IPR enforcement and is a member of the WIPO. Despite a very comprehensive legal framework for IPR protection, as in all economies in SEE, significant efforts are still needed to ensure full implementation of IPR.

Besides protecting IPRs, countries have also developed subsidies to incentivise companies to invest more in innovation. The current trend in most economies is to favour tax measures and grants on specific projects rather than providing direct grants to individual institutions and companies. Most countries use a mix of both approaches as they both have particular advantages and limitations. For example, the *Crédit Impôt Recherche* set up in France allows companies to deduct part of their research expenditures from their corporate income tax. This scheme subsidises research activities across the board and does not preclude the choice of sectors and projects. However, criticisms have been raised on the cost-benefit impact of the scheme and on the level of accountability of firms. Indeed, tax relief may lead governments to subsidise research activities that would have taken place anyway. Furthermore, companies may include in their "research expenditures", expenditures which bear limited relevance to innovation, thereby limiting the effectiveness of the subsidy. In order to increase accountability, governments can also provide project-based grants. An example is provided by the Small Business Innovation Research (SBIR) programme launched in 1982 in the United States. This programme provides grants to innovative firms which co-operate with public research institutions to commercialise innovative products. Although such a programme increases the accountability of the receiving firm, companies may be tempted to reduce their own expenditures by the amount of the subsidies. Moreover, the selection process for projects may lead to the selection of specific projects or areas that may be inappropriate. Although the full benefits of both schemes are still being questioned, tax credits seem to be gaining ground in OECD countries. In 2010, 22 OECD countries offered such credits, compared to 12 in 1995 (OECD, 2010a).

In the Republic of Moldova, the absence of corporate income tax makes fiscal incentives irrelevant for firms and only direct support to innovative firms is available. The current incentive scheme provides co-financing of development costs for companies which use innovation developed in public research institutions. Such a scheme increases companies' incentives to bring to market innovations developed in public institutes. However, its design does not seek to particularly develop research conducted by private companies. In this respect, the comparison with the SBIR programme is useful. The SBIR programme structures the innovation process in three phases. The first phase corresponds to the start-up phase and feasibility study. The second phase, which lasts up to two years, is dedicated to product research and development. The third phase is the actual product development and industrialisation. According to the SBIR programme, only the first two phases of the innovation process are funded. The rationale is that funding for the last phase should be made by the private firms as this phase will yield limited additional social benefit and mainly private benefit. In that respect, the matching grant provided by the Republic of Moldova has very limited impact on innovation intensity by the private sector and is most likely to yield limited economic impact. Companies need limited investment to market a product that has already been developed and private funds, or more traditional support to the SME sector, could just as well finance such projects while better assessing the market potential of the innovation.

As schemes such as the SBIR illustrate, while public research institutions and private companies have very different objectives, a deep level of co-operation can be beneficial to both actors. Recognising the need to strengthen the link between private and public research and development, governments in the OECD countries have designed measures to establish partnerships between public and private research. Three types of collaboration mechanisms have been designed. First, funding mechanisms have usually been conditioned on the establishment of collaboration between public and private institutions. Such a scheme provides incentives both to private and public institutes to seek common projects. Second, consultancy services by public researchers have been developed. These services give private companies the opportunity to tap into the extensive knowledge base of public institutions. Areas of consultancy can address domains such as testing, technical certification, technological assistance and training. Third, a number of studies highlight the role played by academic mobility for technology transfer. Allowing academics to move to the private sector to exploit the commercial potential of innovation has a positive impact on the innovation process. National factors have a particularly strong impact on the mobility of academics (Crespi, Geuna and Nesta, 2007) and governments should ensure that mechanisms are in place to allow such career moves.

The ability to integrate in their processes the innovation realised by others is key to the sustained competitiveness of companies, in particular in economies that are open and subject to international competition through trade. FDI represents a potential avenue for the adoption of innovation. This is particularly true in developing economies where companies are rarely at the forefront of worldwide innovation. However, in order to benefit from the innovation brought into the country by foreign direct investments, significant efforts need to be made by local stakeholders. In particular, technologies developed in another location need to be substantially adapted to the local context. Local producers may have difficulties in identifying the most relevant technology and developing the operational know-how to use it (Dahlman, 1987). Incorporating existing knowledge in operations can represent a significant challenge for smaller companies. International experience suggests that although trade openness is often thought to result in increased innovation capacity, government involvement can play a role if is needed to ensure that domestic firms build capacity to absorb innovations (Gallagher and Shafaeddin, 2010). Institutions such as the Industrial Technology Research Institute, established by the government in Taiwan, have incorporated support to technology absorption in the private sector among their key priorities. Developing support mechanisms to help domestic firms in the Republic of Moldova absorb foreign technology could contribute to building long-term competitiveness.

Conclusion

The national innovation system in the Republic of Moldova is dominated by the Academy of Sciences. The ASM decides on the general orientation of research activities, funds public research organisations and oversees technology transfer schemes. The low level of participation of the private sector in the governance of the Academy of Sciences, and in innovation activity in general, means that the Academy of Sciences has only limited feedback from companies on the effectiveness and relevance of its activities and policies. The current institutional setting seems to be geared towards basic research. Partnerships with the private sector are managed by the AITT which seeks market outcomes for innovations developed by public research institutions. The concentration of power of the Academy of Sciences in the field of research, science and innovation and some aspects of education policy is a very rare occurrence compared to OECD countries where a greater level of decentralisation is usually the norm. Furthermore, extensive consultation mechanisms with the private sector and civil society are instrumental in designing policies and, in some instances, in the actual implementation process.

In OECD countries, the private sector is the main contributor to the research and development effort. In order to develop innovation capabilities, governments need to adopt measures to support innovative activities of companies and help them make the related investments. In particular, in developing economies, ambitious programmes to foster private-sector technology absorption have been instrumental in developing sector-specific expertise to allow countries to make the most of trade openness. In order to develop all stages of innovation, several instruments, from fiscal incentives and direct grants to research partnerships between public organisations and companies, have been developed.

In the Republic of Moldova, these partnerships are undeveloped and current innovation policy does not seem to be focused on developing research and development capabilities in the private sector. The set up of intermediary institutions such as the AITT provides a good example of efforts to more effectively include the private sector in the innovation process. Science and technology parks and business incubators, which are already developed, in particular by the AITT (see Chapter 2, Section 2.8) are examples of initiatives aimed at improving the innovation capabilities of companies. However, the scope of these initiatives is limited and their results are still uncertain. Moreover, the current orientation of the AITT does not seem to focus on developing the R&D activities of the private sector, and relies instead on a strict separation of tasks where public institutions perform research that is then marketed by private companies. Some private companies, for example in the ICT sector, therefore consider that the programmes developed by the AITT are only of limited relevance to their work. The strategic orientations of the AITT and its instruments should be reviewed, in a collaborative manner, so as to design an innovation-oriented strategy, to help develop more innovative companies and to achieve higher economic growth.

Notes

1. As patent and trademarks filed in different offices may be related to the same innovation, the two amounts cannot be added.
2. This high proportion has raised concerns over the ability to fund long-term and basic research.

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Fostering SME Development

Conclusion: Key Findings and Priorities for SME Policy Reform

This report provides a comprehensive assessment of the status of SME policy development and implementation in the Republic of Moldova. In order to facilitate international comparison, it reviews the various aspects of SME policy according to the set of principles defined by the Small Business Act of the EU. The objective of this report is to define the key policy priorities for the next two years (2011-13) and to propose an indicative plan of action for the consideration of the Government of the Republic of Moldova and the SME policy community.

As mentioned in Chapter 1, the SME Programme, adopted in February 2009, defines SME policy in the Republic of Moldova. It identifies the five policy priorities for the 2009-11 period: *i)* legislative and normative framework; *ii)* access to finance; *iii)* entrepreneurial culture and managerial performance; *iv)* development of competitiveness and export performance; and *v)* public-private dialogue. In 2011, a new SME strategy will need to be drafted, which will aim to continue the reforms undertaken. One of the key objectives of the policy review is therefore to provide inputs for the development of a medium-term programme for the development of the SME sector, articulated around a set of selected priorities and to be launched in 2011.

This chapter summarizes the key findings that emerged from the SME policy review in light of the priorities set by the SME Programme and outlines the priorities for SME reform. Therefore It concludes with the presentation of a set of forward-looking priorities and the identification of a number of actions that could form the core of the new state programme. At this stage, those actions are formulated in broad terms and must be viewed as an initial proposal to steer the policy debate on the future of SME policy in the Republic of Moldova.

The contribution of SMEs to the economic performance of the Republic of Moldova

SMEs play a central role in the economic development of the Republic of Moldova. The country has neither a significant endowment in natural resources, as is the case in some of the Central Asian Republics, nor a strong tradition of capital intensive sectors as is the case in Ukraine and Belarus. The country's comparative advantages lay in the availability of a low-cost and relatively well-qualified workforce, on consolidated capabilities in the agriculture and agrobusiness sectors and in access to two large economic and trade areas: the EU and the CIS.

After suffering a sharp drop in the absolute level of GDP and in living standards during the first years of transition, the country has been able to resume growth and build up momentum in what will be a long catch-up process. In order to achieve sustainable economic growth, the Republic of Moldova has to build a diversified economic structure operating under an open trade regime. The development of a dynamic micro, small and medium-sized enterprises sector will ensure that the economy can adapt rapidly to this changing environment and will fully benefit from the comparative advantages of the country.

The expansion phase: 2001-08

From 2001 to 2008 the Republic of Moldova experienced a period of sustained economic expansion. In particular, between 2005 and 2008 it recorded an annual average GDP growth of over 6% per year. At that time, most of the other EP economies also had strong growth performance. However, it has to be noted that Moldova started from a very low base. In spite of this economic recovery, in real terms GDP in 2008 was only 55% of the GDP level achieved in the beginning of the transition process in 1989 (EBRD, 2010). The 2005-08 expansion was driven mainly by domestic consumption, fuelled by a strong expansion of credit to the domestic private sector and by remittances. Economic growth was accompanied by significant structural changes. The service sector and, in general, all non-tradable goods and service sectors, underpinned by strong domestic demand and protected from direct external competition, grew at a much faster rate than the tradable sectors. Employment in large and medium-sized enterprises, particularly in those engaged in manufacturing activities, declined steadily even during the expansion phase. The wine sector, which accounted for a large share of employment, turnover and exports, experienced a major crisis in 2006-07 and remained depressed in the following years.

During that period, enterprise creation remained strong, particularly in the service and retail sector. The number of micro and small enterprises increased very significantly, creating new employment opportunities, compensating for losses incurred in the large and medium enterprise segments. Indeed, many employees lost their jobs during the restructuring of state-owned enterprises and the public sector and as a consequence of the reorganisation of large and medium-sized private enterprises. Many of these individuals became entrepreneurs in their own right, partly out of necessity, and partly thanks to the opportunities offered by a growing domestic market, particularly in the service sector. This shift was facilitated by the simplification of company registration procedures and by the presence of an advantageous patent system. This system allows sole entrepreneurs engaged in a number of predefined activities to buy a temporary licence that works similarly to a forfeit tax and social contribution payment. Therefore between 2005 and 2008 the number of new enterprises, including individual entrepreneurs operating under the patent system, swelled considerably, and continued to grow during the 2009 recession but at a much reduced rate. According to our estimates there are currently between 65 000 and 100 000 active SMEs in the Republic of Moldova. Although the micro-sized enterprise segment of the SMEs population includes a very large number of subsistence enterprises or self-entrepreneurs, it also includes a segment of fast-growing enterprises led by young and relatively well-educated entrepreneurs able to identify and develop new business opportunities in the broad service sector (*i.e.* ICT, private education services), as well as in some of the manufacturing sectors (garment, furniture, construction materials).

At the end of the expansion phase in 2008, the private enterprise population was dominated by micro-enterprises engaged mostly in service activities, with a very low productivity record.[1] Instead, small enterprises performed quite well, increasing employment, average size and turnover, while medium-sized enterprises on average performed poorly, suffering from the progressive loss of competitiveness of enterprises engaged in the traditional manufacturing sectors and due to difficulties in accessing main external markets. The domestic market increased its dependence on imported consumer goods. Economic activity also became even more concentrated in the Chisinau area.

Impact of the global financial crisis

The global financial and economic crisis had a significant impact on the Republic of Moldova. The key transmission channels of the crisis were a sudden drop in external demand and a reduction in the inflow of remittances. The government responded to the sudden deterioration of the macroeconomic framework by applying for support from the IMF, in order to consolidate the public finances, and by launching an economic recovery programme in order to contain the contraction of economic activities. The enterprise sector suffered a considerable loss of jobs, all concentrated in the large and medium-sized enterprises. Micro and small enterprises, however, showed considerable resilience. The number of newly-registered enterprises dropped significantly from the peaks of 2007-08, but still the rate of renewed enterprise creation remained significant and employment in the micro-enterprise segment expanded, although at a much lower rate. By mid-2010, there were clear indications that the country was emerging from recession, with a market recovery in the agricultural and industrial sector and a much slower increase in activity in the construction and service sectors.

Between 2005 and 2009, the business climate in the Republic of Moldova showed signs of improvement. Efforts have been made to improve the regulative and legislative framework, with some success in simplifying regulations, streamlining company registration and improving the tax administration system, while other areas, such as export-import procedures saw no noticeable improvements. There was very limited progress in introducing and implementing structural reforms in key areas such as infrastructure, financial sector regulations and rule of law enforcement.

Review of the priorities of the SME Programme

In order to guide the next phase of SME policy, the results achieved by the current SME Programme need to be reviewed. This section aims to take stock of the current situation of SME policy according to the five pillars defined in the SME Programme.

Legislative and normative framework for the establishment and development of small and medium enterprises

Administrative procedures can present a heavy burden for SMEs. The SME Programme includes a number of measures to facilitate creation of companies and the operation of SMEs. In particular, a number of one-stop-shops have been created and regional programmes set up. Efforts have been made to streamline the number of control and inspection bodies that SMEs interact with. The programme also includes a number of surveys that seek to better inform policy makers on the problems encountered by entrepreneurs. These actions aim to reduce the costs or burden on SMEs as well as giving the government a tool to respond to changing conditions more effectively.

The regulatory reform process, conducted in three phases with the technical assistance of the World Bank and USAID, has led to important regulatory simplifications. The second phase of this process, conducted in 2008, resulted in the amendment of 82 regulations and the abolishment of two laws. The third phase, conducted in 2010, led to the simplification of a number of administrative procedures related to the activities of SMEs. Thanks to investments in information technology in public administration, administrative delays have been reduced. For example, the various government bodies involved in company registration (State Chamber of Registration, Ministry of Justice, National Statistical Office, Fiscal Inspectorate, etc.) are now connected to a shared IT network. A one-stop-shop for company registration allows entrepreneurs to submit applications to the various relevant institutions at one single counter. Hence, the process of business registration can take less than 24 hours once the required documentation is submitted.

Investment in information technologies has accelerated treatment of administrative procedures by public authorities; however, the administrative burden for SMEs remains high. In several cases, the number of documents required to conduct business has remained the same, making the preparation time still significant. In particular, customs procedures and VAT reimbursements remain problematic. Investment in IT has led administrations to further standardise procedures. This can lead to greater predictability and shorter delays. However, in some instances, SMEs have reported that procedures are now less flexible, creating new difficulties. Although the decreased delays are a positive development, further efforts may be needed for SMEs to fully benefit from the progress made by the public administration.

Financial environment for SMEs

Difficulty in accessing finance is the main constraint reported by companies in the Republic of Moldova; 19.5% of companies surveyed as part of the BEEPS identify access to finance as the top constraint in the business environment (EBRD and World Bank, 2009). Both the level of collateral and the interest rates set by commercial banks pose limitations for companies to access external sources of financing. This situation, which was already difficult when the SME Programme was developed, has only worsened as the global financial crisis unfolded.

Measures included in the SME Programme rely on three types of policy levers. Some measures include direct involvement of the government in the financing of SMEs, for example through the direct distribution of grants and loans with preferential rates to SMEs, in particular in rural areas. These instruments are complemented by more “market-based” approaches illustrated by the set-up of a credit guarantee scheme and by programmes aiming at financing young entrepreneurs and at redirecting remittances flows towards productive investments. Finally, the SME Programme includes actions that rely fully on external partners such as commercial banks and international organisations to improve access to finance for companies. The deteriorating quality of banking institutions’ loan portfolios in 2009 and 2010 resulted in difficulties for commercial banks in adopting more flexible loan policies and offering longer-term loans. However, with the support of IFIs, a number of credit lines were established to alleviate the credit constraints of private companies. Besides these measures by the donor community, the government supports the credit guarantee scheme operated by ODIMM and put in place conditions for the operation of a credit bureau. Although both initiatives are in their initial phase of implementation, they constitute a very positive development in improving the credit environment for SMEs and should be sustained.

Information asymmetries in the credit market restrict the ability of companies to obtain loans. The creation of a credit bureau has been made possible due to the enactment of the Law on Credit History Bureaus in 2009, which marks a positive step in improving the credit environment of companies. However, this initiative is likely to have an impact in the longer term due to the current situation of the banking system. In order to further improve the information available to banking institutions, evidence suggests that financial statements of companies must be made available for review. Companies in the Republic of Moldova are currently transitioning to IFRS. Such internationally recognised standards will provide more transparency to potential lenders. However, this can also represent an important cost for SMEs who must change their accounting practices. Developing dedicated training programmes, support services or adapting reporting practices for small companies would help SMEs limit the cost incurred. Acknowledging the specific difficulties faced by SMEs when changing reporting standards, the International Accounting Standards Board has developed a simplifyd version of IFRS. The organisation also provides training material for SMEs. Public authorities should consider similar measures to facilitate the adoption of these standards by SMEs.

Two credit guarantee schemes operate in the Republic of Moldova. Public support contributes to the development of these initiatives. At this stage, the effectiveness of the credit guarantee schemes in improving credit allocation may be limited by the high risk aversion of banking institutions. Experience suggests that reform of the schemes may be envisaged to ensure that they are better used while continuing to serve the most fragile borrowers (Levitsky, 1997). Particular measures may include increasing the rate of guarantee, currently limited in most cases to 50% of the loan amount.[2] In parallel, in order not to subsidise operations that are not profitable, the eligibility conditions for companies which use the guarantee may need to be strengthened. Such measures would contribute to ensuring that the credit guarantee schemes provide support to qualified borrowers who would not otherwise have access to funds.

Entrepreneurial culture and managerial performance of SMEs

Entrepreneurship is a key competence that needs to be addressed at all stages of the education system. In the European Union, entrepreneurship, which relates to the "ability to turn ideas into action", is included within the essential competences that individuals need to develop throughout their initial education and life-longlearning (EC, 2007). In the Republic of Moldova, entrepreneurial culture is in its early stages of development. Accordingly, in order to foster a dynamic SME sector, the government has defined three objectives aiming to: *i)* develop entrepreneurial culture and generalise entrepreneurial learning; *ii)* increase the level of employee training; and *iii)* provide more accessible consultancy services to SMEs.

In order to develop entrepreneurship, dedicated programmes have been set up, such as the entrepreneurship project conducted in schools by the NGO Junior Achievement. Bilateral donors such as Austria and Liechtenstein are also financing projects to support entrepreneurial learning. Entrepreneurial learning is also developed within the framework of continuing education and training. In particular, ODIMM, the National Agency for Employment in Moldova (ANOFM) and the CCI operate programmes to foster entrepreneurial skills both for employed and unemployed workers. These programmes have offered many employees the opportunity to access training. However, due to the limited resources of the agencies delivering the programmes, as successful as they may be, the number of people trained will remain limited if they are not translated into national systems.

The economic transition in the Republic of Moldova has generated important training needs in the workforce. The government is well aware of this issue and has included training within the objectives of both the SME Programme and of the broader National Development Strategy. Currently, programmes exist, in particular those operated by ODIMM and the CCI. However, the number of people that can benefit from these programmes is not sufficient to fully answer training needs. Public authorities should establish a national system for employee training. In particular, in the medium term, public authorities should consider changing their role from providers and organisers of training to brokers and promoters of training services. In OECD economies, public authorities have set up advisory services that help private companies identify their training needs and select adequate training providers. However, they do not organise the training themselves. Instead, they rely on private providers to develop a training offer while supporting companies through information sharing or financial incentives. The potential to implement such a brokerage model relies critically on the development of the market for training. In particular, in areas where no private training offer exists, public authorities will still need to operate training schemes. However, a market-based scheme may also act as an incentive for training providers to improve their services.

Currently, despite actions that were foreseen in the SME Programme, the involvement of the government in promoting professional services seems very limited. The market for professional consulting services in the Republic of Moldova is largely undeveloped. Because the professional services market is facing a number of market failures, further involvement of the government could help develop the market. More precisely, as is the case for training services, brokerage services and quality assurance could be developed to provide SMEs with a guarantee that the quality and type of services that they will be provided are adequate. Furthermore, in the area of innovation, linkages could be more systematically established between SMEs that are in need of specific technical expertise and public research organisations, which may have developed such an expertise. Mechanisms to further elicit such linkages have been developed throughout the OECD and strengthening those links is among the main concerns of innovation policy makers.[3] International experience could be used as a guide to develop efficient linkages programmes in the Republic of Moldova.

Competitiveness and internationalisation of SMEs

Economic growth in the Republic of Moldova over the past few years has been fuelled by private consumption and remittances rather than by exports and investments. The export capacity of companies needs to be strengthened to limit the risk of increasing external imbalances. Given their importance in the economic landscape, SMEs have a critical contribution to the export capacity of the Republic of Moldova. Currently, exports are focused on agricultural products towards markets in the CIS and textiles towards the European Union market. As a consequence, the economy is dependent on the condition of a small number of sectors in a few markets. Moreover, the Republic of Moldova’s exports rely on sectors with limited value-added. Accordingly, the SME Programme has set objectives to improve innovation among SMEs and facilitate trade. Such an approach seeks to develop the export of products with higher value-added and to expand the variety of categories that are exported as well as the number of export destinations for each category.

In order to increase export capacities, various aspects of the general business environment need to be improved and some specific barriers may exist for export-prone companies. Tackling these issues will have a strong impact on the ability of SMEs to serve export markets. In particular, non-tariff barriers can represent a heavy burden for SMEs. The SME Programme addresses both standards and custom regulations. In the areas of standards, the current situation is considered to be confusing by investors; both European standards and GOST standards co-exist despite their incompatibility. Implementation of international and European standards is among the key priorities for the government. However, there seem to be limited mechanisms to help SMEs adopt these standards. Further efforts should be made, targeting in particular SMEs in the agricultural sector as agricultural exports suffer the most from the stringent requirements set by European standardisation regulations. In addition, for companies that are able to comply with export standards, the cost of exporting is still very high despite specific measures included in the SME Programme. Indeed, both international reports (*e.g.* World Bank, 2010b and FIA, 2009) and anecdotal evidence suggest that administrative procedures required to export goods still represent a disproportionate burden for companies. Besides these "negative" measures to improve export capacity, the state agency MIEPO is in charge of developing instruments to pro-actively promote exports and international investments. However, MIEPO's resources are mainly absorbed by the organisation of large promotional events and it has only limited capacity available to provide other forms of support to exporting companies.

In order to enhance the capacity of SMEs in the Republic of Moldova to innovate, a number of measures have been included in the SME Programme. These activities seek to evaluate the innovative capacity of SMEs, and foster their ability to conduct innovation through support and incentives. However, progress made in achieving these goals seems limited. Specific projects such as science and technology parks and business incubators have been established. However, in many cases, although infrastructure facilities are provided to nascent companies, their impact on innovation capacity is limited. More generally, innovation policy in the Republic of Moldova is influenced by a linear conception of the innovation process, where research is driven by public authorities, conducted in public research centres and then applied by private companies. In most OECD economies, this purely top-down approach has been replaced by an integrated approach that gives a more extensive role to the private sector in orienting and conducting research (OECD, 2003). SMEs in the Republic of Moldova need assistance to increase their innovation absorption capacity. Authorities should work to re-shape the innovation system to improve the level of integration of the various stakeholders. Science and technology parks and incubators can provide a melting pot where this evolution could be realised. However, they will not be a substitute for a broader reform of innovation policy.

Dialogue between the government and the private sector

Building a constructive dialogue between the public and the private sector is a necessary condition to conduct effective business environment reform and to adapt the regulatory framework to changes in the economy. In order to ensure that the priorities for policy reform are adequate, policy makers need establish a forum to obtain feedback from private companies. Reciprocally, private players need communication channels to address their potential concerns to the government. For SMEs, establishing a dialogue with the government is particularly complicated. In order to effectively engage in a policy dialogue with administration, SMEs need to set up representative organisations. These organisations need to properly reflect the variety of the SME sector in order for public-private dialogue not to be captured by specific sectors. The SME Programme reflects these concerns. Actions related to public-private dialogue aim at developing private sector involvement in regulatory reforms and at promoting the establishment of representative structures for the private sector.

Private sector consultation is well entrenched in the business regulatory reform programme conducted by the Republic of Moldova. Conducting RIA is a mandatory step to adopt legislation that has an impact on entrepreneurial activity. A RIA working group which includes representatives from the private sector meets regularly to assess project laws before they are presented to the Assembly. Comprehensive reviews of the regulatory framework, the guillotine reviews, have also been conducted in order to simplify regulations. As part of this process, rigorous consultation with the private sector was conducted. Consultation of the private sector by the public authorities is well institutionalised as part of the RIA and the guillotine processes. Despite these positive steps, consultations seem to occur at quite a late stage in the process of policy making. Indeed, little public-private dialogue seems to take place at the drafting stage of regulation. In such a context, although they have the opportunity to voice their criticisms on drafted regulations and private companies and their representatives have limited opportunity to be involved in their design. Ensuring that private companies are consulted at an earlier stage would allow better definition of priorities in accordance with the most pressing needs of the private sector. Moreover, a diverse set of stakeholders need to be included in the consultation process to ensure that public-private dialogue is not captured by specific interest-groups.

The main obstacle that the government of the Republic of Moldova faces when consulting the private sector is the relative lack of independent representative organisations with whom to engage in discussion on policy inputs on horizontal issues regarding SME development. Instead, the government consults with organisations that may not fully reflect the opinions of the broad-based private sector. For example, in the framework of the guillotine process, representatives of the private sector were reported to have been selected to participate in a consultation process without fulfilling any specific criteria. Similarly, representation of the SME sector on the RIA committee is assured by an association whose membership is mainly composed of patent holders and micro-enterprises. While those enterprises constitute the bulk of the SME population, they do not represent the most vibrant part of the population. Several measures have been included in the SME Programme that seek to develop wider representation of the SME sector. In particular, associations of producers in the agricultural sector have been established. Moreover, SMEs were to be further involved in the trans-European networks. Despite these efforts, no formal structure representing the diversity of the private sector has yet been established. Individual associations which already exist, such as the Chamber of Commerce and Industry, the FIA, Timpul, the Association of ICT Companies and the Association of Textile Industry Producers, could be used as a basis to build such a structure of consulting and independent representative organisations. Although much of the responsibility for the establishment of a representative body lies in the private sector, the government could provide incentives to promote this process. For example, long-term commitment by public authorities to increasing the inclusion of private sector representatives in the early design of the legislative programme would provide a strong signal to private companies that they need to set up more structured and representative organisations to increase their visibility.

Notes

1. On average productivity per employee in micro-enterprises in comparable sectors was around 40% of that of the small enterprise segment.
2. The scheme operated by ODIMM offers guarantees of 50% for established companies and a coverage of 70% for start-ups.
3. See for example OECD (2010f) for an example of policy steps taken in this area by governments in OECD economies.

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REPUBLIC OF MOLDOVA

FOSTERING SME DEVELOPMENT

This assessment represents the first phase of the project "SME Development in the Republic of Moldova", implemented by the OECD Investment Compact with the financial support of the Kingdom of the Netherlands. The second and third phases of the project will focus on assisting policy makers in adapting international best practices for the Republic of Moldova.

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