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# EU Support to the Private Sector in the context of Association Agreements/DCFTAs

## Summary Report - Moldova

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## 1. INTRODUCTION

The European Neighbourhood Policy (ENP) provides a privileged relationship which promotes common EU values such as democracy and human rights, rule of law, good governance, market economy principles and sustainable development. Within the framework of this broader policy Association Agreements (AAs) incorporating Deep and Comprehensive Free Trade Areas (DCFTAs) represent a new generation FTA which provided the opportunity to negotiate regulatory and beyond-the-border issues that are not included in traditional FTAs.

Negotiations for AA/DCFTAs in Ukraine were effectively launched in 2009, followed by Moldova and Georgia in 2010. The AA, including the DCFTA, was signed between the EU and Georgia and, EU and Moldova on 27 June 2014 in Brussels. These apply provisionally as of 1 September 2014. This report details the findings of the study on EU Support to the Private Sector in the context of Association Agreements (AA) including the Deep and Comprehensive Free Trade Area (DCFTA) and covers the newly signed agreement in Moldova. It summarises the findings of the wider study on Georgia, Moldova and Ukraine. More detailed analysis can be found in the main report should be read in conjunction with this summary.

### 1.1 SME DEFINITIONS

The focus of support from the European Commission will be on small and medium enterprises (SME). Whilst during the survey and analysis stage, the EU definition will be used, it is not possible to differentiate national statistics between large firms as defined nationally, and medium firms as defined by the EU. As a consequence, throughout this report, when referring to national data, we necessarily have to use the national definition as follows:

**Table 1 Definition of SME in Moldova<sup>1</sup>**

Indicator	Employees	Total Assets	Total Annual Sales
Large	>250	>€ 3 million	>€ 3 million
Medium	50-250	€ 1.5 million - € 3 million	€ 1.5 million - € 3 million
Small	10-49	€ 182,000 - € 1.5 million	€ 182,000 - € 1.5 million
Micro	<10	<€ 182,000	<€ 182,000

### 1.2 SME SECTOR IN MOLDOVA

Moldova currently enjoys relatively high growth rates with average GDP growth since 2010 of 5.5% (although there was a contraction in the economy in 2012 by 0.7%, but 2013 showed highest ever growth of 8.9% driven by agricultural recovery from failed harvests of 2012). Forecast growth in 2014 is 2.0% with growth of 4-4.5% from 2015-17.

After wholesale and retail sectors (14%), manufacturing is the largest sector of economic activity in the economy, representing 12% of GDP compared with agriculture of 10%. Other significant sectors are transport and communications, financial services and construction contributing 11, 5 and 3% respectively.

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<sup>1</sup> Law of the Republic of Moldova on Support to Small and Medium Sized Enterprises (Law No. 206-VXI of July 2006),

**Table 2 SME Activity by Sector**

	Value of Sector contributed by SMEs (€)	Contribution of SMEs to the total Sector (%)	No. of SMEs in sector	Employment in SMEs
Wholesale and retail trade	2332.8	36.8%	20036	79870
Manufacturing	612.0	28.6%	4857	46095
Transport and communication	442.5	35.4%	3309	22833
Real estate renting and business activities	332.7	64.5%	8488	39496
Health and social work	74.3	24.8%	788	12975
Agriculture hunting and forestry	316.9	67.9%	2477	36246
Construction	343.8	63.4%	2702	22500
Other community social and personal service activities	53.1	54.5%	3418	16097
Electric and thermal energy gas and water	16.8	1.2%	249	2705
Hotels and restaurants	87.8	74.6%	1657	12092
Education	17.2	69.6%	362	3292
Financial intermediation	38.0	11.3%	903	2767
Mining and quarrying	19.7	51.1%	104	2142
Fishing, pisciculture	2.2	100.0%	84	597

In addition, it should be noted that there are 902,211<sup>2</sup> agricultural holdings in Moldova but 99.6% of these are informal and will only be affected if they sell to formal markets.

The majority of registered SMEs in Moldova are located in Chisinau metropolitan area (64%) and Centre, accounting for 77% of all SMEs in Moldova.

**Table 3 Geographical Distribution of SMEs (number of SMEs)**

	Total	Large	Medium	Small	Micro
<b>Municipality Chisinau</b>	<b>33580</b>	<b>867</b>	<b>897</b>	<b>5890</b>	<b>25926</b>
<b>North</b>	<b>5991</b>	<b>142</b>	<b>249</b>	<b>1410</b>	<b>4190</b>
..Municipality Balti	2331	54	63	469	1745
..Soroca	600	16	20	115	449
<b>Centre</b>	<b>7144</b>	<b>137</b>	<b>233</b>	<b>1378</b>	<b>5396</b>
..Anenii Noi	660	20	21	152	467
..Hincesti	642	17	21	132	472
..Ialoveni	1036	25	34	182	795
..Orhei	1103	18	27	180	878
..Ungheni	984	15	23	138	808
<b>South</b>	<b>2581</b>	<b>58</b>	<b>108</b>	<b>602</b>	<b>1813</b>
..Cahul	735	18	28	176	513
..Causeni	462	8	21	99	334
<b>T.A.U. Gagauzia</b>	<b>1385</b>	<b>33</b>	<b>51</b>	<b>290</b>	<b>1011</b>

<sup>2</sup> GAS-2011, NBS, Moldova

## 2. ISSUES AND SCOPE OF IMPACT

In this study, we have focused exclusively on the provisions that will have a direct impact on the day-to-day operations of a business. This section details those provisions. It also details the gap analysis between existing legislation in country and the requirements to align to the EU acquis relevant to SMEs as detailed in the AA/DCFTA.

### 2.1 IDENTIFICATION OF KEY PROVISIONS OF THE AA/DCFTA THAT WILL AFFECT BUSINESS

Based on our audit of the AA/DCFTA and its provisions that will have a direct effect on the business administration of SMEs, the following summarises these effects.

Area of Association Agreement	Likely Impact on business	Sectors potentially affected
Money laundering/crime & corruption	Requirement for increased financial reporting/controls	All
Market access	Market opportunities in EU and cheaper imported inputs	Depending on current structure of tariffs
Approximation of TR, standards, and CA and labelling	Adaption of production and CA.	Manufactures
Approximation of SPS	Compliance with EU SPS and animal welfare standards	Agriculture Agro processing sector of manufacturing
Approximation to EU customs law (customs code)	Procedures for customs administration	All importers and exporters
Approximate on public procurement	Opportunities to bid on EU contracts	Professional services Construction Manufacturers
Area of Association Agreement	Likely Impact on business	Sectors potentially affected
Approximation relating to energy cooperation	Product standards regarding energy and labelling thereof, of products and buildings	Manufacturing Construction Real Estate Professional services
GMO monitoring	Use and control of GMOs	Agriculture
Road transport	Road and vehicle safety	Transport Wholesale/retail Manufactures (of dangerous products in particular)
Company law, corp. governance, accounting and auditing	Changes in corporate governance	All
Environment	Control of industrial pollutions and hazards (vehicle emissions waste and waste water)	Transport Manufacturing (esp chemicals) Agriculture

Area of Association Agreement	Likely Impact on business	Sectors potentially affected
Health and safety	Safety and health of workers at work,, use of work equipment, personal protective equipment	All sectors Especially construction Manufacturing (esp chemicals)

## 2.2 GAP ANALYSIS

A total of 23 organisations in Moldova were interviewed comprising government ministries, departments or agencies responsible for implementation or regulation and donor projects (mainly EU funded) assisting with implementation of the acquis.

The following analysis relates specifically to articles of the AA/DCFTA that will have a **direct** effect on the operations or opportunities for business as identified in the audit. It also reflects the understanding of those interviewed rather than any new analysis undertaken by the team. The following analysis presents the findings of both interviews and review of implementation plans and strategies along the relevant areas of the AA/DCFTA.

### Money laundering and terrorism financing and Fight against crime and corruption

Legislative Gap	Institutional Gap
To be prepared, MoUs and Cooperation Agreements with FATF, MONEYVAL and authorities of EU Member States.  Agreement with Eurojust to be Ratified.  CNPJ to develop correlation tables for transposing EU.	Establish national mechanisms for cooperation and participation in international fora.  Strengthening national authorities on enforcement.

### Market access (reduction in tariffs, export duties, TRQS and reference prices)

Legislative Gap	Institutional Gap
Amendments to the Law on Tariffs have been prepared, including cancelling ad valorem fees for customs procedures - presented to the Government for consideration.	Procedural and administrative changes to enable functioning of the TRQ mechanism needs to be established.

### Approximation of technical regulations, standards, and conformity assessment and EU standards and labelling

Legislative Gap	Institutional Gap
Transposing EU Technical Regulations in accordance with Annex XVI.  Most standards need to be either changed or updated to align with the EU; Withdrawal 1090 conflicting national standards	Develop infrastructure related to the administration of technical regulations, standardisation, metrology, accreditation, conformity assessment procedures and the market surveillance system, including creation of a national information system.

**Sanitary and phyto-sanitary, animal welfare and other legislative measures**

Legislative Gap	Institutional Gap
<p>More than 100 EU SPS Directives will be transposed into national legislation (70% of them will be new laws– 30% amendments) .</p> <p>Removal of mass of redundant legislation.</p>	<p>National Food Safety Agency is operational but laboratory infrastructure requires upgrading.</p> <p>FVO approved residue monitoring plans for eggs, poultry and aquaculture.</p>

**Customs Law (Customs Code)**

Legislative Gap	Institutional Gap
<p>Ministry of Finance is preparing the New Customs Code and Customs Service is drafting administrative acts for implementing SAD and simplified declaration procedures.</p>	<p>Capacity of customs built with modern customs techniques, including risk assessment, Human resource management, post clearance controls and company audit methods; data and documentation.</p> <p>Establish independent body for appeals against customs.</p>

**Approximation of legislation to the relevant EU acquis on public procurement**

Legislative Gap	Institutional Gap
<p>Legislative approximation all public procurement including amendments to Law on Public Procurement, adopt new Law on Utilities and prepare a comprehensive PP Roadmap for implementation.</p> <p>Identify and amend discrepancies in the secondary legislation.</p>	<p>Creation of a National Agency for Review of Complaints not yet approved</p> <p>Adjusting the guidelines and other reference documents for training and improving the contracting authorities.</p> <p>Identify contracting authorities to apply the Law on utilities.</p>

**Legislative and Institutional Gap on Enforcement of use of GIs**

Legislative Gap	Institutional Gap
<p>Amendments to the Law on Protection of Geographical Indications is needed together with amendments to the regulation on procedure to apply, examine and register geographical indications.</p>	<p>To ensure the implementation of the enforcement mechanism provided by the legislation, there is a need to improve the institutional capacities of the enforcement bodies with competences on GIs.</p>

**Approximation of legislation relevant relating to energy cooperation**

Legislative Gap	Institutional Gap
<p>Laws and regulations relating to energy efficiency of products is to be developed including energy labelling and energy performance of products and buildings.</p>	<p>This will be enforced through market surveillance bodies (see technical regulations above).</p>

**Approximation of legislation relevant relating to GMO monitoring**

Legislative Gap	Institutional Gap
<p>Need to approximate legislation that deals in particular with the GMO issues : submitted for approval draft law on the deliberate release into the environment and placing on the market of GMOs;</p>	<p>In 2014, a signed Memorandum of Understanding between agencies and Israeli Joint Project Agricultural Cooperation on the creation of a molecular biology laboratory to detect genetically modified organisms (GMOs).</p>

### Approximation of legislation relevant relating to Road Transport

Legislative Gap	Institutional Gap
All Legislation is yet to be developed and adopted although there is a transport Strategy 2013 – 2022.	Implementation of intelligent system of management and control of road traffic (in development)

### Approximation of legislation relevant relating to Company law, corporate governance, accounting and auditing

Legislative Gap	Institutional Gap
Amendments are needed to existing laws on audit, accounting; joint stock companies, and the state register of legal entities and individual entrepreneurs.  A new Code on corporate governance is being developed with IFC support.	A specific unit or agency for financial investigations will need to be established.

### Approximation of legislation relevant relating to Environment

Legislative Gap	Institutional Gap
Plans to transpose 41 EU acts relating to Environmental governance; Air quality; Water quality and resources; Waste and resource management; Nature protection; Industrial pollution and hazards; Chemical products and substances and Climate action policy.	Strengthen systems and equipment for full implementation and monitoring.  To develop water quality and water resource pollution monitoring authorities.

### Approximation of legislation relevant relating to Health and Safety

Legislative Gap	Institutional Gap
The Labour Code of Moldova will have to be amended to transpose five key EU Directives related to labour rights  Secondary legislation to transpose the other 26 directives in health and safety at work will also have to be developed and adopted	The Ministry of Health has created a new unit for occupational health and safety. However, it consists of only 3 persons and significant capacity building is needed.

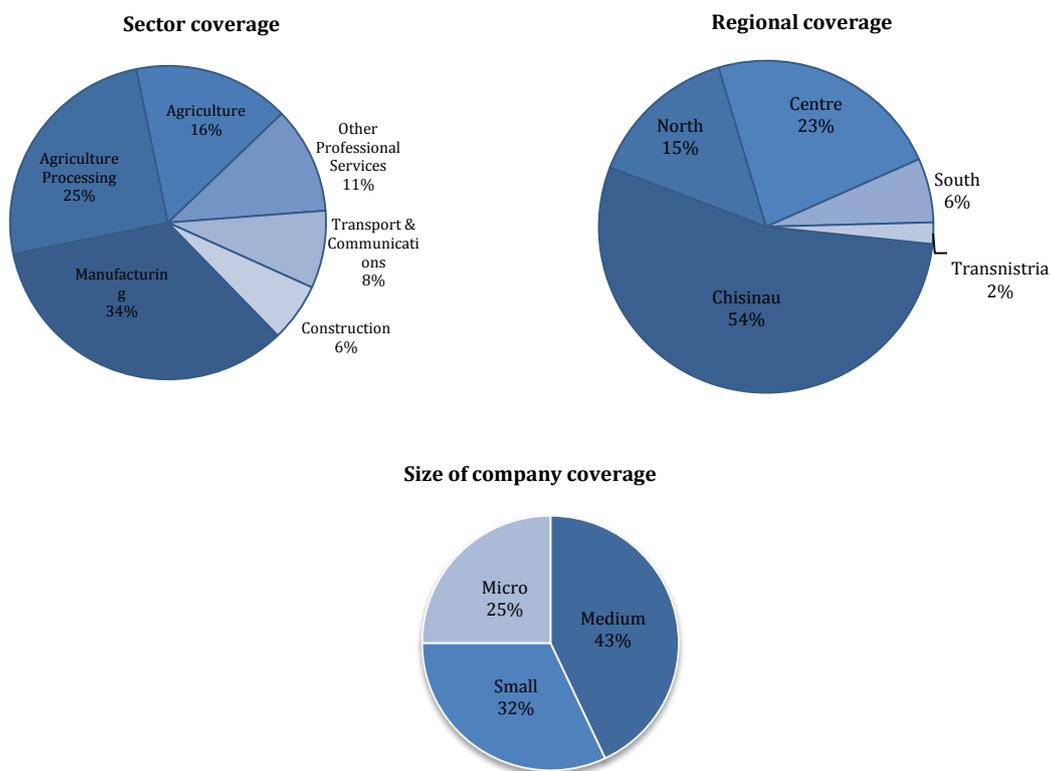
### 3. SURVEY RESULTS

The following section presents the findings of 3 surveys undertaken under this study, of SMEs, Business Support Organisations and Financial Institutions. This presents the results and should be used for reference only. An analysis of the implications of these results are presented in section 4 of this report.

#### 3.1 SME SURVEY RESULTS

##### Scope and Coverage of Survey

The SME survey was undertaken between October and December 2014 and 185 SMEs were surveyed. A profile of the respondents is provided by sector, regional and size, as well as a breakdown of those currently exporting:



##### Opportunities under the AA/DCFTA

###### *Firms who can sell or want to sell to EU*

- 55 % of the surveyed firms estimate that they can sell to EU now.
- 68 % of the surveyed firms expressed their wish to sell to EU.

###### *Market Access to the EU market*

- There is very little knowledge amongst those that were surveyed of how to access the EU market and where to obtain information with less than 21% having the knowledge.
- Around 20% knew how to find information on exporting to the EU.

**Understanding of the Changes to EU market access under the DCFTA**

There was little understanding amongst those surveyed of the changes in market access resulting from the DCFTA:

- 22% knew about the changes affecting tariffs;
- 16% about TRQ's; and
- 25% about Certificates of Origin.

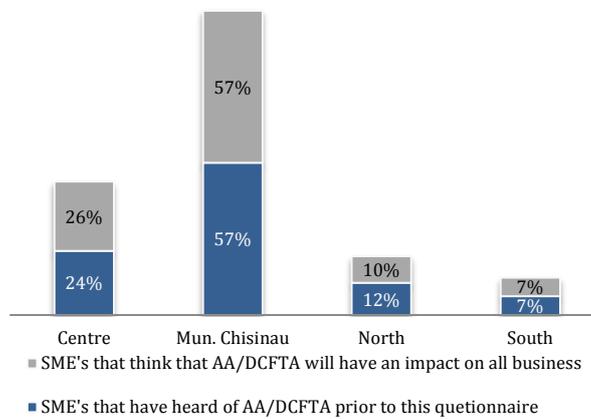
**Understanding of the changes from implementation of the AA/DCFTA**

**General Awareness of the AA/DCFTA**

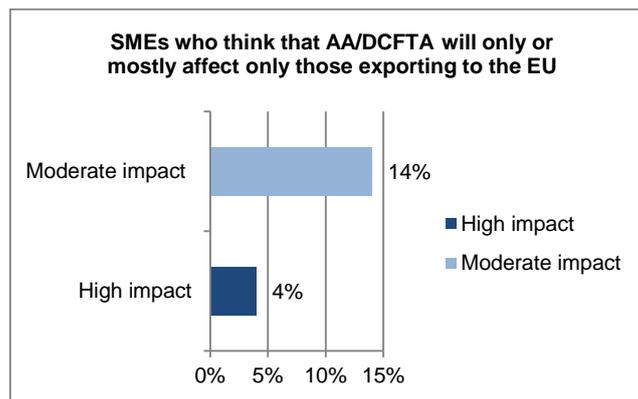
- 33% of the surveyed SME's heard of AA/DCFTA prior to the Questionnaire
- 43% of the surveyed SMEs think that AA/ DCFTA will have an impact on all business in country

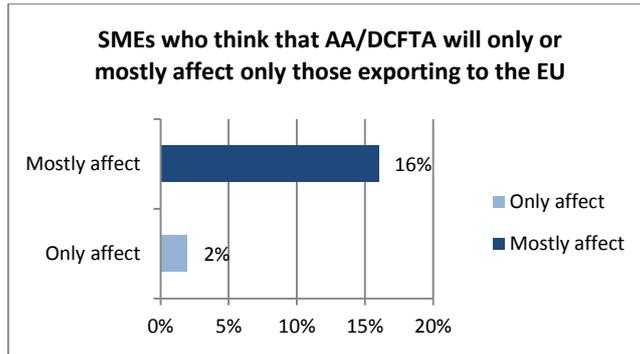
*Awareness of AA/DCFTA by Region*

**Moldova - SMEs General Awareness by region**



*Impact of AA/DCFTA on SMEs*

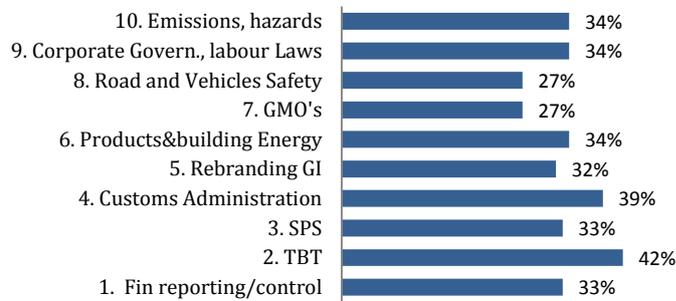




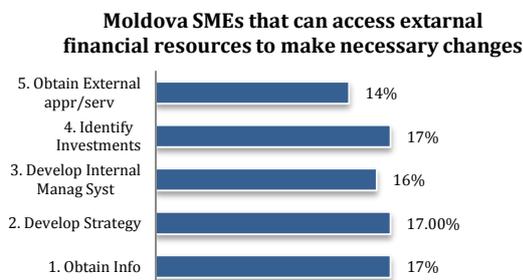
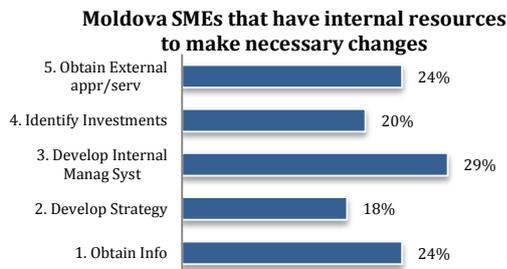
SMEs do not think that their business will be affected with very little impact as only 2% of the respondents think that they might be affected.

*Specific knowledge of Changes amongst SMEs*

**SMEs that understand the changes to their business in specific areas**



*Availability of resources for compliance with AA/DCFTA*



Around one quarter of SMEs in Moldova stated they had internal management capacity to implement necessary changes resulting from AA/DCFTA.

Around 13% of SMEs stated they have internal financial resources and an additional 17% stated they could get access to external finance for the necessary changes. This means only 30% of firms can finance the necessary changes resulting from AA/DCFTA implementation

*Support required for compliance with AA/DCFTA*

Support suggested by Participants: Free information, free trainings, financial support, information available in Russian, or a simple translation if there is another language, financial support, collaboration with similar companies.

**3.2 SURVEY OF BUSINESS SUPPORT ORGANISATIONS AND BUSINESS SUPPORT PROJECTS**

**Scope and coverage**

A total of 63 organisations supporting SME development across the 3 countries were interviewed to gather data and information, these including 13 Ministries and state organisations responsible for business support, 34 business support projects (BSPs), 3 think tanks focussing on SME needs and 14 business support organisations (BSOs).

**Table 4 Breakdown of BSOs and BSPs Surveyed**

	Moldova
Ministries Responsible for SME Development	2
State Business Support Institutions	2
Business Support Projects and Donors	16
Business Support Organisations	4
Think Tanks	1
	25

**Awareness of the AA/DCFTA**

*Awareness of AA/DCFTA requirements/opportunities amongst BSOs interviewed*

- DCFTA is a popular topic, but the overall awareness, in particular in view of implications of DCFTA on firms is rather low
- SMEs are little aware of the implications of DCFTA on their firms, but export, export-ready and “better-off” firms in all countries are quite well aware
- SMEs are not really aware of how to benefit from DCFTA
- The awareness on DCFTA also differs between sectors; e.g. IT and manufacturing firms are better aware than most of the agricultural firms except for firms from the wine sector who are quite well aware
- the Government has taken steps to inform people on DCFTA, e.g. via web sites
- In Moldova the Government is not yet prepared to inform people honestly on DCFTA as there is a fear of Russian propaganda in a pre-election period

*Management and marketing capacities of SMEs to comply/benefit DCFTA*

In general, management and marketing skills are considered to be low.

Many firms are not aware of what needs to be done to comply with DCFTA.

Export and export-ready firms in all countries possess the necessary skills to comply with DCFTA

The EU export help desk is used

### *Technical capacities of SMEs to comply/benefit DCFTA*

Technical capacities are better developed than the managerial and marketing ones, but still considered to have room for improvement.

Exporting, export-ready and “better-off” firms usually have better technical knowledge to comply with DCFTA than SMEs.

### *Financial capacities of SMEs to comply/benefit DCFTA*

It is expected that compliance with DCFTA will require a lot of fund.

Many firms have difficulties to quantify their financial needs as they are not aware of the requirements for adapting to DCFTA.

Access to finance is difficult as interest rates are considered high; in all countries collaterals are an issue and prices for loans are considered too high.

Liquidity for SME lending is said to be no problem but banks mention a lack of bankable projects due to the lack of financial literacy and business planning skills.

Lending is the most used financial instrument; leasing and factoring is available, but trade finance is usually not used by SMEs; the demand for any other instrument than lending is low.

SME lending is heavily collateralized.

Long-term local currency lending is practically not available for SMEs.

Similarly, significant efforts and creativity are often required to identify and exploit support mechanisms available for DCFTA implementation at the firm level.

The non-functioning legal system creates problems for banks and firms alike

### **Available support for AA/DCFTA Compliance and realising opportunities**

#### *Capacity to support SMEs in AA/DCFTA compliance and realising opportunities*

- BSOs have no capacities to offer services on DCFTA
- capacities seem to be concentrated in the capital cities with limited outreach to remote areas
- there seem to be international chambers leading the DCFTA process, but not really reaching SMEs

#### *Available services for AA/DCFTA compliance (e.g. for testing, certifying, auditing)*

- there are some facilities for testing and certification, but with limited capacities; only a few of them are internationally accredited
- there are State labs and a limited number of private labs, which are competing with each other
- many facilities are outdated and need upgrading and improvement
- international donors are supporting the setting up of testing and certification bodies
- There is a competition between State and private labs
- international donors are supporting the setting up of testing and certification bodies
- the metrology infrastructure is improving, but still a lot needs to be done

### **3.3 SURVEY OF FINANCIAL INSTITUTIONS**

#### **Scope and coverage**

A survey of 6 financial institutions was undertaken in Moldova as well as interviews with EBRD and EIB.

## **Major challenges in lending to SMEs**

### *General Lending Environment*

- SME lending is an attractive market for banks, but it is difficult to find clients able to prepare bankable projects;
- banks considered themselves as “partners of SMEs”
- There is no real liquidity problem within banks for SME lending
- Financial literacy is countries low in all
- there is a lack of demand for SME lending noted by the banks
- Costs of loans are considered too high
- Many SMEs lack knowledge on banking products and do not understand the logic (and needs) of the banks
- Long-term, local currency loans are a problem in all countries
- In general, banks are rather risk-averse and conservative in SME lending

### *Loan Applications*

- Banks are supporting SMEs to prepare loan applications, but banks are complaining that the financials of most firms are sub-optimal and not well structured or opaque
- MFIs have less sophisticated loan applications than banks; often loan officers visit firms to prepare the loan application with the clients together on-site.
- Microfinance is done in many banks via retail banking; there are several MFIs active on the market.

### *Realisation of Collaterals*

- Realization of collaterals is a very difficult, time-intensive and expensive process
- Credits are heavily collateralized.
- For recovery of the collaterals courts need to be involved.
- Most costs from realization of collaterals can be recovered
- There is a buyer’s market for collaterals, which makes the selling of collaterals difficult for banks
- The recovery via court systems is very time consuming in all countries (up to 15 years in Moldova)
- the court systems are considered highly inefficient and corrupt

### *Loan Performance*

- The overall NPL rate of banks is reported in Moldova between 6% and 25% (15% official NBM rate). NPL rates of smaller firms are lower than bigger firms as one default loan of millions of USD can bring down the NPL of a bank substantially;
- MFI NPL rates are much lower than NPL rates of banks
- The interest rate at banks ranges between 8-14%; foreign currency loan interest rates ranges between 5-9%.

## **Awareness of AA/DCFTA**

### *Awareness of AA/DCFTA amongst Financial Institutions (FIs)*

- knowledge on DCFTA among financial institutions is rather limited
- some banks are aware that DCFTA will be a topic for SMEs – providing business opportunities – but the overall knowledge even in these banks remains rather limited
- banks and MFIs would be interested to receive further training on DCFTA as many of them have realized that there are a lot of opportunities upcoming for financial institutions

*Awareness of AA/DCFTA amongst SMEs*

- All financial institutions consider that the awareness, knowledge and management, technical and financial capacities of SMEs with respect to DCFTA are rather limited

*Support from FIs to SMEs on AA/DCFTA implementation*

- Most of the FIs were not really aware of DCFTA and its implication on firms; however, some of the banks conduct information and awareness creation events on DCFTA using external expertise;
- All banks interviewed in all countries would like to see some training on DCFTA for FIs.

#### **4. MAIN FINDINGS**

##### **4.1 NEEDS OF SMES TO COMPLY WITH CHANGING BUSINESS RULES DURING AA/DCFTA IMPLEMENTATION**

###### **Lack of Awareness of the Impact of the AA/DCFTA on business**

The scale of the task facing small and medium sized business in Moldova in order to both take advantage of the opportunities, and to comply with the national reforms resulting from implementation of the AA/DCFTA cannot be underestimated. There are eleven areas of the AA/DCFTA that will have a direct impact on the operations of business, implementing over 500 new EU directives and introducing over 500 new harmonised standards. These will affect the majority of SMEs including the 50,000 economically active registered SMEs.

Moreover, the current level of knowledge and understanding of the changes required is little known within the country with only 33% of SMEs surveyed, having even heard of the AA/DCFTA, and only 43% of these believing that it will actually impact their business. There is also a significant difference across the various regions of Moldova with awareness highest in Chisinau Municipality at 57% dropping to 24% in central region, 12% in the north and only 7% in the south of the country. Therefore, the basic need is for the Government and donors to increase the general awareness amongst business of the AA/DCFTA. It should be recognised that efforts have been made over recent years to inform business and there have been a plethora of seminars relating to the AA/DCFTA provided by the Government, BSOs and donors. However, the survey of BSOs, donors, donor support projects and Government Ministries, Departments and Agencies highlighted a lack of knowledge and understanding of the actual impact of the AA/DCFTA which has been reflected in the lack of focus on the concrete effects on business noticeable during previous rounds of events and aforementioned seminars; they tend to concentrate on the overall benefits of integration with the Single European Market, rather than actual changes that will arise. Similar attitude is noticeable within government Ministries and Donor Support programmes for implementation of specific aspects of the AA/DCFTA, which tend to focus on regulatory compliance rather than on communicating and supporting business to adapt to the new reforms.

###### **Lack of knowledge of the scope and coverage of the changes to business operations**

There is a general lack of understanding of the scope of changes that will effect business. Of the SMEs surveyed, 18% stated that any changes under the AA/DCFTA would only or mostly affect exporters and similarly, only 18% thought that any impact on all SMEs would be moderate or high. Only around 35% of SMEs stated that they understood the changes that would arise from the AA/DCFTA across the various sectors, with the highest level, 42% of SMEs stating an understanding of changes to technical regulations and lowest understanding, only 27% stating they understood the road transport safety and GMO requirements for business arising from legislative changes in implementation of the AA/DCFTA. It should be noted that these figures probably overestimate the actual understanding as for some firms interviewed, although they stated they understood, clearly did not.

###### **The needs of SMEs to take advantage of the provisions of the AA/DCFTA**

The majority (68%) of SMEs surveyed want to export to the EU, but only 30% of SMEs believe the AA/DCFTA provides business with an opportunity.

However, there is a lack of knowledge amongst SMEs as to the changes in market access under the DCFTA, with only 20% of SMEs stating they know, or know where to obtain information on, exporting to the EU.

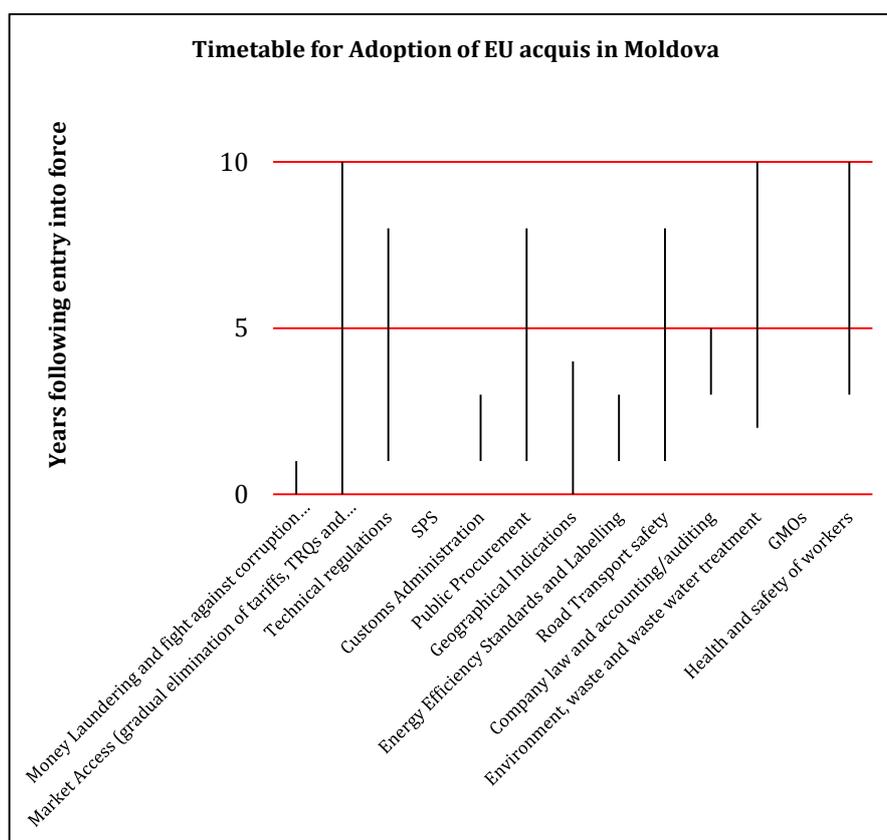
SMEs do not have the technical capacity to understand requirements with limited knowledge and understanding of where to find information on exporting and EU tender opportunities with only 5% of SMEs stating they know where to find information.

#### 4.2 SCALE AND SCOPE OF CHANGES

Not all areas will affect all business in the same way. There will be varying levels of scale of changes required, levels of investment and timing.

##### Timetable for adoption of the EU Acquis directly affecting business

It is important to recognise that implementation of the AA/DCFTA will be over a 10 year period and therefore, within each strategy it is necessary to prioritise not only sectors that are prominent in each country and will be affected most, but according to the timeframe for implementation.



**Note:** The timetable for adoption of regulations on SPS has yet to be determined and is in preparation by the Government of Moldova

The timetable indicates that most of the changes affecting SMEs will occur within the first 4 years focusing on financial reporting (for money laundering and fight against corruption purposes), market access changes, changes in customs administration, public procurement and adoption of energy efficiency, road safety requirements, and technical regulations. In the longer term, further adoption of technical regulations and the adoption of environment and health and safety at the workplace regulations.

##### Scope of changes for SMEs

Moreover, some of the changes that will affect business will not be too onerous, nor require high levels of investment.

Those areas that will require little investment will be:

- Money Laundering, Terrorism Financing and Fight Against Crime and Corruption: will lead to increased record keeping of financial transactions. The effect on SMEs will be allocation of internal human resources to improve accounting and reporting of finances within the business, training, use of external BDS (accountants/book keepers) and some very minimal investment perhaps in accounting software, largely OTS packages.
- Market Access (reduction in tariffs, export duties, TRQS and reference prices): will mean that importers of certain agricultural products will have to obtain licenses and exporters will see administrative changes on issuance and confirmation of compliance with rules of origin (EUR 1 certification by Customs). Whilst this will affect logistics management, it will not require any investment.
- Gradual Approximation to the Union's Customs Law (Customs Code) and some International Law, as well as the EU Law on Customs Enforcement of IPR: all importers and exporters will have to work with new customs procedures and rules. Again, whilst this will affect logistics management, it will not require any investment.
- Approximate National Legislation to the Relevant EU acquis on Public Procurement: developing open and transparent systems for government tendering will provide opportunities for SMEs to supply and work on government contracts. In order to do so, SMEs will need to understand the rules, monitor publications and exercise rights (transparency and disputes). This will not require investment.
- GMO Provisions: ensuring the control and use of GMOs (deliberate release/spread of GMO into the environment, trans-boundary movement and contained use) will require agricultural producers and agro processors to put in place monitoring, tracking, record keeping and ensure labelling of food when GMO products are used. This would require limited investments.
- Company Law, Corporate Governance, Accounting and Auditing: largely this relates to the adoption of international standards on accounting practices, record keeping and financial reporting. For SMEs, improved accounting and reporting of finances within the business, training, use of external BDS (accountants/book keepers) and some very minimal investment perhaps in accounting software, largely OTS packages.
- Employment, Social Policy and Equal Opportunities: largely this relates to health and safety of workers and requires procedures put in place, signage and a small amount of investment in safety equipment but this would be small purchases of personal protective equipment such as safety shoes and fluorescent jackets.

Those areas that will require higher levels of investment will be:

- Approximation of Technical Regulations, Standards, and Conformity Assessment and EU Standards and Labelling: compliance with one or more technical regulations will require understanding of the requirements (key characteristics), review of available standards that confer presumption of conformity, product redesign and adaption of production processes, industrial metrology, testing and analysis, certification of conformity assessment. To comply with these technical regulations and associated standards, SMEs may need (depending on the product) to invest in new technologies and equipment. In addition, some SMEs will have to either purchase testing equipment or outsource testing to laboratories, as well as certification to designated conformity assessment bodies. This will apply to domestic production as well as imported products for distribution and sale domestically).
- Gradual Approximation of Sanitary and Phytosanitary, Animal Welfare and Other Legislative Measures: Compliance with EU SPS measures nationally will mean agricultural producers and agro processors will need to comply with risk, hygiene and food safety standards. This

will involve understanding requirements, putting controls in place, testing and monitoring throughout production and in batches and certification and external approvals. It will also mean checking standards throughout the supply chain and verifying compliance of suppliers (farm to fork). This will affect record keeping, production processes and hygiene (procedures, training and facilities) as well as in-house or external testing and control verification. This will require investments in both facilities (adapting buildings, product & production quality and standards) and technologies and equipment.

- Road Transport: adopting EU road safety acquis will affect any business that operates commercial vehicles and transport of goods, whether logistics/transport firms or producers with own vehicles. Compliance with road safety provisions will include regular testing of roadworthiness, maintenance records and procedures. For commercial transporters, either having weigh bridges or access to external facilities would be required as well investments and retro fitting of required equipment such as speed limiters, driving log meters, GPS systems etc.).
- Approximation Relating to Energy Efficiency: compliance with legislation on energy efficiency and labelling of buildings and household goods would require manufacturers of household goods and building materials to adapt production, to measure and rate products for energy efficiency and certify such. Investments would be needed in new equipment and technologies for manufacturers, as well as testing facilities; building materials manufacturers may also require new technologies and equipment although this applies only to new buildings.
- Environmental Protection: compliance with air quality and waste management (including waste water) directives will require SMEs that are involved in sectors that produce potentially hazardous waste to understand requirements, monitor waste and install systems to control, limit and treat their commercial waste, or have it disposed of by external commercial providers. This may require investments in monitoring and treatment facilities and equipment.

#### **4.3 RESOURCES AND CAPACITY TO ADAPT AND COMPLY WITH THE REQUIREMENTS OF THE AA**

##### **Resources of SMEs**

SMEs do not have the resources to comply with AA/DCFTA requirements with around 25% of firms with internal capacity to manage and implement the necessary changes resulting from implementation of the AA/DCFTA. Although it is likely that firms have under-estimated the complexity of the changes necessary and these figures are therefore overstated.

Based on case studies and experiences of other countries there are 5 generic steps which SMEs will need to undertake to comply with, or take advantage of, the AA/DCFTA:

- Step 1: Information and knowledge of changes required
- Step 2: Strategy for implementation and compliance
- Step 3: Internal management and process changes
- Step 4: Investment in plant and equipment
- Step 5: External certification (as necessary)

Whilst 29% of SMEs stated they had internal capacity to make management changes and 24% to obtain information and knowledge, only around 18% stated they would be able to develop the necessary strategy, 20% identify investments needed and 24% be able to qualify for external certification. This identifies a big gap for BSOs to provide support to SMEs.

Moreover, these SMEs stated that even with capacity, they do not have their own financial resources nor can they obtain external finance for these steps with 13% stating they had financial resources for obtaining information, 11% for developing a strategy and making management changes, 11% for

necessary investments and 14% for external certifications. Only 17% of SMEs believe they will be able to obtain financial resources to fund these steps. Again, there is a needed role to provide such funding.

### **Capacity of BSOs**

Notwithstanding the need identified above for BSOs to provide business development services to SMEs to support compliance with AA/DCFTA requirements, the ability and capacity of existing BSOs (public and private sector), government departments and donor SME support programmes is limited and needs to be strengthened.

Few SMEs (only 21% of those surveyed) use business development services and of those using BDS, 86% were unsatisfied with the services provided, 85% wanted a broader range of services and 85% think such services are unaffordable.

There are few BSOs with knowledge of AA/DCFTA in both the private and public sector. The BDS market is very weak and concentration of both governments and donors is in legal compliance and none of the actors has so far been seriously involved with ensuring SMEs are supported.

### **Finance**

External finance to fund compliance with the AA/DCFTA and taking advantage of the opportunities is an extremely important factor identified above. Many of firms (40% of those surveyed) had experience of obtaining loans from financial institutions and only 12% reported these loans were easy to obtain, 90% reported the interest rate was unaffordable and most financial institutions report that SMEs have inadequate financial literacy.

### **General Constraints to Business**

It should be borne in mind that the general business and finance environment will affect the ability of SMEs to comply, as well as affecting their ability to survive and develop in the short to medium term. Whilst we do not address these factors in this report (as we concentrate on direct effects of AA) these should be addressed within the wider PSD development framework. These include:

- SMEs face major constraints: Cost and access to finance; Taxation rates and drawback; Slow and inconsistent implementation of reforms; Geopolitical instability caused by Russia; Corruption, Business Licensing and red tape; Unfair competition and macro-economic instability.
- Finance and enforcement of new regulations by government were cited by BSOs as a concern in all countries for compliance with AA/DCFTA. Other constraints listed by SMEs, BSOs and FIs were not related to the business environment but rather BDS such as availability of information on AA/DCFTA.
- The overwhelming constraint within the general business environment that will affect AA/DCFTA compliance and taking advantage of the opportunities is access to finance. Most SMEs, all BSOs and even FIs in each country listed access to finance as a binding constraint to SMEs compliance.

## **5. RECOMMENDATIONS**

The scale of the task for SMEs to understand the changes resulting from AA/DCFTA compliance and to adapt their administration procedures, production processes and facilities cannot be underestimated. In order that business in each of the countries can be better prepared to comply with changing national legislation, as well as take advantage of the opportunities, a full range of support and “hand holding” is required through a comprehensive programme of targeted and very specific support. The following summarises the recommendations. Full details of these are elaborated in the main report.

### **5.1 STRATEGY 1: AWARENESS**

To improve the understanding of the actual effects of the AA/DCFTA on business and the opportunities it provides. Current and future planned awareness across all countries is based on high level political statements rather than concrete information, so all information in this programme will be specifically oriented to business.

Awareness of AA/DCFTA to business must be more than the current “headline” approach and be specific as to the ‘effects’ (as well as impact) on SMEs business operations. The specific objectives will be:

- to ensure that all SMEs understand how the agreements affect business;
- to stimulate SMEs to consider and incorporate AA/DCFTA implications into their corporate planning;
- to ensure FIs and BSOs understand the needs of SMEs;
- to encourage government to consider and communicate changes to business.

In order to achieve these objectives, the following programmes could be developed in each country:

1. National Business Awareness Campaign
2. Outreach Programme for and through Financial Institutions, BSOs and Government MDAs (Ministries, Departments and Agencies)

### **5.2 STRATEGY 2: KNOW HOW**

The overall objective of this strategy is to enable SMEs to comply with the requirements of the AA/DCFTA as they are adopted nationally and take advantage of the opportunities it provides; also to provide SMEs with assistance and tools to make all the necessary changes within their business operations to enable them to adapt and prepare for the AA/DCFTA.

The specific objectives of this strategy will be:

- Increase the cadre of skills and knowledge of how to operate and adapt business under the AA/DCFTA
- To create and make available adequate and available BDS for AA/DCFTA compliance

In order to achieve these objectives, the following programmes could be developed in each country:

1. Availability of BDS for AA/DCFTA strategy and planning
2. Thematic Specific BDS (new and existing)
3. Business Linkages Approach
4. Establishment of National AA/DCFTA Centre (creator and keeper of knowledge)

### **5.3 STRATEGY 3: INVESTMENT FINANCE**

The changes that will occur as a result of implementation of the AA/DCFTA, as well as taking advantage of the opportunities, will require investments. However, not all these changes will affect all

businesses, not all will apply to all sectors and not all will require financial investment. Therefore, the objective of the AA/DCFTA financial strategy is to fund activities and investments targeted to those enterprises that will be most affected so as to enable them to comply and take advantage. These recommendations relate exclusively to the financing needs for compliance with AA/DCFTA requirements. However, as detailed in the analysis, there are a number of underlying access to finance issues that need to be addressed in parallel including financial literacy, systems for realisation of collateral, cost of finance and local currency lending, amongst others. Without such actions, the reach and effect of these other suggestions will be limited (for example, access to finance is limited by financial literacy of SMEs, so unless this is addressed, SMEs will not be able to access the suggested facilities).

The general approach to providing finance to SMEs to assist in compliance with the requirements arising from national implementation of the AA/DCFTA must have the following considerations:

- SMEs in each country need investment for upgrading to meet market requirements and to ensure competitiveness. Whilst this investment is needed, it is not necessarily linked to the needs arising from compliance with the rules to be adopted as a result of the AA/DCFTA. Therefore, it is important that the facilities offered provide a direct link to effects of AA/DCFTA compliance.
- It should be recognised that the focus should not just be on compliance but for taking advantage of the resulting opportunities. So although existing exporters already comply with the EU acquis, facilities should also be made available to potential exporters to the EU. Therefore, the principle focus should be on SMEs supplying structured domestic markets and potential exporters.

In order to achieve these objectives, the following programmes could be developed in each country:

- Credit Lines for compliance with technical regulations and SPS measures
- Credit Lines for Approved Technologies for transport, energy efficiency and environmental protection
- Credit Lines for Equipment for testing

#### **5.4 STRATEGY 4: SUPPORTING CERTIFICATION AND APPROVALS**

Adoption of EU legislation in each of the 3 countries under the AA/DCFTA or compliance with EU requirements in order to export, necessitate changes in businesses operations and processes. SMEs will not only be required to adapt but must also verify those changes through verification systems such as inspection by national authorities or independent certification and approvals. However, the availability and cost of certification is often a major constraint to growth and compliance and will be addressed within Strategy 4.

The specific objectives of this strategy will be:

- to ensure that certification and approval processes do not become a barrier to compliance with national legislation adopted within the context of AA/DCFTA implementation or access to the EU market;
- to reduce the cost of certification for SMEs;
- to improve access to competitive market for certification and approvals.

It should be noted that the development of the required quality infrastructure in each country for compliance approvals is necessary for implementation of the commitments under the AA/DCFTA. However, it is considered that this role will be undertaken within other programmes such as EU legal approximation and thematic programmes. Therefore, the activities within this strategy focus on

“access” to the required quality infrastructure, not creating or strengthening the existing or planned structures.

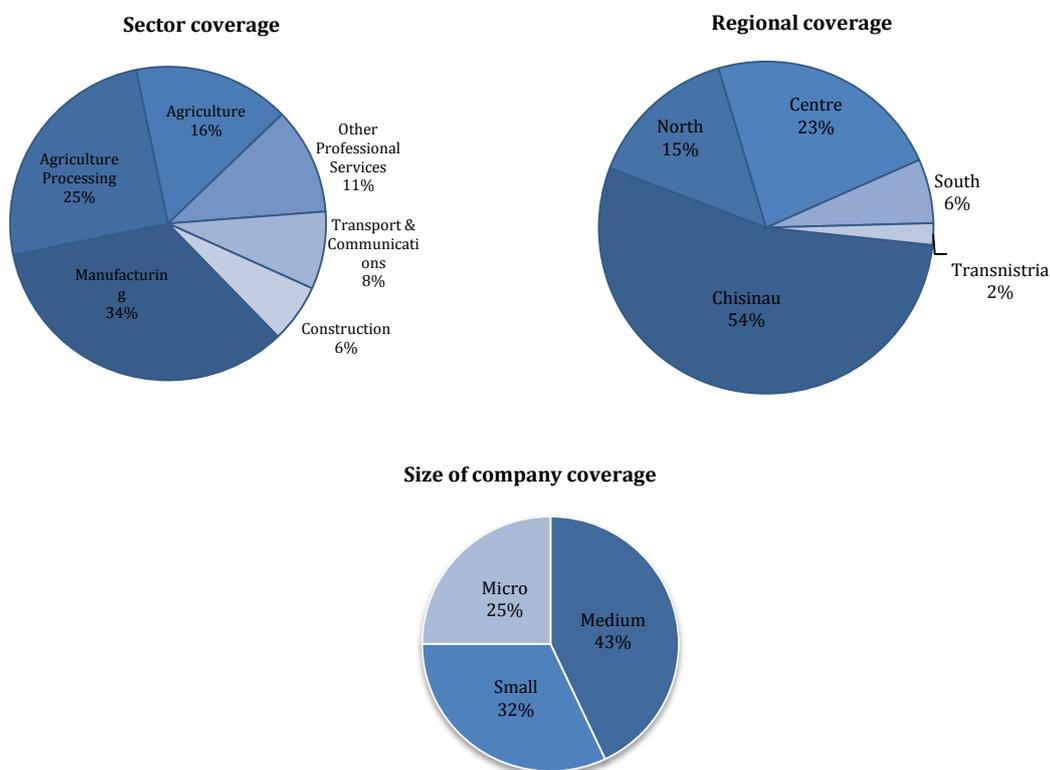
In order to achieve these objectives, the following programmes could be developed in each country:

1. Financing Certification Costs
2. Facilitating Access to Certification Bodies

## Appendix 1: SME Survey Results

### Scope and Coverage of Survey

The SME survey was undertaken between October and December 2014 and 185 SMEs were surveyed. A profile of the respondents is provided by sector, regional and size, as well as a breakdown of those currently exporting:



### General Business Environment

#### Top 5 Constraints Perceived by SMEs Surveyed

- Cost of finance
- Availability of finance (willingness to lend)
- Corruption
- Difficulties with collateral requirements
- Business licensing and permits

#### Views on Business Prospects

- 30% of firms surveyed think they can grow in the current business climate
- 16% of the surveyed firms state they are able to invest in the current climate

### Opportunities under the AA/DCFTA

#### Firms who can sell or want to sell to EU

- 55 % of the surveyed firms estimate that they can sell to EU now.
- 68 % of the surveyed firms expressed their wish to sell to EU.

### **Market Access to the EU market**

- There is very little knowledge amongst those that were surveyed of how to access the EU market and where to obtain information with less than 21% having the knowledge.
- Around 20% knew how to find information on exporting to the EU.

### **Understanding of the Changes to EU market access under the DCFTA**

There was little understanding amongst those surveyed of the changes in market access resulting from the DCFTA:

- 22% knew about the changes affecting tariffs;
- 16% about TRQ's; and
- 25% about Certificates of Origin.

### **Preparedness of SMEs for changes under AA/DCFTA**

Although the vast majority of SMEs surveyed intend to develop a marketing plan to access the EU market, few believe they have the internal resources or can gain access to external resources to implement it properly.

- 54% of the surveyed companies stated they will develop a marketing plan to access the EU Market;
- 37% confirmed they have access to external financial to implement the plan; and
- 24% stated they have internal resources to implement it.

The reported support needed to implement an EU marketing strategy: grants; liberalisation of legislation; financial assistance; information on EU tariffs and quotas and how to export in the EU; contacts.

### **Opportunities to Participate in EU Government Tenders**

There is reasonable knowledge of the EU public procurement opportunities with SMEs interested in participating in tenders. However, there is virtually no knowledge of where to get information on tender notices and the rules of tendering.

- 9% SMEs state they are aware of ability to participate in EU Government tenders;
- 29 % confirmed they interest to participate in the EU government tenders;
- 5% SMEs state they know where to find information about the rules for tendering in the EU;
- 5% SMEs surveyed know where to find information about calls for tender in EU.

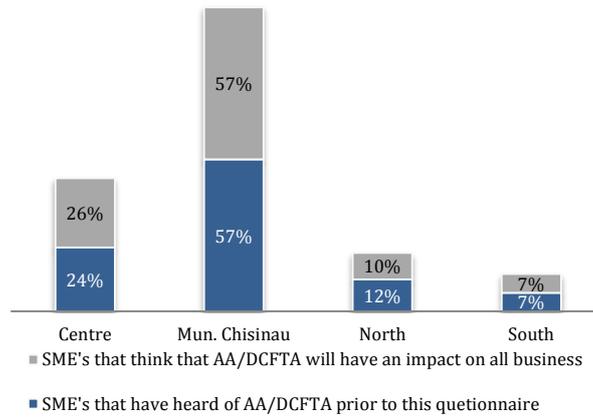
### **Understanding of the changes from implementation of the AA/DCFTA**

#### ***General Awareness of the AA/DCFTA***

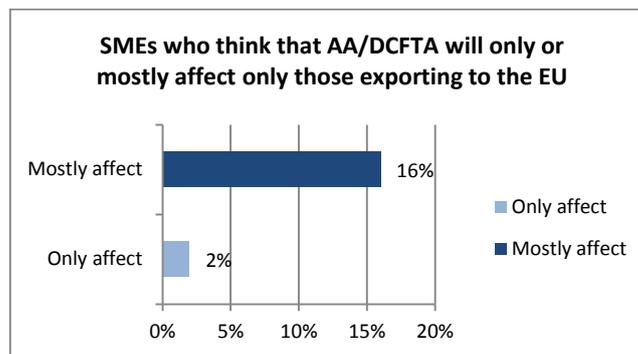
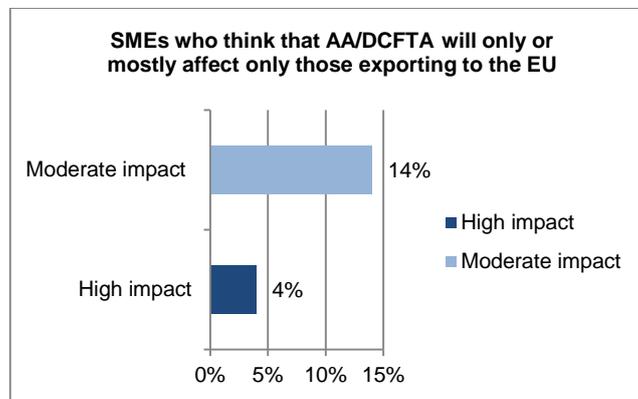
- 33%of the surveyed SME's heard of AA/DCFTA prior to the Questionnaire
- 43% of the surveyed SMEs thing that AA/ DCFTA will have an impact on all business in country

## Awareness of AA/DCFTA by Region

Moldova - SMEs General Awareness by region



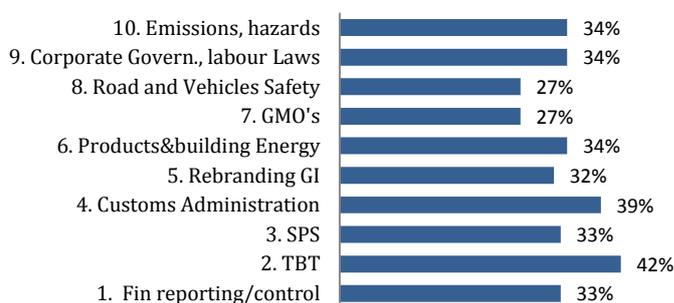
## Impact of AA/DCFTA on SMEs



SMEs do not think that their business will be affected with very little impact as only 2% of the respondents think that they might be affected.

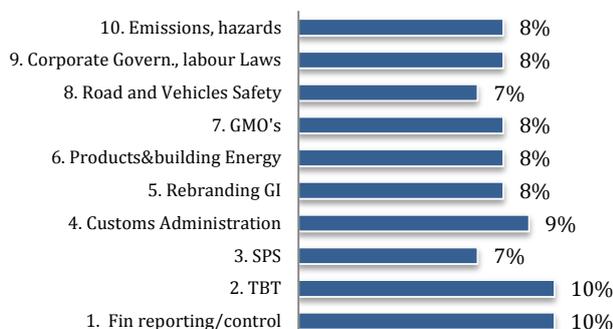
## Specific knowledge of Changes amongst SMEs

SMEs that understand the changes to their business in specific areas



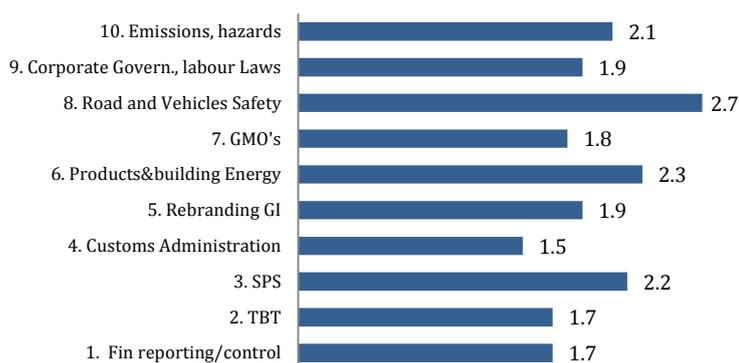
## Business who know where to find information on each area affected

Moldova level of understanding of the changes required in areas affected



## Timetable for adoption of EU acquis

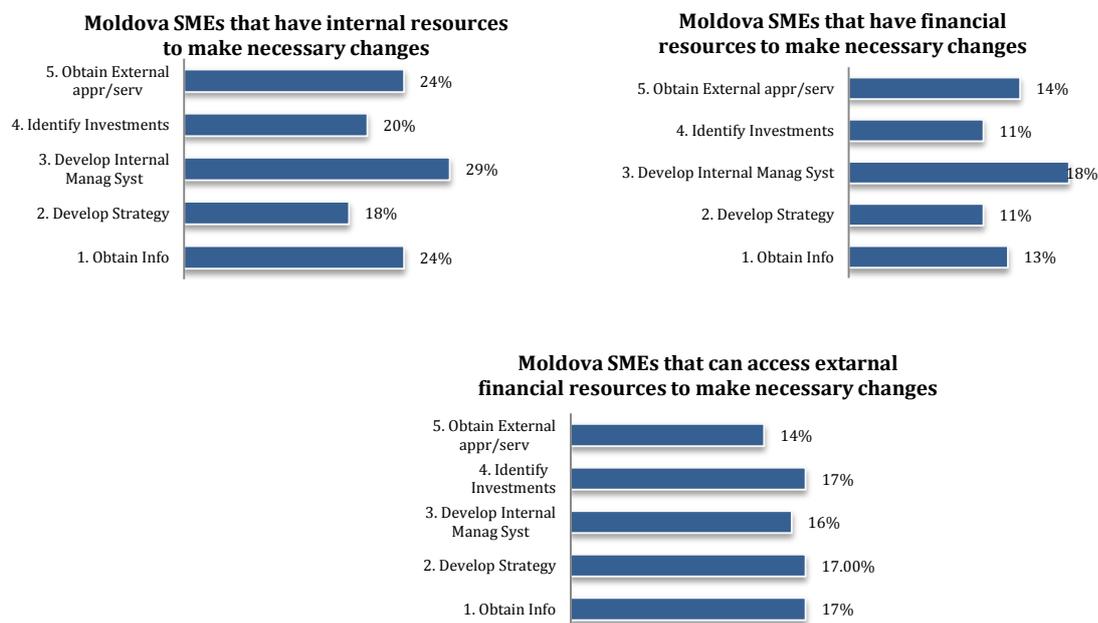
Moldova SMEs view on timetable to become national legislation (years)



In general, SMEs have only very general and poor knowledge of the time table for the implementation of the legislation;

Most of the respondents didn't know the answer to this question and in most cases answers were made up.

## Availability of resources for compliance with AA/DCFTA



Around one quarter of SMEs in Moldova stated they had internal management capacity to implement necessary changes resulting from AA/DCFTA.

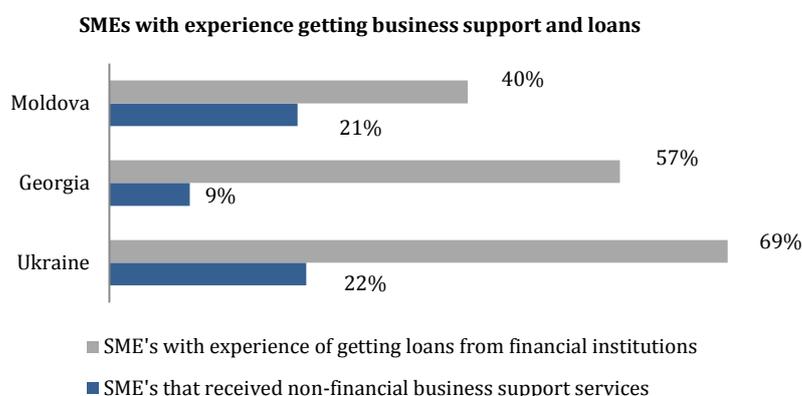
Around 13% of SMEs stated they have internal financial resources and an additional 17% stated they could get access to external finance for the necessary changes. This means only 30% of firms can finance the necessary changes resulting from AA/DCFTA implementation

### Support required for compliance with AA/DCFTA

Support suggested by Participants: Free information, free trainings, financial support, information available in Russian, or a simple translation if there is another language, financial support, collaboration with similar companies.

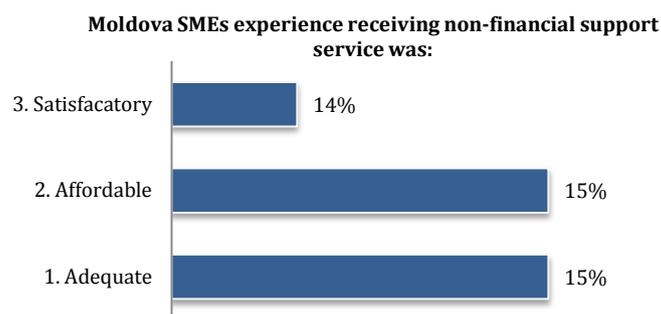
## Adequacy of available business development services

### Experience of BDS



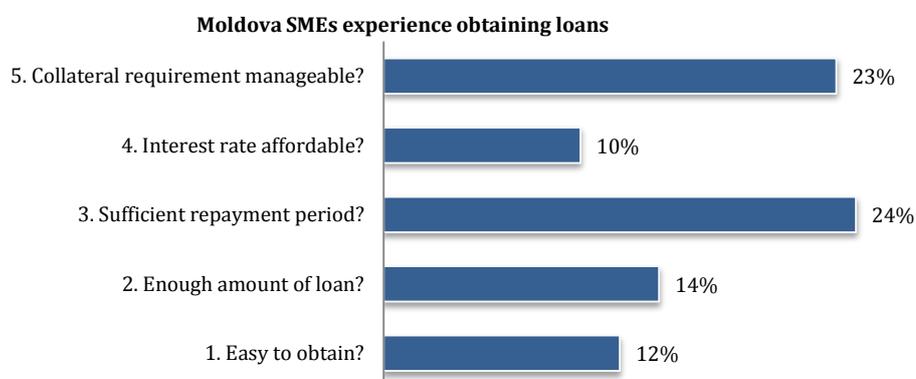
The majority of firms have received loans but few across the three countries have received BDS.

## **Adequacy of Business Development Services**



Of those companies with experience of BDS, only 14 % of SMEs were satisfied with the services they received and thought that the range of BDS was adequate. Regarding cost of BDS, 15 % of SMEs who received BDS thought it was affordable.

## **Experience of loans**



12% of SMES reported that loans were relatively easy to obtain, only 24 % reported loans were sufficient and over a sufficient repayment period.

SMEs reported interest rates unaffordable with around 90% of SMEs stating unaffordable interest rates.

Collateral requirements were problematic for 77% of SMEs.

## Appendix 2: Survey of Business Support Organisations and Business Support Projects

### Scope and coverage

A total of 63 organisations supporting SME development across the 3 countries were interviewed to gather data and information, these including 13 Ministries and state organisations responsible for business support, 34 business support projects (BSPs), 3 think tanks focussing on SME needs and 14 business support organisations (BSOs).

**Table Breakdown of BSOs and BSPs Surveyed**

	Moldova
Ministries Responsible for SME Development	2
State Business Support Institutions	2
Business Support Projects and Donors	16
Business Support Organisations	4
Think Tanks	1
	25

### Awareness of the AA/DCFTA

#### ***Awareness of AA/DCFTA requirements/opportunities amongst BSOs interviewed***

- DCFTA is a popular topic, but the overall awareness, in particular in view of implications of DCFTA on firms is rather low
- SMEs are little aware of the implications of DCFTA on their firms, but export, export-ready and “better-off” firms in all countries are quite well aware
- SMEs are not really aware of how to benefit from DCFTA
- The awareness on DCFTA also differs between sectors; e.g. IT and manufacturing firms are better aware than most of the agricultural firms except for firms from the wine sector who are quite well aware
- the Government has taken steps to inform people on DCFTA, e.g. via web sites
- In Moldova the Government is not yet prepared to inform people honestly on DCFTA as there is a fear of Russian propaganda in a pre-election period

#### ***Management and marketing capacities of SMEs to comply/benefit DCFTA***

- In general, management and marketing skills are considered to be low.
- Many firms are not aware of what needs to be done to comply with DCFTA.
- Export and export-ready firms in all countries possess the necessary skills to comply with DCFTA
- The EU export help desk is used

#### ***Technical capacities of SMEs to comply/benefit DCFTA***

- Technical capacities are better developed than the managerial and marketing ones, but still considered to have room for improvement.
- Exporting, export-ready and “better-off” firms usually have better technical knowledge to comply with DCFTA than SMEs.

#### ***Financial capacities of SMEs to comply/benefit DCFTA***

It is expected that compliance with DCFTA will require a lot of funding.

- Many firms have difficulties to quantify their financial needs as they are not aware of the requirements for adapting to DCFTA.

- Access to finance is difficult as interest rates are considered high; in all countries collaterals are an issue and prices for loans are considered too high.
- Liquidity for SME lending is said to be no problem but banks mention a lack of bankable projects due to the lack of financial literacy and business planning skills.
- Lending is the most used financial instrument; leasing and factoring is available, but trade finance is usually not used by SMEs; the demand for any other instrument than lending is low.
- SME lending is heavily collateralized.
- Long-term local currency lending is practically not available for SMEs.
- Similarly, significant efforts and creativity are often required to identify and exploit support mechanisms available for DCFTA implementation at the firm level.
- The non-functioning legal system creates problems for banks and firms alike

***Type of support needed by SMEs to comply with AA/DCFTA***

**Table Support Needs of SMEs as Perceived by BSOs Interviewed**

	<b>Moldova</b>	<b>Rank</b>
Management	2,17 (1)	1
Marketing / Labelling	2,44 (2)	4
Technology / Product Development	2,67 (3)	3
Finance (Financial Literacy)	2,72 (4)	2

The relevance of support needs is rather close, but a ranking can be made according to which, the major need for support is management, followed finance / financial literacy, technology / product development and marketing, incl. labelling.

**THE GENERAL BUSINESS ENVIRONMENT**

**Major constraints to business development**

***Constraints listed by all BSOs and BSPS:***

- The implementation of rules and regulations was considered sub-optimal and reform processes are considered as taking too long
- The implementation of political decisions and the institutional framework for policy implementation is considered to be problematic
- The general geo-political situation (with Russia) is considered as a major challenge for the business environment
- Some reluctance to organize in associations could be found
- The statistics related to SMEs could be improved
- Access to foreign markets was considered difficult
- Access to finance was mentioned as a major impediment for firms
- Access to innovation and new technologies, incl. technology infrastructure, was considered sub-optimal
- Business and entrepreneurial skills were said to be sub-optimal
- FDI attraction is considered sub-optimal though because of the economic situation
- Taxes are considered too high; the tax system is considered to need an overhaul
- FDI attraction is considered sub-optimal because of the economic situation

- Finding strategic EU partners was considered difficult
- A lack of skilled labour was mentioned
- The size of the market was considered too small
- There is no coherent SME policy in place yet and state support to SMEs is in its infancy
- there is no coherent SME policy in place
- There is no lobbying on Government level for SMEs
- Corruption, non- or mis-functioning legal systems, unfair competition, informal sector and lack of transparency were considered problematic for firms
- It was mentioned that there was too much red tape and that the governments are controlling firms rather than supporting them
- High transaction costs and difficult VAT return as well as non-transparent public procurement systems were mentioned as constraints

#### *General Business Prospects*

- Several sectors are considered as having good potential for international trade
- There are opportunities to attract foreign investment
- There are good human, natural and material resources to be exploited
- The introduction of e-governance systems is seen as positive
- It is felt that the general business environment is improving
- The general business environment was considered positive, good and corruption free facilitating doing business
- The banking system is considered good and supportive to SMEs
- there are many well-trained, young people eager to learn

#### *Effect of BEE constraints on AA/DCFTA compliance (all countries)*

- There is a lack of understanding what SMEs will require to comply with DCFTA
- Access to information and knowledge on DCFTA was considered sub-optimal; there is also misinformation around, mainly by Russian propaganda
- There is some fear on the investment requirements to comply with DCFTA
- There are fears that there will be tougher competition, also in the country, and that some of the less competitive firms will not survive the DCFTA harmonisation
- The adaptation to the food safety standards are considered a particular problem
- Lack of appropriate testing and certification infrastructure was noted
- Firms were traditionally targeting the Russian market and there is a fear that the EU market will have no demand for CIS products
- There is resistance among firms as it is expected that DCFTA will make doing business more expensive as there will be new rules, regulations and inspections on DCFTA compliance within the national legislation
- there is perception of a lack of public consultations on DCFTA
- Access to information and knowledge on DCFTA was considered sub-optimal; there is also misinformation around, mainly by Russian propaganda

#### *Effect of BEE constraints on opportunities under the AA/DCFTA*

- DCFTA is expected to have a positive impact on the country's competitiveness, product standards, environmental standards, food safety, etc.
- There is hope that DCFTA will bring more opportunities for SMEs and will improve firm competitiveness
- There is expectation for DCFTA to bring more export opportunities
- There is expectation that DCFTA will allow more FDI

## **Available support for AA/DCFTA Compliance and realising opportunities**

### *Capacity to support SMEs in AA/DCFTA compliance and realising opportunities*

- BSOs have no capacities to offer services on DCFTA
- capacities seem to be concentrated in the capital cities with limited outreach to remote areas
- there seem to be international chambers leading the DCFTA process, but not really reaching SMEs

### *Available services for AA/DCFTA compliance (e.g. for testing, certifying, auditing)*

- there are some facilities for testing and certification, but with limited capacities; only a few of them are internationally accredited
- there are State labs and a limited number of private labs, which are competing with each other
- many facilities are outdated and need upgrading and improvement
- international donors are supporting the setting up of testing and certification bodies
- There is a competition between State and private labs
- international donors are supporting the setting up of testing and certification bodies
- the metrology infrastructure is improving, but still a lot needs to be done

## **Needed Support for AA/DCFTA compliance**

### *Support needed to improve policy and regulatory framework*

- All policy decisions should be translated into action plans with budget allocations and clear responsibilities
- Donors should make the implementation of policy recommendations conditional for policy loans and budget support
- Proper stakeholder consultation mechanisms should be institutionalized ensuring the participation of firms and farms
- Sufficient knowledge should be created amongst all those responsible for DCFTA implementation on implications of DCFTA on firms taking into consideration international best practice
- Knowledge in the Government should be institutionalized, not personal

### *Awareness and Information Needs*

- A proper (and branded) awareness campaign on DCFTA in simple and target-group oriented language should be organized
- Government, experts and media should work closely together to organize and implement an awareness campaign and information provision
- The awareness campaign should be well organized, coordinated and implemented using all available information channels
- All involved in the awareness and information campaign should be trained well.
- The campaign should be in English, Romanian and Russian
- All information should be available in one place (One Window), incl. information, templates, interactive tools such as helpdesk functions
- A public-private dialogue platform should be created to facilitate information outreach

### *Needs for improved Business Development Services and business linkages*

- Firms should be participating in the costs of consulting, if provided by donors
- Select consultants not only on price, but also on a quality basis
- Local consultants should be matched with international consultants to get exposure to international practice

- Firms and farms should be better informed about the benefits of associations
- Country specifics should be taken into consideration when pushing for organization in associations
- More information on business interaction is needed – in Moldova and in the EU
- Business linkages with EU countries should be product- and sector-specific

#### *Training Needs for AA/DCFTA compliance*

- A top-down approach in training should be applied, training first “master trainers” to train local trainers
- International expertise should be used to train at least the master trainers
- Only those with proven easy interaction with firms and farms should be trainers
- Trainers should be coached after the initial training
- When developing trainer capacity in DCFTA, knowledge should be institutionalized, not personalized
- DCFTA / entrepreneurial training should be incorporated in VET system and e-governance system
- The selection of participants is vital for the success of the training; participants should prepare up-front for training
- Training should be well targeted in content and language to target-group
- Implementation of training contents should be monitored and institutionalized
- Training could be bundled with financial assistance
- Associations should be trained to train their members

#### *Technical Service Needs (Testing, Certification)*

- Testing and certification bodies should be upgraded and supported
- International accreditation – in particular for meat – is needed

#### *Financial Needs for AA/DCFTA compliance and realising Opportunities*

- Staff at financial institutions should be trained and they should develop suitable financial instruments to guarantee firms and farms access to finance
- There should be technical assistance to support the Government to solve the systemic problems of the banking sector, incl. NBM regulations
- Grants could be matched with consulting to achieve better results
- Sustainability of grants should be carefully monitored
- Guarantee Scheme should be revised

## **SURVEY OF FINANCIAL INSTITUTIONS**

### **Scope and coverage**

A survey of 6 financial institutions was undertaken in Moldova as well as interviews with EBRD and EIB.

### **Major challenges in lending to SMEs**

#### *General Lending Environment*

- SME lending is an attractive market for banks, but it is difficult to find clients able to prepare bankable projects;
- banks considered themselves as “partners of SMEs”
- There is no real liquidity problem within banks for SME lending
- Financial literacy is countries low in all
- there is a lack of demand for SME lending noted by the banks
- Costs of loans are considered too high
- Many SMEs lack knowledge on banking products and do not understand the logic (and needs) of the banks
- Long-term, local currency loans are a problem in all countries
- In general, banks are rather risk-adverse and conservative in SME lending

#### *Loan Applications*

- Banks are supporting SMEs to prepare loan applications, but banks are complaining that the financials of most firms are sub-optimal and not well structured or opaque
- MFIs have less sophisticated loan applications than banks; often loan officers visit firms to prepare the loan application with the clients together on-site.
- Microfinance is done in many banks via retail banking; there are several MFIs active on the market.

#### *Realisation of Collaterals*

- Realization of collaterals is a very difficult, time-intensive and expensive process
- Credits are heavily collateralized.
- For recovery of the collaterals courts need to be involved.
- Most costs from realization of collaterals can be recovered
- There is a buyer’s market for collaterals, which makes the selling of collaterals difficult for banks
- The recovery via court systems is very time consuming in all countries (up to 15 years in Moldova)
- the court systems are considered highly inefficient and corrupt

#### *Loan Performance*

- The overall NPL rate of banks is reported in Moldova between 6% and 25% (15% official NBM rate). NPL rates of smaller firms are lower than bigger firms as one default loan of millions of USD can bring down the NPL of a bank substantially;
- MFI NPL rates are much lower than NPL rates of banks
- The interest rate at banks ranges between 8-14%; foreign currency loan interest rates ranges between 5-9%.

## **Awareness of AA/DCFTA**

### *Awareness of AA/DCFTA amongst Financial Institutions (FIs)*

- knowledge on DCFTA among financial institutions is rather limited
- some banks are aware that DCFTA will be a topic for SMEs – providing business opportunities – but the overall knowledge even in these banks remains rather limited
- banks and MFIs would be interested to receive further training on DCFTA as many of them have realized that there are a lot of opportunities upcoming for financial institutions

### *Awareness of AA/DCFTA amongst SMEs*

- All financial institutions consider that the awareness, knowledge and management, technical and financial capacities of SMEs with respect to DCFTA are rather limited

### *Support from FIs to SMEs on AA/DCFTA implementation*

- Most of the FIs were not really aware of DCFTA and its implication on firms; however, some of the banks conduct information and awareness creation events on DCFTA using external expertise;
- All banks interviewed in all countries would like to see some training on DCFTA for FIs.

## **The General Business Environment**

### *Major constraints to business development*

- The general geo-political situation – and the Ukrainian-Russian conflict – is considered as a major challenge for business environment
- political instability and the Russian embargo are seen as problems
- implementation of political decisions and the institutional framework for policy implementation is considered problematic
- room for improvement was mentioned for law enforcement
- Regulatory framework for SMEs was considered sub-optimal; it was shortcomings within the regulatory framework
- access to finance was considered a shortcoming, but often it was said that it is the access to rather than the availability of actual funds
- the size of the market is seen as a problem
- the grey economy was mentioned as problem
- the lack of business and financial skills among SMEs were often mentioned as challenging constraints
- corruption is considered a big problem
- the legal and court system is seen as a constraint for businesses

### *General Business Prospects*

- it is felt that the general business environment is improving
- the potential for agriculture was considered positive

### *Effect of BEE constraints on AA/DCFTA compliance*

- it was mentioned that most of the SMEs are not yet aware of the implications of DCFTA on their firms
- it is expected that firms will have high costs expected to comply with DCFTA as a lot of investments will be required to adapt to the EU standards
- there is some kind of fatalism as it is considered as “just another hardship to come” (or “just another animal in the zoo....”)
- the pace of DCFTA implementation is considered as too slow

- an insufficient level of state support was mentioned

*Effect of BEE constraints on opportunities under the AA/DCFTA*

- it is expected that DCFTA will have a positive impact on the business environment
- it is expected that DCFTA will be conducive for the modernization of the country
- it is expected that DCFTA will open new market opportunities
- it is expected that DCFTA will open firms' access to new technologies and innovations
- DCFTA is expected to improve the countries' competitiveness