

STABILITY PACT

SOUTH EAST EUROPE COMPACT FOR REFORM, INVESTMENT, INTEGRITY AND GROWTH



MOLDOVA

ENTERPRISE POLICY PERFORMANCE ASSESSMENT

Prepared by

**ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT
AND EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT**

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ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

The Stability Pact for South Eastern Europe is a political declaration and framework agreement adopted in June 1999 to encourage and strengthen co-operation among the countries of South East Europe (SEE) and to facilitate, co-ordinate and streamline efforts to ensure stability and economic growth in the region. (see www.stabilitypact.org)

The South East Europe Compact for Reform, Investment, Integrity and Growth ("The Investment Compact") is a key component of the Stability Pact under Working Table II on Economic Reconstruction, Development and Co-operation. Private investment is essential to facilitate the transition to market economy structures and to underpin social and economic development. The Investment Compact promotes and supports policy reforms that aim to improve the investment climate in South East Europe and thereby encourage investment and the development of a strong private sector. The main objectives of the Investment Compact are to:

- Improve the climate for business and investment.
- Attract and encourage private investment.
- Ensure private sector involvement in the reform process.
- Instigate and monitor the implementation of reform.

The participating SEE countries in the Investment Compact are: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Moldova, Romania and Serbia and Montenegro. Building on the core principle of the Investment Compact that "ownership" of reform rests within the region itself, the Investment Compact seeks to share the long experience of OECD countries. It provides region-wide peer review and capacity building through dialogue on successful policy development and ensures identification of practical steps to implement reform and transition.

The work of the Investment Compact is actively supported and financed by seventeen OECD member countries: **Austria, Belgium, Czech Republic, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Norway, Sweden, Switzerland, Turkey, United Kingdom and United States.** (see www.investmentcompact.org)

This report has been jointly produced by the OECD Investment Compact Team and the EBRD Office of the Chief Economist in cooperation with expert regional consultants. It draws on the extensive experience and work of both organisations in transition economies including the countries of South East Europe. The Enterprise Policy Performance Assessment process, highlighting feedback from SMEs as a key element of the analysis and assessment, was instigated by Declan Murphy, Programme Director of the Investment Compact (OECD) with support from Antonio Fanelli, Principal Administrator (OECD, Investment Compact) and Ricardo Pinto (Administrator, OECD).

Background research and information was provided by Igor Munteanu, Svetlana Ikizli and Ion Jigau (IDIS "Viitorul", Moldova), who prepared the first draft of the report. The analysis, assessment and preparation of the final report were undertaken by Ricardo Pinto (OECD), Francesca Pissarides (EBRD) and Sam Fankhauser (EBRD) with advice from other colleagues in the OECD and EBRD. The final editing was undertaken by Declan Murphy, OECD and Georgiana Pop, OECD. The assessments and views expressed in this report are those of the Investment Compact Team of the OECD secretariat and the EBRD Office of the Chief Economist and do not necessarily reflect the views of the institutions participating in preparing this report or of OECD and EBRD member countries.

FOREWORD

Starting a business in today's environment brings opportunities and challenges. Changing lifestyles demand greater choice of products and services. New technologies and better access to global markets have provided increased business opportunities. At the same time increased competition, insistence on quality and unremitting pressure for lower costs, just to mention some issues, represent major challenges for business. For Small and Medium-sized Enterprises (SMEs) the challenge is greater. They lack scale, resources and the capacity to handle complex business management. Typically, less than half survive more than five years and only a small proportion go on to become large companies. Entrepreneurship and enterprise development are important elements in creating dynamic market economies. SMEs are a vital source of new jobs, exports and economic contribution to countries. How to ensure the growth of the SME sector – a fundamental feature of all developed and growing economies – is a major policy challenge for all countries.

This Enterprise Policy Performance Assessment (EPPA) on Moldova seeks to help address that challenge. The South East Europe (SEE) Compact for Reform, Investment, Integrity and Growth (Investment Compact), a key component of the Stability Pact, has consistently affirmed that the economic revitalisation of South East Europe is primarily dependent on private sector investment. Through the Investment Compact process, Stability Pact partners support and promote the structural policy reforms that will improve the climate for private enterprise and increase investment. This assessment aims to assist Moldova in stimulating entrepreneurship and enterprise development. Progress has been achieved in some areas. For example, in Moldova the Government-approved State Programme to Support SMEs (2002 – 2005) highlights a number of policies and actions designed to increase SMEs' share of the national economy. Nevertheless, the report shows that the environment for creating and sustaining businesses remains very much underdeveloped in Moldova compared to the rest of SEE. Reforming and improving the environment for entrepreneurship remains a priority.

The EPPA draws on the practical experience and views of Moldovan SME representatives, expert advisors and the complementary experience and skills of the Organisation for Economic Co-operation and Development (OECD) and the European Bank for Reconstruction and Development (EBRD), two Stability Pact partner organisations that have been closely involved in the reform process in transition countries.

The analysis and assessments based primarily on research with SME owners and managers provide valuable insights into the key issues confronting the government in Moldova. The Investment Compact for South East Europe, will continue to contribute to establishing this framework in Moldova and in the region as a whole through regular up-dates of the information contained in this report.



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SUMMARY CONCLUSIONS AND RECOMMENDATIONS

1.1. Summary Conclusions

The Moldovan investment climate is one of the most difficult in the region as regards the SME sector. It should be noted, however, that the country is at an earlier stage of economic transition compared with most countries in the SEE region; that it still has a strong state owned enterprise legacy of its Soviet Union past; and that it has not benefited as much as other countries in the SEE region from international technical assistance with respect to small enterprise development. Nevertheless, the Moldovan authorities are taking steps to increase their support to the SME sector, in recognition of the growing importance of SMEs to the national economy. This political support is manifested in developments such as:

- Creation of the Department for SMEs at the Ministry of Economy (and work towards an Agency for SMEs) with responsibility for co-ordinating SME policies and measures.
- Adoption of a State programme with a focus on small business support and development.
- Commitment to improve the legal and regulatory framework for businesses.

This Enterprise Policy Performance Assessment (EPPA) highlights some of the main policy issues in the sector, grounded on insights from SME owners and managers and building on the recently published OECD-EBRD reports (2001 and 2002). It identifies a number of actions needed in order to improve the policy environment for SMEs.

Entrepreneurs participating in focus groups judged the business environment for SMEs to be “poor” along most of its dimensions. Only the quality of advisory services was considered “satisfactory”. In overall terms, the study finds that, albeit starting from a low base, some progress has been made by the Government of Moldova and Ministry of Economy in setting out and beginning implementation of new policies to support the growth and development of SMEs. A stronger outreach and constructive partnership with SMEs is needed if the opportunities for growth of the sector are to be maximised.

In line with experience in other countries at a similar stage of transition to a market-based economy, there are issues emerging relating to policy implementation. It will take a persistent and determined effort to ensure that implementation is kept on track and momentum maintained. The best way to do this is with regular progress reviews to obtain feedback to identify areas requiring attention.

The main issues identified in this assessment can be summarised as relating to the practicalities of:

- Communicating and consulting effectively with SMEs spread throughout the country.
- Co-ordinating the activities of the various bodies working to support SME development.
- Reducing complexity and ensuring coherency and consistency in policy, laws, regulations, procedures and support programmes, particularly between fiscal and developmental policies.
- Avoiding unnecessary changes in laws, regulations and programmes to facilitate planning of investments.

1.2. Summary Recommendations

Institutional Framework

Institutional Stability

- Ensure that the current institutional structure (Department for SMEs) is strengthened through technical assistance to improve resources, human and financial, to deliver small enterprise policies, laws, programmes, strategies, etc.
- Assess the pros and cons of establishing an Agency for Small Business Development, using international best practice with regard to procuring medium-term funding for operations and programmes, identifying staff requirements, outlining its mandate and ensuring institutional integration.

Inter Ministerial Co-ordination

- Implement an Inter Ministerial Group on SME Policy, co-ordinated by the Ministry of Economy and including key ministries such as Finance, Chambers of Registration and Licensing, etc. to ensure that the needs of small businesses are fully considered in national policy-making. The disparate nature of SME policy-making and the limited degree of co-ordination make this a priority issue.

Policy and Strategy

- Assess, rationalise and integrate the current programmes, strategies and action plans into a single National SME Strategy, using international best practice.
- Ensure that the new (draft) strategy is widely disseminated for consultation and that feedback is incorporated in order to secure credibility and “buy-in” from SME stakeholders.
- Secure Government approval and funding (national and international) commensurate with the priorities identified in the new National SME Strategy.

Communication with SME Stakeholders

- Communicate and consult with SMEs on Government policies and strategies by developing a regular and permanent mechanism for dialogue between Government and the sector. This mechanism should be representative of the range of bodies constituting the SME policy community.
- Task the Ministry of Economy with disseminating information (programmes, strategies, funds, etc.) through web sites, forums and other means, and ensure that SMEs are aware of the latest SMEs developments and can provide feedback.
- Seek more proactive communication by business associations to their members of government policies and strategies.

Regulatory Environment

Registration, De-registration, Re-registration

- Evaluate the effectiveness of the Chamber of Registration, the Chamber of Licensing and the Register of Enterprises with a view to streamlining and reforming the present, rather ineffective, system.
- Evaluate, simplify and publish the regulatory regimes that affect the setting-up phase of businesses. The same applies to procedures for re-registering and terminating enterprises. Work towards reducing the time and cost associated with these procedures.
- Evaluate the creation of a “One-Stop-Shop” system throughout the country, as in the case of other SEE countries, such as Romania (see OECD-EBRD, 2002).

Regulations

- Create a high-level Inter Ministerial Business Simplification Task Force in order to oversee and co-ordinate the urgent reform needed in Moldova. The Task Force requires sufficient resource and capacity to recommend reforms, co-ordinate and monitor implementation. SME stakeholders should be consulted before proposals are converted into law.
- Reduce the number of authorisations, limit the number of inspections and controls, simplify and reduce the number of forms, reduce the frequency of company reporting.

- Take steps to ensure a greater focus on a “proactive” and “enabling” approach by, for example, introducing the principle of “silence is consent” as soon as practical (the “silent is consent” concept specifies that, if the relevant public body fails to answer/deal with an application within a prescribed period, it will be deemed that the public body has given consent).

Communication with SME Stakeholders

- Consult SME stakeholders on legislation and regulations affecting small businesses before proposals are converted into law.
- Build effective co-operation between the key SME stakeholders and disseminate information through web sites and forums to ensure that SMEs are aware of the latest developments and can provide feedback.

Tax Policy for Small Businesses

Policy Principles

- The Ministry of Finance and the Ministry of Economy, should co-operate with the SME stakeholders to ensure that:
 - Simplicity, stability and clarity are achieved in tax policy vis-à-vis small enterprises.
 - The fiscal administration is made much more constructive and sensitive to the needs of the SME sector.
 - Consultation with SMEs or their nominated representatives on tax issues is carried out regularly.
 - SMEs are able to obtain regular, simple and up-to-date information explaining the tax system.
 - All new rules or changes are widely disseminated and freely available.

Tax Reporting and Payment

- Evaluate and reduce the number of fiscal and statistical returns required in line with international good practice.
- Evaluate and reduce to a minimum the number of pre-paid taxes for newly established and small enterprises.

Administration of SME Tax Incentives

- Ensure that the tax incentives available are publicised and the procedure for claiming them is accessible to all.
- Ensure that tax officials are aware of the incentives and assist entrepreneurs to claim their rights.

VAT

- Set the VAT refund period to facilitate cash flow, at the international standard of one month.

Informal Economy

- Strengthen efforts to collect arrears, regardless of firm size, and fight tax evasion, thus widening the tax base.
- Ensure that tax laws and regulations are consistently and fairly enforced.

Financial Instruments for Fostering New and Small Businesses

Collateral

- While the central bank rightly pays close attention to the quality of lending portfolios, its risk assessment of bank loans is perhaps too narrowly focused on collateral. Without affecting credit quality, a more flexible interpretation would allow banks to ask for a wider variety of collateral than currently done.
- Requesting only real estate or vehicles as collateral greatly restricts access to finance for SMEs, partly because of the inability or unwillingness to provide it and partly because of the high transaction costs involved.

- More flexibility would unblock available credit from those banks that have acquired the necessary skills through participation in donor / International Financial Institute programmes in the past.

Expand the Range of Financial Services Available

- Improve the legal and regulatory framework for non-banking financial activities. This would greatly benefit SMEs, particularly in the current environment of low bank intermediation.
- Leasing in particular functions in other transition countries as a flexible alternative to bank financing for the small enterprise sector. Improvements in the mortgage law could similarly broaden the range of financial products available to small borrowers.

Redirect Government Intervention in the Financial Sector

- Reorganise the existing State Fund for the support of SMEs. This is already a priority of the policy agenda for the Government. Its mandate should shift away from the provision of finance towards the creation of the support infrastructure that would strengthen SMEs applying for bank loans. The role of the state should move away from direct provision of finance, a task better left to private sector operators, and move towards softer (but not less important) forms of support to the SME sector.
- Expand the practices of mutual crediting for SMEs on the concept and experience of the Saving and Credit Associations (SCA), while assisting this with relevant legislation and financial resources.

Advisory Services Supplied to New and Small Businesses

Co-ordination and International Support

- Prioritise support to SMEs, especially start-ups, through subsidised business support services in order to deal with market failure. In the longer term, competitive private provision of business advisory services may reduce the need for government or donor-funded initiatives.
- Work towards achieving financial sustainability as soon as possible. The Ministry of Economy should take the lead in working towards the sustainability of these services.
- Review the geographical coverage of business support centres and co-ordinate initiatives, ensuring coverage in areas with little or no support.
- Strengthen capacity to support SMEs by training existing staff and hiring qualified expertise. The Department for SMEs (and the future Agency, as well as county and local authorities) is the key institution responsible for developing and implementing SME policy. Yet it is relatively inexperienced in the area of enterprise policy and development such as customer relations, research, and policy formulation and implementation.

Quality Standards

- Introduce a system of certification and accreditation of advisory bodies to set quality standards and improve confidence in the benefits of services. Certification and accreditation should be carried out by a credible representative body (see below).
- Encourage business advisory centres to develop and publish customer charters, setting out the range of services provided and the standards they will adhere to. Entrepreneurs need to be aware of the potential gains from receiving professional advice to be more willing to pay for them.

Representative Bodies

- Evaluate the role of the Chamber of Commerce with regard to such issues as: nature of membership, organisational structure, linkage with Government institutions (e.g. information dissemination at branch level), focus on SME support services, etc.
- Evaluate the possibility of creating a representative body for business advisory bodies and consultants as a way of strengthening support and services, and of ensuring co-ordination of activity in the SME field. This would contribute to raising standards.

The Implementation of Business Incubators

National Policy

- Develop a strategy for business incubators, including responsibility for implementation, and secure commensurate national and international resources in order to promote business incubators effectively.
- Disseminate information and promote the role of business incubators to entrepreneurs, relevant ministries and agencies, as well as leaders of business associations, such as Chambers of Commerce and other business representatives.
- Develop training and education programmes for business incubator managers in order to ensure greater adherence to best practice in OECD Member countries.
- Evaluate the possibility of using business incubators to support the agribusiness and high-tech sectors.
- Evaluate effectiveness and financial sustainability of small business incubators of less than 2.000 m².
- Ensure that incubators provide more than a physical infrastructure for micro enterprises and SMEs, i.e. in conjunction special advisory, mentoring, training and business consultancy services should be networked as part of the Incubator support framework. Such “soft” services could extend to practical assistance on production methods, quality systems, business development, export marketing, access to loan finance, etc. and could be provided on commercial terms when there is substantial time and input provided.

Chapter 2.

INTRODUCTION

Private investment by Small and Medium-sized Enterprises (SMEs)¹ is a key generator of economic growth and social change in OECD member country economies. In most countries, over 90% of all enterprises are SMEs. It is now widely accepted that the contribution of SMEs to new jobs, exports, innovation and regional development is vital to national development. How to benefit from and maximise this contribution is a continuous challenge for all countries. This Enterprise Policy Performance Assessment, similar to assessments undertaken in other countries in the region, seeks to help address that question for Moldova and highlight issues that require attention and priority action.

The State has a fundamental role to play in providing a favourable framework and environment for private sector development in OECD member countries. In the transition economies of South East Europe (SEE), where private investment levels lag behind those of developed countries, the necessity to create an enabling environment for SMEs and private investment is more urgent. Reform of the business and investment environment leading to the creation of a dynamic entrepreneurial culture is crucial to drive the process of change in industrial structures and the transition to market economy structures.

The OECD and the EBRD have undertaken a series of Enterprise Policy Performance Assessments (EPPAs) in all SEE countries in order to monitor the development of policies and infrastructures to support the SME sector. Substantial emphasis has been placed in eliciting the views of private SMEs on their past experience and perception of the key barriers to business and new investment, and their assessment of progress in implementing policies to encourage the development of SMEs. Previous OECD research has identified six broad dimensions of the framework and environment supporting SME growth and development, which are particularly important for governments to get right:

- Institutional framework for SME policy.
- Rule of law and the regulatory environment.
- Tax policy for small businesses.
- Financial instruments for fostering small businesses.
- Advisory services supplied to new and small businesses.
- Implementation of business incubators.

The Investment Compact, endorsed by the countries of SEE including Moldova, explicitly acknowledges that the revitalisation of the region must rely primarily on private sector development and investment (Investment Compact Charter, OECD, 2001, pp. 5-7). This EPPA captures private sector insights measured against the above six dimensions of good practice. It presents views on performance and progress made on the basis of good practice indicators developed for transition economies. It takes into account other OECD and EBRD studies such as the EBRD Country Strategy (2003).

The EPPA research provides a qualitative “snap-shot” of the SME perceptions of the business and investment environment. It highlights issues for attention and recommends actions. This report is intended to enhance policy dialogue between the key SME representative associations and the

supporting State institutions. It will be up-dated on an annual basis, thus allowing a fuller picture of progress to be developed over time.

The methodology employed in the EPPAs is set out in Box 2-1.

Box 2-1. EPPA Methodology

- I. The EPPA methodology has been designed to provide insights and assessments of the performance in the *implementation* of policies to improve the investment environment for business. The EPPAs have been conducted on a standard basis in all countries of the region and provide a benchmark for (a) highlighting key reform issues (b) measuring private sector insights and assessments of the business environment (c) assessing progress on a country by country basis and (d) comparative cross-country review for the SEE region.
- II. The main components of the EPPA undertaken in Moldova are as follows:
 - A question template derived from extensive case study work on good practice in transition economies and OECD country experience (OECD-UNIDO, 1999) was used in the research.
 - Country-based experts/consultants were selected for their enterprise policy knowledge and experience.
 - Focus group research: group discussions were held with SME representatives.
 - Individual SME interviews: to validate the focus group research and to provide insights on key issues.
 - Expert interviews: to cross-reference information from the focus groups and contribute to views.
 - Desk research: examination of existing reports, databases, documents, etc.
 - Expertise from OECD, EBRD and experts from OECD countries.
- III. Under the guidance of OECD, the focus group research with the private sector in Moldova was carried out by local consultants, *IDIS "Viitorul"*, using a structured brief and template of questions developed by OECD and EBRD. The focus group research commenced in September 2002 and other interviews and desk research extended to the end of 2002. It focused on six dimensions of good practice in the following policy areas:
 - The Institutional Framework for SME policy.
 - Rule of Law and the Regulatory Environment.
 - Tax Policy for Small Businesses.
 - Financial Instruments for Fostering New and Small Businesses.
 - Advisory Services Supplied to New and Small Businesses.
 - The Implementation of Business Incubators.
- IV. Three focus group discussions took place in Căușeni (South), Chișinău (Centre) and Bălți (North). 47 entrepreneurs took part in the detailed discussions, covering the following sectors: services, trade, transportation, food processing, industry and IT. The participants included representatives of micro, small and medium-sized companies, ranging from start-ups to well established firms. Standard templates were used for the discussion and the collection of ratings.

- V. Eight individual interviews with SME owners and managers and local SME experts were carried out. Representatives of business associations and other institutions, including the Ministry of Economy, World Bank, Chamber of Trade and Industries, etc. took part in the research, allowing for a wider perspective than the focus group discussions.
- VI. The findings from the focus groups and interviews obtained through the procedure detailed above were complemented with additional information provided by the EBRD. The EBRD's Office of the Chief Economist has assessed progress in structural and institutional reform across the region since 1994. The EBRD jointly with the World Bank launched the Business Environment and Enterprise Performance Survey (BEEPS) in 1999. The BEEPS asks enterprises to evaluate economic governance and state institutions and assess the extent to which the business environment creates obstacles to the operation and growth of their businesses. In 2002, a second stage of the BEEPS was undertaken, surveying close to 6,000 firms across 26 countries of the region.
- VII. The analysis in this EPPA is based on the methodologies described above (focus group research, expert interviews, secondary data collection) and is complemented by the EBRD assessment and the BEEPS 2002 results. The information has been analysed by the OECD and EBRD, resulting in the assessment presented in this EPPA.

NOTE

1. The notations SME and small enterprise in this report also includes micro-enterprises, which according to the EU definition (http://europa.eu.int/comm/enterprise/enterprise_policy/sme_definition/index_en.htm) are independent enterprises with up to 9 employees and whose turnover or balance sheet asset value are \leq €2 million. Small enterprise are likewise defined as having between 10 and 49 employees and turnover or balance sheet asset value of \leq €10 million and medium sized companies as having between 50 and 250 employees and turnover of \leq €50 million or balance sheet asset value of \leq €43 million.

INSIGHTS FROM SME OWNERS, MANAGERS AND REPRESENTATIVE BODIES

3.1. Introduction

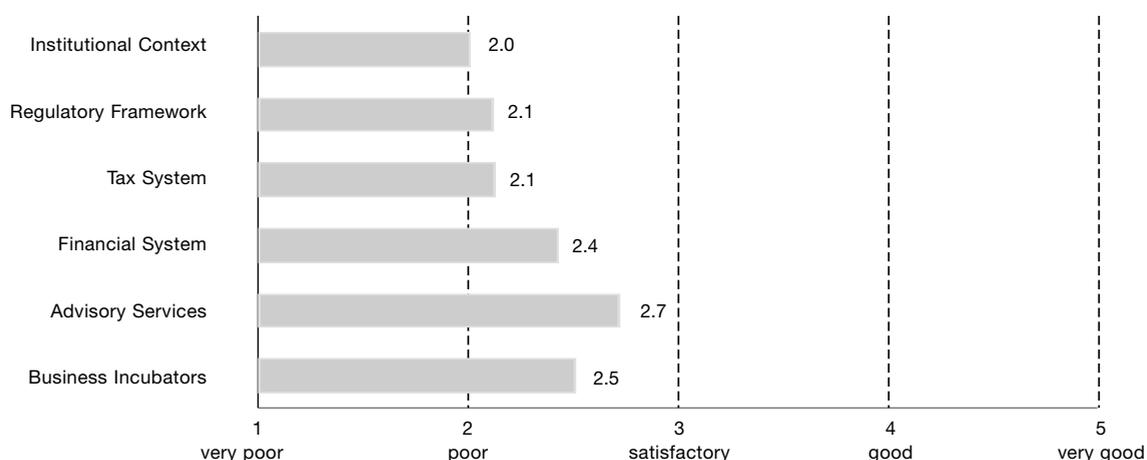
The analysis of the results of the research with the SME focus groups is presented under six framework dimensions of good practice for the business environment:

- Institutional framework for SME policy.
- Rule of law and the regulatory environment.
- Tax policy for small businesses.
- Financial instruments for fostering small businesses.
- Advisory services supplied to new and small businesses.
- Implementation of business incubators.

The analysis highlights the main issues arising from the discussion with the private SMEs participating in the EPPA research. The key questions dealt with in the focus group research are summarised at the beginning of each section. The average ratings used to represent the views of the entrepreneurs range from 1 to 5 and can be read as follows: 1 = very poor, 2 = poor, 3 = satisfactory, 4 = good and 5 = very good.

The average ratings per dimension of good practice are highlighted in figure 3-1. In general, the ratings are low with most dimensions of good practice obtaining a “poor” rating. The Business Incubators obtained a slightly better rating (2.5) and Business Advisory Services obtained the highest average rating of all (2.7), although none of the six dimensions of good practice attained a “satisfactory” rating.

Figure 3-1. Average Ratings of the Six Dimensions of Good Practice by SME Owners and Managers



The main points made by the participants during the focus groups are reported verbatim and the quotations most relevant to the analysis are highlighted. Each section concludes with a summary of the issues emerging from the research.

In addition, this chapter presents selected analysis of the Business Environment and Enterprise Performance Survey (BEEPS) 2002 survey. The BEEPS is a survey of 174 Moldovan enterprises and, like the focus groups, was carried out in 2002. Of these, 153 were considered to be SMEs (of which 38.6% micro, 38.6% small and 22.9% medium-sized) according to the EU definition for employment (i.e. they had less than 250 employees). The results presented in this document refer only to the responses provided by the SME sub-sample. The BEEPS research is based on a sample survey and complements the focus group research and analysis in this report. The BEEPS analysis is presented in separate text boxes (for example, see box 3-1. below) and a summary of main results is contained in Appendix 1.

Box 3-1. Obstacles to Doing Business (BEEPS, 2002)

The entrepreneurs were asked to rate the severity of obstacles pertaining to several aspects of the business environment (the scores can be interpreted as follows: 1 = no obstacle; 2 = minor obstacle; 3 = moderate obstacle; 4 = major obstacle). Three areas of analysis overlap with the areas investigated through the focus groups methodology: regulation, taxation and provision of finance. On average they are rated respectively between minor and moderate obstacles. A direct numerical comparison between the two types of analysis is not possible, due to the very different formulations of questions asked, however, the results are broadly consistent. It should be noted that the BEEPS included other areas of investigation in which obstacles of greater severity were identified, such as crime, land (title and access), labour regulations, etc.

3.2. Institutional Framework for SME Policy

The issues researched under this heading:

1. Clear assignment of organisational responsibility for the development of SME policy.
2. The effectiveness of organisation/s in developing an environment to encourage entrepreneurship and the development of SMEs.
3. The quality and effectiveness of the SME development strategy.
4. The local and regional governments' mandate and resources (funding, people and skills) to promote SME development.
5. The information provided and awareness by business people of the government's institutions, policy and programmes to support new entrepreneurs and develop existing SMEs.
6. The quality and regularity of consultation between government and the private sector on SME policy and its performance and assessment.

Organisational Responsibility

1. Has Government assigned clear organisational responsibility for the development of SME policy?	No
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This section analyses the comments and opinions expressed by focus group participants, namely SME owners and managers, as well as SME experts on issues of institutional development. The ratings relate only to the assessments made by SME managers and owners. The majority (75%) of entrepreneurs believe that the Government has not yet managed to delegate a clear-cut mandate to a specific body that is responsible for co-ordinating and implementing national SME policies:

“There is certainly an SME department, but it is not clear how it can influence the small business situation in our country. [There are] working meetings, media events, many words, but little effective output.”

While not refuting the need for such co-ordinating body, some of the entrepreneurs suggest that the Ministry of Economy’s SME Department is not yet central to the overall process of business development:

“It’s as if it was created to improve the image of the Government in the eyes of the international donors, rather than to deal with the real situation, ... it seems to have a ‘decorative’ function.”

Furthermore, the entrepreneurs participating in the research think that there is not yet coherent support for SMEs, despite the existence of policy statements and programmes to this effect:

“... it is not really possible for people wishing to start-up a business to obtain the necessary information and advice from the state institutions that they are supposed to provide...”

There is some indication of institutional changes, such as the establishment of clearer responsibilities within the Ministry of Economy for SME development (see section 4.1). However, the changes have not yet had a visible impact on the SMEs and they are unaware of them. This highlights a lack of involvement of the SME sector in the government’s policy making.

Issues: The poor visibility of the bodies specialising in SME issues and their level of activity with SMEs leads to a widespread perception amongst entrepreneurs of a lack of Government action and, therefore, commitment to SME development.

Effectiveness of the Organisation/s

2. Rating given to the effectiveness of the organisation/s in developing an environment to encourage entrepreneurship and the development of SMEs	2.0
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High-ranking State officials argued during the expert interviews that the current SME strategy pursued in Moldova is in line with policies being promoted in other CEE countries, and that the State is providing adequate tax incentives for start-ups. Whilst acknowledging that greater priority is being given to business development, the SME owners and managers held different opinions. The discussions indicate little confidence that serious steps are being undertaken by the State in respect to the SME sector. Even the existence of a national strategy on SME development divided the participants in the discussions. Some feel that a strategy exists, while others are sceptical about its existence in a meaningful sense:

“The strategy was adopted this summer [2002].”

“Why should we talk about strategies? There is only ‘paperwork’ in this field. [There is] nothing that actually makes our life easier.”

Many of the entrepreneurs raised serious doubts about the effectiveness of the relevant national organisations. SMEs were critical of the Ministry of Economy for apparently not taking into account the proposals submitted to stimulate SME development on behalf of the SME sector by business associations in 2001 and 2002. Entrepreneurs were even more critical about the level of its “bureaucracy”:

“They are poorly acquainted with the real needs of the entrepreneurs. Frequent legislative changes are mostly due to the fact that they feel the need to ‘reinvent’ their role by producing new registration forms, new licensing [requirements], etc.”

The discussants also pointed to the low level of funding available to the SME Division to pursue its mandate. The government’s policies on SME development are not considered to be effective since they are rarely accompanied by the funding needed to implement them. The perception remains that despite

the existence of some formal institutions vested with functions of co-ordination and development of the small business sector, they are not perceived as being efficient in promoting a favourable environment for the sector that they are responsible for. An expert argues the following:

“... despite the significance of this sector [SMEs] to the economic revival of the country, the SME Department responsible for the policies affecting 20,000 SMEs consists of just four employees. This is not even saying anything about the low level of funding available for this Department to pursue its mandate.”

Issues: Entrepreneurs acknowledge the importance of a co-ordinating body at national level and anticipate that the SME Department may become more effective as it grows into its role and obtains resources to fulfil its mandate. They insist that such a body should have the capacity (people, skills, resources) to perform a role which goes beyond the collection of SME data and that what they require is a body able to deliver real improvements to the business environment facing small enterprises.

Programme for SME Support

3. Rating given to the quality and effectiveness of the SME development strategy	2.0
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The focus group discussions highlight a perception that there is a lack of involvement of “competent” specialists in the field of SME policy development at national level. The SME representatives participating in the research argue that the policies being promoted by the Government should be understood more as: ***“... fashionable measures rather than real policies.”***

Such policies and strategies are not perceived as being “real” pre-requisites for economic growth since there is little consultation and thus, it is argued, they fail to meet the needs of the business community:

“The [public] administration pays little attention to the SME sector. It places a greater emphasis on large enterprises. ... this is why some officials have a negative attitude towards small business, applying principles and policies that are clearly advantageous to large factories and plants.”

“Of course, we do have some annual Congresses organised by the Government with prominent business people, but I dare to say they’re just ‘window dressing’, a ‘show’.”

There is currently no defined and approved national SME strategy in Moldova. The most prominent document stating a commitment to support the small business sector, is the State Programme for SMEs Support (2002-2005), adopted by the Government of Moldova in June 2002. The State Programme (see section 4.1) incorporates a wide range of measures and policies to improve the legal and practical functioning of small business, though it falls short of being a national SME strategy. The SME owners and managers in the focus group research often maintained that there is a lack of systematic planning of economic policies, which hampers the Government’s pursuit of a well-defined strategy for SME development.

Issues: A national SME strategy is yet to be developed, though a State Programme has been defined. Both the entrepreneurs and the experts maintain that an effective framework for SME policies and development is required. There is a feeling that the government is not yet focusing and seriously addressing issues of importance to SMEs.

Local and Regional Governments

4. Rating given to the local and regional governments’ mandate and resources (funding, people and skills) to promote SME development	1.7
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Experts believe that local / regional policies for SMEs development and support are still in their infancy. Neither regional nor local authorities are perceived to have sufficient experience, training and competence to accomplish the task of promoting SME development in an effective manner, according to about 70% of the participants in the research. According to the discussions, due to the existing budgetary constraints and lack of financial autonomy, local governments can only “*watch from a distance*” central government policies that affect SMEs in their territories. Although SME Development Offices have been created in 11 counties, they are seen as operating more as facilitators than as genuine instruments for the formulation and implementation of policies to support SMEs:

“Regional authorities are usually sensitive to our problems, but they lack resources. Our co-operation is impeded by the lack of fiscal autonomy [of these institutions].”

There is some activity performed by such bodies that entrepreneurs are aware of, such as the organisation of roundtables, seminars and discussions. According to the entrepreneurs, certain counties have started the first regional programmes for small business support, for example in Căușeni, Ungheni, Bălți and Soroca. Nevertheless, there is much criticism of the relationship between the private sector and the local and regional public authorities, due to the bureaucracy and corrupt behaviour of some of those who interact with SMEs:

“In most cases, local authorities decline responsibility for dealing with business issues. There is no difference between central and regional officials - they repeat the same mistakes with respect to SMEs.”

“I see a serious problem with [their] mentality ... Often they create artificial problems for us because of their ridiculously low wages and their lack of transparency... In reality, local governments can do very little to improve the conditions for businesses.”

Entrepreneurs are clearly aware of the lack of adequate resources for the promotion of SME at the local level. They argue that the apparent lack of “interest” in co-operation with SMEs is motivated as much by the modest resources available, as by the limited knowledge and skills available:

“... most of the people undertaking these activities have only approximate knowledge about the real situation affecting small business and do not even make efforts to be well informed. Their main concern is that firms pay the taxes [that are due] ...”

Issues: Entrepreneurs would like to have more consistent and effective co-operation with regional and local authorities. For the moment, the capacity (financial, human capital, general willingness, etc.) to assist the process of enterprise development remains very limited.

Information and Awareness

5. Rating given to the information provided and awareness of the government’s institutions, policies, programmes to support new entrepreneurs and develop existing SMEs	2.2
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Based on the discussions in the focus groups, it appears that the recent policies and decisions initiated on behalf of SMEs are largely unknown to the small business community. Whatever exists is:

“... perceived merely as exceptions, which will not be followed by serious steps.”

There was little evidence of information (rated 2.3) or awareness (rated 2.1) amongst the SME representatives of the institutions, policies and programmes by the Governmental bodies in charge of SME development. For example, very few of the participants were able to identify the officials working in the Ministry of Economy as relevant counterparts for the business community. The perception is that there is very little in common between the “**paper-work**” being done by the Government and “**real life**”

faced by the enterprises. This impression is reinforced by the fact that since 2000, the State budget has not provided financial resources for the implementation of the State Programme to Support SMEs.

It was pointed out that the frequent staff changes within governmental structures, the changes of the legislation itself and the adoption of new policies lead to chronic instability and increase the tension between central government and the SME sector. At the same time, as noted by one of the experts, SMEs need to be reasonable in their expectations:

“Apathy and misconceptions characterise the attitude of many SME stakeholders; they expect the state to be the most important player for every single aspect of private business development, and that only the state can promote the long-term interests of the SME sector!”

The SMEs participating in the research do not have a sense that new policies will be initiated in the near future. Indeed, they maintained that many of the policies and measures adopted did not necessarily prove to be beneficial to SME development. The experts that were interviewed also acknowledged that:

“...in the last couple of years, the country has witnessed a sharp decline in the willingness of central authorities to respect their commitments towards the SME sector.”

Issues: The level of awareness and information of the institutions, policies and programmes that exist to support SMEs is “poor” in Moldova. It is the role of the relevant institutions, governmental and non-governmental, to ensure that this improves in future. It should be noted that SME and business associations have an independent responsibility here as well.

Consultation between Government and the Private Sector

6. Rating given to the quality and regularity of consultation between government and the private sector on SME policy and its performance	2.1
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The absence of Government – Business consultation is one of the most notable features of the discussions that took place in focus groups. The manager of a consulting firm was particularly critical of the “cynical attitude” to consultation:

“Our Government pretends that it loves us from 09:00, when the conferences start, until 16:00, when they end.”

Only a couple of entrepreneurs argued that they had some contact with the Ministry of Economy, though this was intermittent: ***“Once every six months.”***

The entrepreneurs participating in the focus groups argued that there was an absence of mechanisms for maintaining regular contact and co-operation between the SME community and the responsible bodies, an issue confirmed in the discussions with SME experts. In any case, the majority of the respondents think that there is not necessarily a link between the limited consultations that may take place and the SME policies and activities actually promoted by the State:

“... there is a pejorative or even hostile attitude towards SMEs. They ask us to come up with suggestions but when we do, nothing is taken seriously! The result is always different to what we discussed.”

Some of the institutions with a mandate to enhance the level of co-operation between the business community and the State are considered to be neutered by bureaucracy. An example put forward was the Ministry of Economy’s Economic Council, which in the participants’ view, has proved to be ineffective:

“I used to be a member of an Economic Council, formed to find out our [SME entrepreneur] opinions. This was the first and the last time that this Supreme Economic Council debated the issues of SMEs. We were photographed; we said some loving words [to each other] and then we went home.”

A more effective approach would require a larger degree of transparency and co-operation between the State and business representative bodies such as the SME associations, business clubs and various professional associations. According to the experts:

“The country lacks a permanent instrument of consultation with SME representatives; there is no dialogue between public institutions and the SME associations.”

Issues: Co-operation and communication between the SMEs and Governmental agencies are either poor or non-existent. It is not clear that the relevant institutions have the capacity to absorb and respond to the suggestions that are made by the SMEs community. Effective consultation schemes need to be developed between SMEs and state agencies with the mandate to improve the business environment.

3.3. Rule of Law and Regulatory Environment

The issues researched under this heading:

7. The formalities for new company registration and comment on the process.
8. The procedures for obtaining licenses, permits and certificates necessary for business operations.
9. The existence of a government approved programme for reducing the legal / administrative barriers for business and rating of the quality and effectiveness of this programme.
10. The efficiency of the programme for reducing the impact of corruption.
11. The quality and regularity of consultation between government and the private sector / SME policy community on draft legislation and regulations that affect business.

Company Registration

7. Rating given to the company registration procedure	2.5
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Most of the participants in the focus groups argue that the existing procedures for registering a business are too complicated and should be simplified if the government wishes to see the emergence of additional firms and to broaden the tax base. They argue strongly that the registration process is overly bureaucratic, normally requiring between 10 to 30 days to register a new company from the moment when they have collected all the relevant documents. It appears, from the discussions, that the procedure varies from place to place:

“...Civil servants mandated to perform these procedures confuse matters ... forcing the entrepreneurs to conform to personal interpretations of the legislation. Unfortunately, in practice, the right of the entrepreneurs to defend their interests in court is not always a remedy as it [the judicial system] is perceived as being corrupt and poorly articulated with respect to... law enforcement and impartiality.”

The SMEs representatives illustrated the procedure of re-registering their firms as follows:

“Just too expensive.”

“For every document, we need to pay twice as much as the official price, or even more.”

“I know that some people paid 950 lei [ca. €68] only for changing the address; and others paid 150 lei (€11) for an official notification [that the change was done].”

Much of the discussion in the focus groups revolved around the role and effectiveness of the Licensing Chamber, which was formed in 2000 in order to simplify the procedures related to licensing, including those necessary to register a company. According to the discussions, the view is that the Licensing Chamber does not actually issue licenses unless the entrepreneurs have first applied and

received various other permits from the responsible ministries and departments, which continue to be involved in the process. This appears to result in a good deal of confusion among the SME entrepreneurs about issues related to registration and licenses, as well as the associated costs for obtaining them. In addition, the professional skills and qualifications of the Licensing Chamber's staff do not meet expectations of the SME entrepreneurs. Participants stress that rather than delivering the necessary improvements:

“Anyone who attempts to follow the registration procedure according to the letter of the law, knows that things have become more complicated ...there are many doors that have to be opened ... and ‘tips’ to be paid along the way.”

The main complaint in the focus groups was that the registration process lasts excessively long, from several weeks up to months. Experts have also confirmed that business people spend too much time searching for ways of accelerating the registration procedure:

“The procedures could be less expensive if they were more transparent.”

Since these obstacles are so “front-loaded” at the business registration stage, the entrepreneurs were aware of cases where people had simply given up. Others did not register, choosing to operate in the “shadow” economy where things are considered to be much “simpler”. This also explains the very large number of individuals in Moldova working on the basis of Entrepreneurship Patent. This involves a much simpler procedure, no accounting or statistical reporting, as well as a simple process of terminating a business.

Issues: The creation of the Licensing Chamber was designed to simplify and accelerate the process of registering firms and issuing the appropriate permits. In fact, SMEs argue that the opposite has happened. They must still approach numerous other ministries and organisation prior to submitting the forms to the Licensing Chamber. Further reform is required to create a clear and stable environment, which is not characterised by regulations and procedures that that allow too much freedom in interpretation.

Licenses, Permits and Certificates

8. Rating of procedures for obtaining licenses, permits and certificates	2.1
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The majority of the entrepreneurs were robustly critical of the current procedures of licensing, arguing that they are still highly complicated and leave far too much scope for abuse by public officials:

“I totally disagree with the way in which various licensing bodies operate. They come too frequently and they stay for too long ... Every control in my firm means a lost day! If I have obtained a license for five activities, why should they... insist that I obtain additional licenses?”

“Where there is much bureaucracy and over-regulation, one must expect high degrees of corruption.”

Some experts from the state bodies were of the opinion that:

“The Government has recently started implementing many measures to simplify the bureaucracy and the licensing requirements in co-operation with SMEs.”

However, the opinions expressed by the entrepreneurs, suggested a different viewpoint:

“The number of bureaucratic barriers has increased lately and there is no governmental programme that works for a reduction of these obstacles, especially for start-up businesses.”

Entrepreneurs are frustrated about the high costs for obtaining licenses, the complicated paperwork involved which: “... *seems to be written for bureaucrats and not for businesspeople*”, and the general lack of accurate information on license, permit and certificate issues. Over and above specific authorisation, officials often request additional documentation that is not always stipulated by the rules:

“Civil servants in charge of these activities... force entrepreneurs to conform to their personal interpretations of the legislation.”

Further business regulation issues identified in the BEEPS survey are discussed in box 3-2.

Box 3-2. Business Regulations (BEEPS, 2002)

According to the BEEPS, the aspects of the business environment for SMEs pertaining to regulation (labour regulations, customs and trade regulations, title or leasing of land, access to land and business licensing and permits) are considered to be a less severe obstacle than the focus groups analysis suggests. However, the variance in the rated severity of various aspects of the regulatory environment is rather high, with issues related to business licensing and customs and trade regulations seen as the most difficult for entrepreneurs, followed by issues related to access to land and to titles or leasing of land and by labour regulations.

Issues: The licensing, permit and certificate regime remains bureaucratic, confusing and opaque. There is a lack of information on the procedures involved. The SMEs participating in the focus groups were frustrated by this situation and critical of the public employees’ efforts to extract payments for approvals. Despite a Government commitment to undertake active steps to reduce and/or simplify the procedures for doing effective business, in practice there is no clear “road-map” for this.

Simplification Programme

9. Rating given to the efficiency of the programme for reducing administrative barriers for business	2.1
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The entrepreneurs were unaware of any institutional effort to reduce the administrative barriers for businesses (quality: 2.3 and efficiency: 1.9), with the SME experts confirming this. According to them, the only means open to them to deal with the bureaucracy, are bribing and networking:

“Basically, if you have money, the registration procedure becomes simple and can be tackled in two or three days.”

The entrepreneurs believe that government’s intention to simplify the registration and licensing procedures, for example through the Licensing Chamber, has simply not succeeded. In addition to Licensing Chamber’s procedures, a co-ordination process is required with the other relevant ministries, thus undermining the concept of a “one-stop-shop”. Long after the creation of the Licensing Chamber, small businesses still point to the cumbersome formalities in place. For example, they argue that although the majority of SMEs’ business activities have no effect on national security or public health, they still need such permits on an annual basis. The general conclusion is that there has been a backward step:

“... when the relevant ministries were responsible for issuing licenses, we knew ... which sectors needed a license and the requirements for obtaining it. Nowadays there’s much confusion about the criteria used for issuing licenses, the duration of the licences, etc.”

Issues: SMEs' frustration vis-à-vis registration and licenses procedures need to be tackled by simplifying the registration process, clarifying the registration fees and reducing the scope for abuse through the implementation of "one-stop-shops". The system of agencies, ministries and other State bodies involved in this process needs to be simplified and clarified so as to increase efficiency. This requires a determined effort to reduce the barriers to doing business through a dedicated programme.

Anti-Corruption Programme

10. Rating given to the quality and effectiveness of the Government's programme for reducing the impact of corruption	1.8
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A State Programme to reduce the impact of corruption exists. It includes an array of measures and policies to fight organised crime, corruption and the "shadow" economy, for example by strengthening judicial and law enforcement agencies and enhancing co-operation with international bodies. However, the entrepreneurs rate its quality and effectiveness as "poor". The SMEs in the focus groups argue that the laws may be fine, but the "**implementation**" of the measures, let alone any independent evaluation of the impact, leaves much to be desired.

As part of the process of reducing corrupt activities, more attention is being given to checks and controls of businesses. Both experts and entrepreneurs are concerned that these have the potential to be misused:

"... the controls are increasingly transformed into measures for reprisals, which impact negatively on business activity."

This leads the SMEs participating in the discussion to focus on inspections, an issue of a major concern to enterprises. They think that the inspectorates, especially the Tax Inspectorate, the Centre for Preventive Medicine and the Fire Authorities, repeatedly monitor and inspect the same enterprises. In addition to the loss of time involved for the enterprises, a series of other costs are incurred:

"The state officials create their own system. They can easily subdue companies by organising multiple inspections. These both encourage obedience and/or facilitate the extraction of exorbitant bribes."

"...after each of our national exhibitions, we are visited by representatives of the Financial Guard. They claim certain expensive products as the reward for 'caring' for companies."

All this results in deep suspicion of the raison d'être of the inspectorates:

"The state inspectorate has transformed itself into a system for extracting money from the business sector. This is the consequence of over-bureaucratic procedures and the lack of transparency."

The constantly changing regulatory environment contributes to this situation by creating ambiguity and uncertainty, thus generating scope for rent-seeking activities (see also box 3-3.).

Box 3-3. Corruption (BEEPS, 2002)

Some evidence of corruption affecting the SME sector also emerged from the BEEPS analysis. It found that SMEs pay 2.1% of total annual revenues in unofficial payments/gifts to public officials. This percentage is lower than the one in the 1999 BEEPS (3.2%). Also, a slightly smaller percentage of firms are affected by corruption with respect to 1999, according to the same sources. In 1999, 34.4% of those interviewed admitted to having made frequent bribe payments, whereas in 2002, 34.3% of firms did so. Corruption is the sixth most severe obstacle to doing business (out of 21) and is rated 2.6 (i.e. between minor and moderate).

Issues: The entrepreneurs rate the impact of the national programme to combat corruption as “poor”. They perceive little positive impact on the ground and call for an evaluation of its effectiveness. Entrepreneurs are highly critical of the frequency of inspections, the non-transparent procedures, as well as the capacity of the inspectorate services to harass and extract payments and gifts from entrepreneurs.

Consultation between Government and the Private Sector

11. Rating given to the quality and regularity of consultation between government and the private sector on draft legislation and regulations that affects business	2.0
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The development and adoption of legislation and regulations affecting businesses is currently performed with little participation of the business community and its representatives. The distinct perception of the SME representatives is that this co-operation is not desired, resulting in a “poor” rating of the quality and regularity of Government-Business consultation. For instance, an SME business association participating in the research indicated that it was invited to comment on the State Programme for SME Support and Development, but it doubted the value of its contribution:

“Several observations and suggestions on the fiscal and legal aspects of SME development were made to the Ministry of Economy. In addition ... a very high-level meeting was held. But after several months it became obvious that none of our proposals were reflected in the final version of the programme.”

Another SME Association sought to forewarn its members of planned government policies, held discussions on the draft regulations and assembled proposals for reform:

“... all suggestions were again ignored by the authorities.”

In this context, the BEEPS survey examined two related aspects of interest. Box 3-4 deals with issues to do with contractual rights and changes to the legal system.

Whilst recognising that government cannot be expected to agree to and incorporate all suggestions and recommendations made by the SME policy community, the SME owners and managers participating in the research maintain that the procedures for reform of laws and regulations could be made more flexible and transparent. Although some steps have been taken by Government to be more open, the view is that there is still no regular consultative forum through which SMEs can influence the policy-making process.

Box 3-4. Legal System: Contractual Rights and Impact of Unforeseen Changes (BEEPS, 2002)

When entrepreneurs were asked to what degree they agree with the following statement: “I am confident that the legal system will uphold my contract and property rights in business disputes”, most (68%) tended to disagree, as can be seen from the table below.

	%
Strongly disagree	12
Disagree in most cases	16
Tend to disagree	40
Tend to agree	25
Agree in most cases	3
Strongly agree	1
Don't know	3

Box 3-4. Legal System: Contractual Rights and Impact of Unforeseen Changes (BEEPS, 2002) (cont.)

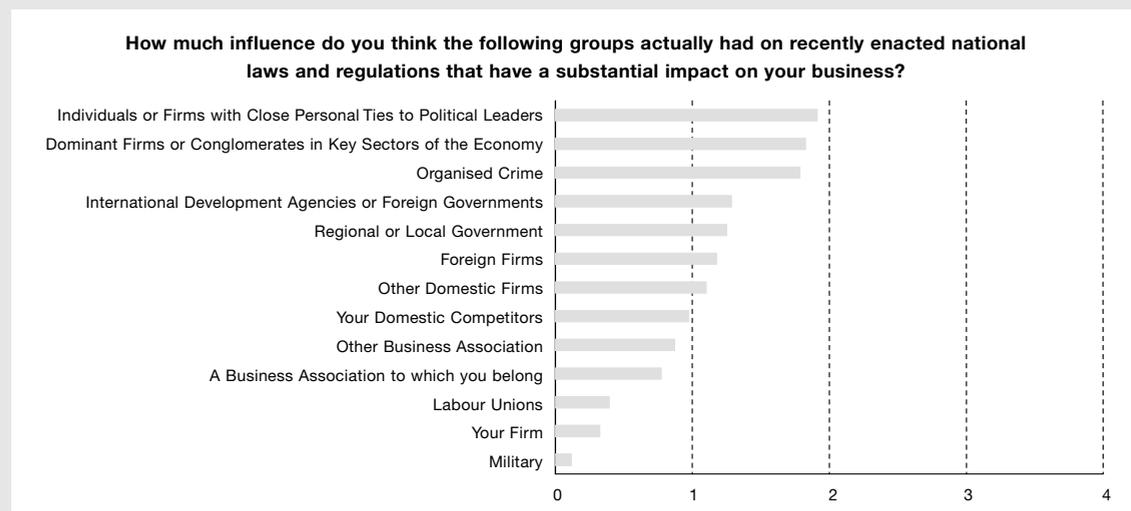
Also relatively more entrepreneurs (71% of all SMEs interviewed) found that an unforeseen change in laws and regulations would occur in 2003 and would have a significant impact on their business. The following table shows the specific results for the SMEs interviewed.

	%
Extremely unlikely	5
Highly unlikely	10
Fairly unlikely	10
Fairly likely	27
Highly likely	34
Extremely likely	10
Don't know	4

Box 3-5. examines the private sector's perceptions of the lobbying power of various organisations on the making of laws and regulations.

Box 3-5. Private Sector Perception of Lobbying Power of Various Entities (BEEPS, 2002)

The entrepreneurs were also asked about the link (in terms of lobbying power) between the legislative powers and regulatory authorities with various organisations and economic agents (the scores can be interpreted as follows: 0 = no impact; 1 = minor influence; 2 = moderate influence; 3 = major influence; and 4 = decisive influence). As can be seen from the chart below firms with ties to political leaders, large firms and conglomerates in key sectors of the economy, organised crime, international development agencies and regional or local government are believed to be able to exercise, to a minor degree, some sort of lobbying power on the legislative and regulatory authorities. The entrepreneurs interviewed in the BEEPS believe that SMEs and their business associations have almost no impact on the making of laws and regulations.



Issues: There is a considerable gap in effective communication between the Government and the business community in Moldova, which affects entrepreneurs' willingness to engage in communications with respect to SME issues. The fragmentary nature of consultations and the lack of responsiveness to the contributions and recommendations made are a drawback to effective policy formulation.

3.4. Tax Policy for Small Businesses

The issues researched under this heading:

12. Whether the present tax policy encourages new enterprise and rating of the tax system in terms of the encouragement, support and ease of use that it provides to new and existing SMEs.
13. The stability and transparency of the tax system for small enterprises.
14. The consultation and communication between government and the private sector on tax rates and incentives for enterprises.
15. Co-ordination of tax policy with other government policies.

Encouragement of Enterprises

12. Rating given to tax policy in terms of the encouragement, support and ease of use that it provides to new and existing SMEs	2.0
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The widespread opinion among small business people in Moldova is that although there are tax incentives, in fact the fiscal system does not stimulate the development of SMEs. While SME representatives agree that taxes are not necessarily higher than in neighbouring countries, they also affirm that the tax legislation is particularly confusing and burdensome to taxpayers. The biggest complaint relates to the complexity of the system, which compels SMEs to employ accountants or, if they already have them:

“... the response by enterprises is to double the number of accountants and bookkeepers. This, in itself should be an incentive to state bodies to simplify matters.”

The argument is not simply that national policy disadvantages SMEs by imposing an undue fiscal burden:

“The most serious difficulty which SMEs face is not so much related to the tax burden, as to fiscal instability.”

“A large number of taxes greatly complicate the accounting procedures and the submission of financial reports, resulting in extra costs for bookkeeping and business administration.”

However, entrepreneurs do perceive an improvement in the tax system:

“We welcome the efforts to reduce the overall tax burden in 2003, however, our main concern is that we remain confronted with a highly unstable tax system. Despite the challenging tax environment, we are trying to keep abreast of the changes and to ensure that we have some basis for planning ahead with a degree of confidence.”

Based on the views of the SMEs participating in the research, the most important deficiencies in the present system are related to the instability of tax legislation, followed by procedural complexity and the general opacity of regulations (see below).

Issues: The constructive steps to reduce the tax burden was seen as positive. However, the current tax policy is not considered to be conducive to encouraging SME development in Moldova. The main problems relate to the fact that the system is unstable and unpredictable, making it particularly hard for small entrepreneurs to cope with. It is indispensable for small firms to employ accountants and tax advisors in order to ensure that they comply with the legal requirements.

Stability and Transparency

13. Rating given to the stability and transparency of the tax system for small enterprises	2.0
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In the area of taxation, the main obstacles to carrying out business are:

“The instability of the legislation, high tax rates, complicated tax system, large number of regulations and instructions...”

The issues of instability and lack of transparency of the legislation were the central topics of the discussions concerning the tax system. Although instability is perceived as being the most important obstacle, there is no shortage of criticism of the rates themselves:

“I have to hide my income, but it would be impossible for my business to survive otherwise. I declare lower salaries to reduce payments to the Social Fund. I am compelled to do this.”

“The instability of taxes is generated by frequent increases in tax rates which are regularly adopted by the National Parliament in the middle of the year and which are payable from the beginning of the same year, with fines for delays in payment of these new taxes!”

The resulting unpredictability, it is argued, leads to an inability to plan investment and take business decisions. The interviewed entrepreneurs are particularly critical of the lack of transparency, for example, in terms of the tax service’s lack of interest in applying the rules (such as on tax incentives) but at the same time, penalising small enterprises on the basis of “*nebulous pretexts*”. Entrepreneurs are concerned that tax inspectors seem to issue fines on the basis of their pre-determined financial plans, regardless of the actual situation and the merits of the case. This undermines the confidence in the tax authorities:

“The fines are very steep ... as a general rule, the tax inspectors [artificially] find a reason to ... [levy a] fine. The amount is pre-determined on an annual basis.”

The interviewed entrepreneurs stress that: ***“Taxes and duties are levied from the very first day of activity.”*** Although Article 49 of the Tax Law provides incentives for newly created SMEs in the form of a three-year tax holiday (see section 4.3), the public authorities in charge of firm registration do not necessarily inform their clients of this. For this reason, in Tighina County for example, none of the entrepreneurs participating in the research had actually benefited from the above incentive, which has been in force since 2001. It was argued that not all tax changes and deductions are actually transmitted clearly or in due time to the business community. The reason behind this “*secrecy*” is widely believed to be pure and simply that this enables certain fiscal inspectors to extract rents from entrepreneurs. Since entrepreneurs are not notified of changes in tax, they feel themselves to be effectively “*blackmailed*” by the tax authorities.

The least transparent activities are believed by SME representatives to be those carried out by the Tax Inspectorate. Moreover, it is perceived to be an institution that issues instructions, regulations, including internal letters, to its territorial representatives for “*official use only*”. This secretive modus operandi increases the perception that changes may be designed to facilitate the imposition of penalties on enterprises. It was felt that entrepreneurs only find out about the existence of these changes once they are already in force:

“... the inspectors keep referring to various letters issued by the Inspectorate. They know that entrepreneurs do not have public access to them. It is done deliberately by the Tax Inspectorate; it is easier to manipulate businesspeople when they fear fines and penalties.”

Issues: The instability and lack of transparency in tax system and associated regulations is one of the main constraints that SMEs face. Some of the public authorities charged with tax administration are believed to be uninterested in providing clear, timely and accurate information for the simple reason that they can obtain payments from enterprises that fail to submit their tax returns accurately.

Consultation and Communication on Tax Policy

14. Rating given to the communication between government and the private sector on tax rates and incentives for enterprises	2.3
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The experts and entrepreneurs are critical of the quality of consultation by state authorities on tax issues:

“Based on my own experience, I can say that when you propose something to the State, you can be certain that the opposite will occur! Recognising that the tax burden for farmers was high, in 2001 it was proposed to create new tax incentives to develop rural SMEs. But, instead ... rural SMEs now have to pay even more tax than before!”

The entrepreneurs participating in the research discussed the lack of inclusive and transparent systems for the reform of fiscal and economic policies:

“[The] Government simply seeks new ways of collecting taxes as rapidly as possible. It never discusses these changes with representatives of the private sector...”

“... a large majority of SMEs operates outside the tax system, otherwise most SMEs would become unprofitable because of the tax burden.”

As evidence of the lack of consultation, the SME owners and managers point to the fact that they witness various changes that affect small enterprises on an annual basis, yet in the majority of cases, SMEs only find out about them when the new amendment are printed in the “Monitorul Oficial”, which publishes newly adopted legislation, decrees and other regulations. It was also noted by the participants in the focus groups that tax policies are sometimes adopted by the Ministry of Finance or the Tax Inspectorate that do not appear in the compulsory publication.

Issues: The current approach to the reform of the tax system is perceived as being ad hoc and largely bypassing the SME sector. Dialogue, information and consultation with government are viewed by entrepreneurs as critical to enable them to prepare for change and comply with the law. Instead, it is argued, the changes intended to put into effect the government’s SME policy commitments are often not discussed and sometimes not even publicised and disseminated.

Co-ordination of Tax Policy

15. Rating given to the tax policy co-ordination with the overall government policy	2.2
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Based on the focus group discussions, tax policy is perceived to be “poorly” co-ordinated with other government policies. It is argued that many decisions regarding SMEs support are adopted in vain because of a lack or co-ordination with other policies and programmes. This perception leads to the conclusion that tax policy is by no means designed to stimulate the SME sector:

“We have tax policies that derive mostly from the desire of the State to accumulate as much revenue as possible - this is not in line with other national policies. It results in frequent legislative change and increases the risks for SMEs.”

SME experts participating in the research suggest that, in order to improve business performance and reduce unnecessary costs, the system must be simplified. For example the frequency of tax payments must be reduced. It is argued that such a simplified tax system could be particularly beneficial in helping to reduce SMEs’ operational costs and enhance their flexibility:

“The bookkeeping and regular reports for the Fiscal Inspectorates could be substantially simplified. For instance, quarterly reports should be sufficient for SMEs. We spend so much effort keeping pace with a large number of instructions, regulations, orders, letters, etc. from the fiscal authorities, that sometimes we have the impression that bookkeeping is more important than the actual business!”

“A single, all-inclusive tax could be a very good thing for SMEs. It is a pity that the government applies the same tax system to SME as for large enterprises.”

The “patent tax” is used in the focus group discussions as an example of the benefits of implementing a unified tax system for SMEs. Some of the participants report that the Russian Federation has implemented a single tax band for all SMEs, reportedly resulting in a significant increase in tax collection, whereas:

“Moldova continues to hesitate on this issue. It is not even resolute in the implementation of policies in favour of the SME sector.”

According to the 2002 BEEPS, the two aspects of the business environment for SMEs pertaining to taxation, tax rates and tax administration are rated as moderate obstacles to doing business. They rank third and fourth in the list obstacles to SMEs activity and development and are second only to macroeconomic instability and economic policy uncertainty.

The entrepreneurs participating in the focus groups stress that the tax system penalises new enterprises:

“Taxes and duties are imposed from the very first day of operation.”

“Taxes should be lower for small enterprises at the beginning of their activity and increase gradually after one or two years of activity.”

They stress that this is the reality for SMEs, despite the fact that Article 49 of the Tax Law provides incentives for newly created SMEs. The public authorities in charge of registering firms do not instruct their clients appropriately, for example, none of the entrepreneurs from Tighina seemed to be benefiting from the national SME incentives that have been in force since 2001:

“The tax credit is well-intended, but the procedure for obtaining it is just too bureaucratic.”

“The SME sector needs stability in the tax legislation. [But] It seems that the existing procedures and tax ‘punishments’ are of greater importance than business development.”

Issues: Tax policy is not perceived to be well co-ordinated with other government policies, resulting in perceived disadvantages to the SME sector. The tax authorities need to co-ordinate their plans and activities with SMEs and their representatives. Numerous changes could be foreseen, such as the simplification of tax system for small enterprises, dissemination of information in order to enhance transparency, enhancement of take-up of tax incentives for start-ups, reduction in the reporting requirements, etc.

3.5. Financial Instruments for New and Small Businesses

The issues researched under this heading:

16. The stability, competitiveness and services of the banking system.
17. The commercial banks’ interest in extending credits to the SME sector and lending attitude with respect to the SME sector.
18. The SME access to the following main sources of finance:
 - Own/family capital.
 - Micro finance.

- Venture capital/Equity.
 - Repatriation capital (from family / friends abroad).
 - Commercial banks.
 - Leasing.
 - Credit reference sources.
 - Bank personnel skills.
 - Others (e.g. credit unions).
19. The availability of finance for SMEs at local and regional level.
20. The availability of funding for all sectors including technology companies.

Stability, Competitiveness and Services

16. Rating given to the stability, competitiveness and services provided by the banking system	3.0
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There is a relatively strong confidence among SME representatives in the stability (rating: 3.1) of the banking sector in Moldova. It obtained a rating of “satisfactory”, and similar ratings were received for the competitiveness (3.0) and the services provided (2.9) by the banking system. This assessment applies to the banking system in general, though the views of the focus group participants change, when discussing the situation with respect to the SME sector. They maintain that commercial banks have little to offer them at the present time and this is mainly because of three issues: the high interest rates charged for credit, the demanding collateral requirements to secure loans and a lack of competition between banks to finance small business activities:

“Recently, a businessman from Firladeni wanted to build a mill in his village. He presented all the papers to the bank, but quickly gave up on the idea because the interest rate was 30%. Then he applied to the Fund [State Fund to support small businesses], but this had no money at all.”

“Banks demand high interest rates for their credit and impose unbearable collateral requirements! They are unaffordable to small businesses.”

There was some discussion about the fact that although most of the commercial banks have already been privatised, there is little evidence that commercial banks actively address the financial requirements of small businesses, although a focus on micro-finance is detected:

“The only financial institution assisting the development of SMEs is MEC [Micro Enterprise Corporation]... I think that banks exaggerate the risk of lending to small businesses!”

Issues: The banking system is considered to be stable, competitive and providing useful services, but not to the SME sector. Entrepreneurs believe that commercial banks are not interested in lending to them. The interest rates and collateral requirements are considered to be excessive, partly due of the lack of competition for small businesses finance.

Banks' Interest / Attitude to SMEs

17. Rating given to the commercial banks interest in developing SMEs and their lending attitude to the SME sector	1.8
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Almost all SMEs participating in the research view the existing range of banking services available to small businesses as being limited. They also characterise the lending attitude to SMEs as being generally unfriendly and unsatisfactory. The perception is that the commercial banks are simply pursuing hard-nosed commercial interests. This, in the opinion of the SME experts, is:

“... natural for financial institutions that lost a lot of money by granting loans to certain businesses in the past...”

Bank credit is usually short-term in nature, typically not exceeding one year for SMEs; interest rates of 30% are standard for loans denominated in local currency; as are collateral requirements of 130 – 140% of the borrowed sum. The SMEs in the research are aware of the fact that commercial banks insist on such terms in order to cover the risk of non-payment, however, they were also concerned about the lending attitudes of bank officials:

“It is much easier to work with one [large] client than to work with 100 small ones.”

“Banks exaggerate the risks of lending to SMEs..., primarily because small firms do not always have real estate or other assets ... that larger companies may have.”

Banks follow the same detailed credit application procedures, irrespective of size of the sum in question:

“There is great demand for small credits in Moldova. ... In fact, there is no difference between applying for a €500,000 or a €1,000 loan. The same bundle of documents [and procedures] is required!”

In addition, even when the lending requirements are met, that the processing is usually perceived by the SMEs participating in the research to be too slow and complicated.

Issues: Banks are thought to be overly cautious and not particularly friendly to the small business sector. Entrepreneurs feel that the high interest rates and the difficulties in securing loans hinder business development. Banks are also perceived to be slow in responding to credit requests and to fail to respond differently to the different size of loan requested.

Access to Finance

18. Rating given to the access to key sources of finance and guidance on financial matters to small businesses	2.4
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All respondents concurred with the view that the financial sources available are largely restricted to individual or family capital, including relatives and friends (see table 3-1.):

“In order to start-up a business, we use our own capital. We borrow from our relatives and people working abroad. You can reach a credit agreement in one hour with these people.”

Participants, for example, from Căușeni argued that their principal source of finance is remittances – savings from people working abroad sent home to their families and relatives:

“The largest part of investment to small business derives from the people working abroad. One can obtain the necessary funds from relative and friends; this is always very simple and quick, without any formal contract, collateral, etc.”

While there is some access (rating: 2.4) to finance from commercial banks for SME, the owners and managers participating in the research argue that they are unable to guarantee the loans with collateral, and therefore, usually cannot fulfil the criteria applied by commercial banks. This leads to a perception that banks are only interested in small enterprises when such firms had no real need for them:

“Banks in Moldova have a propensity to provide you with an umbrella when the sun shines and take it away when it rains!”

The SMEs participating in the focus groups recognise that there is some access to micro financing, especially for entrepreneurs based in rural areas and focusing on the agribusiness sector. This is rated slightly better than commercial banks (rating: 2.5).

Table 3-1. Relative Importance of Main Financial Sources Accessed by SMEs

Financial Sources	Rating	Ranking
Own/family capital	3.4	1
Remittance capital	2.7	2
Micro-finance	2.5	3
Commercial bank crediting	2.4	4
Venture capital/Equity	2.4	5
Others (e.g. credit unions)	2.2	6
Leasing	2.0	7
Bank personnel skills	2.0	
Credit reference sources	2.3	

Note: The ratings used to represent the views of the entrepreneurs range from 1 to 5 and can be read as follows: 1 = very poor, 2 = poor, 3 = satisfactory, 4 = good and 5 = very good.

Leasing is considered by SMEs to be a very interesting financial tool but the entrepreneurs stress that it is not very accessible in Moldova (rating: 2.0). There was a perception that leasing operations are still underdeveloped, even though the legislation was adopted in 1996. As a result, few entrepreneurs participating in the focus groups were knowledgeable about leasing.

Boxes 3-6. and 3-7. examine respectively the sources of finance for SMEs' needs and their perception of the ease of obtaining bank loans.

Box 3-6. Sources of Finance for SMEs' Needs (BEEPS, 2002)

According to the BEEPS, the two aspects of the business environment for SMEs pertaining to finance (cost of and access to capital) are rated at almost moderate obstacles to doing business (respectively at 2.9 and 2.5). They are ranked fifth and eight in the set of 21 potential obstacles to doing business. Overall, the survey results highlight that the relative severity of the cost of credit appears to be secondary to economic policy uncertainty and macroeconomic instability, and tax issues, whereas access to finance is also secondary to corruption and business licensing. Supporting this finding, an analysis of the sources of finance used by the Moldovan entrepreneurs in the past to finance both their working capital needs and new investments shows a high reliance on internal funds and loans from family and friends. In particular 76.8% of new investments and 76.5% of working capital needs are financed through internal funds and family/friends, with local banks and equity providers playing a modest but significant role in relative terms. However, whereas all firms interviewed were able to access either internal or external sources of finance for their working capital needs, only 73% were able to obtain finance for their new investment needs. The following table presents the relevance of sources of finance used by interviewed entrepreneurs for working capital needs and to finance new investments in percentage of total.

Source of Working Capital		Source of New Investment	
Internal funds	66.9%	Internal funds	63.9%
Private local banks	10.0%	Family/Friends	12.9%
Family/Friends	9.6%	Private local banks	11.1%
Supplier credit	5.4%	Supplier credit	3.6%
Other	2.2%	Other	3.2%
Customer credit	1.7%	Customer credit	2.0%
Foreign banks	1.3%	Leasing	1.3%
State-owned banks	1.1%	Government	0.9%
Money lenders	0.7%	Money lenders	0.6%
Government	0.6%	Credit cards	0.4%
Equity	0.2%	Foreign banks	0.1%
Leasing	0.2%	State-owned banks	0.0%
Credit cards	0.0%	Equity	0.0%

**Box 3-7. SMEs Perception of Ease of Obtaining a Bank Loan
for Working Capital/Investment Needs (BEEPS, 2002)**

A further question was asked regarding the entrepreneurs' perception of the ease with which they would be able to obtain a loan from a commercial bank for both working capital needs and for financing a new investment. Despite the very positive results in the questions regarding sources of finance used, the answers from this hypothetical question still point to difficulties in dealing with the banking sector. Only 42% of entrepreneurs think it would be easy to obtain a bank loan for working capital needs and 14% are of the same opinion as regards obtaining finance for new investments. It is worth noting that SMEs believe that accessing bank loans for the financing of new investments is relatively more difficult than accessing working capital loans from banks. The entrepreneurs' responses to this question are presented below in percentage of total.

Accessing Bank Loans for	Working Capital	New Investment
Impossible	1%	12%
Very Difficult	21%	35%
Fairly Difficult	27%	27%
Fairly Easy	39%	11%
Very Easy	3%	3%
N/A	9%	12%

Issues: Typical of most countries in SEE, the main source of finance accessed by SMEs is own/family capital, followed by remittance capital. Entrepreneurs perceive accessing credit from formal sources such as commercial banks and to a lesser degree micro-finance institutions as difficult. Other forms of credit are largely unavailable.

Access at Local and Regional Levels

19. Rating given to the access to finance at **local and regional levels**

2.4

The support offered to entrepreneurs at local and regional level is almost non-existent in Moldova. The entrepreneurs think that:

“Sub-national governments are themselves trapped into a vicious circle of being under-funded ..., which means that they are still unwilling to carve a larger role in supporting SMEs.”

Although such bodies generally lack funding, there is a perception that there are some programmes and funds at the regional level in support of small enterprise development. The role of family credit and remittances in assisting start-ups is argued to be even more significant in remote areas of the country.

Issues: Due to budget constraints, the scope for local and regional governments to assist the creation of a viable and effective SME community is limited.

Access by sector

20. Rating given to the access to **financial sources** for **all sectors** including technology companies

2.2

Entrepreneurs think that financial institutions prioritise the more traditional sectors of the economy, such as agriculture and food processing:

“Yes, there are some programmes to support farmers; some foreign investments targeting landowners in the countryside, but there is very little done to stimulate manufacturing.”

The representatives of newly established companies, such as hi-tech enterprises, feel that they cannot necessarily value their companies on the basis of real estate or other tangible assets, with the consequence that they are unable to justify their investment projects and are thus ineligible for bank credit:

“The intellectual capacity of such companies cannot be quantified by traditional valuation methods and cannot easily be presented as collateral.”

“Banks exaggerate the risks... particularly when the applicants are new, small businesses, or belong to the so-called ‘new age’ economy, primarily because these firms do not always have well defined real estate as other companies ... may have.”

Issues: Not all sector of economic activity appear to benefit in terms of access to finance. Entrepreneurs believe that the agricultural and food-processing sector benefits more than other sectors from bank finance.

3.6. Advisory Services for New and Small Businesses

The issues researched under this heading:

21. Satisfaction with the range and quality of advisory services available to new entrepreneurs and SMEs and rating of the present services and comment on the changes needed.
22. Efficiency of advisory services operations.
23. Responsiveness of advisory services provided to demand and the needs of enterprises.
24. The skills, experience and quality of the staff providing business advisory services.
25. The continuity of business advisory services available.

Range of Advisory Services

21. Rating given to the satisfaction with the range of advisory services available to new entrepreneurs and SMEs	2.6
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Almost all business advisory services focusing on SME clients, such the Association of Small Business, Moldo-American Centre for Private initiative (MACIP) and the Centre for Economic Training and Assistance (CIAE), were established as a result of international donor projects (see section 4.5). There is also a national network of the Chambers of Commerce and Industry providing business assistance at the branch level. Business advisory services have been established in the last decade and focus on the start-up and SME market niche. They tend to suffer from the ubiquitous problem of achieving financial sustainability, which in turn affects the range of services available to their target group:

“We have not received finance from international grants for six years, so we try to survive from the income we generate. It is not easy to be profitable by providing consulting services in Moldova’s economic conditions.”

The SME experts interviewed maintain that in the last couple of years, private business consultancies have also been established. Their services are delivered on a commercial basis and hence not necessarily targeted or accessible to start-ups or newly established SMEs:

“There are some experienced consultants, lawyers, tax and audit experts working with these consultancies ... a basic consultancy infrastructure certainly exists, but the lack of funds [available to small businesses to pay for such consultants] limits the influence they can have on the SME market.”

Based on the focus group discussions, the general perception is that the range and quality of advisory services available to start-ups and existing SMEs approaches the “satisfactory” (2.6) rating. The SME entrepreneurs feel that they also have to rely on their own initiative:

“Yes, there is plenty of literature on business issues, but I think we need something else. For instance, how to write a business plan, negotiate a good business contract, or plan future investments. I cannot say that there is plenty on offer to us.”

Furthermore, the entrepreneurs participating in the focus group discussions think that the support that exists tends to be provided for agriculture, echoing an earlier discussion with respect to the sectors of economic activity that tend to be financed:

“In the Ștefan Vodă District alone, we have four or five consultancy services for farmers, but nothing at all for activities such as manufacturing, services and [other] industries.”

This focus on agriculture is considered to be symptomatic of a general lack of national policy focus with regard to the provision of business advisory services for potential or embryonic firms. Entrepreneurs think that with the exception of foreign programmes for SME assistance, the Government is not very supportive of small businesses in a systematic manner:

“The State has never been interested in having comprehensive business advisory services; the contribution of the State ... is absent or very limited.”

Issues: There is a growing range of business advisory services, including commercial provision, but the services on offer in this market niche are in need of development. There is a perception that Government has not sought to influence the development of this sector and that the existing provision tends to be either financially unsustainable or skewed towards the agricultural sector.

Efficiency of Advisory Services

22. Rating given to the efficiency of advisory services available to SMEs	2.6
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The efficiency of the business advisory services available to SMEs is also considered to be close to “satisfactory”. It is thought that the private sector consultancies tend to be fairly good, in the sense that they have to be sensitive to what clients are prepared to pay for and ensure that they deliver value for money. Nevertheless, the entrepreneurs felt that advisory services, such as training, are not always commensurate with their needs and that there are important elements that should be improved:

“We expect these organisations to do much more than just look at the legislation for us. For the fees required for these services, they should identify solutions to my problems. Presently, we have firms that provide general information, but take no responsibility for its validity.”

According to the views expressed in the focus groups, there is a need for further development of the consultancy environment for SMEs, so as to enhance the efficiency of the advisory services.

Issues: Improvement in the quality and effectiveness of the business advisory services on offer is needed. If this does not happen business advisors risk losing credibility, thus affecting their chance of achieving financial sustainability in the long term.

Responsiveness to Demand

23. Rating given to the responsiveness of advisory services to demand and needs	2.7
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SME entrepreneurs related examples of useful consultancy services received, resulting in an acknowledgement that such services can be responsive to their demands and needs. But it was also noted that changes in demand were not always followed by appropriate adjustments of what is on offer. A recurring theme in the focus groups is that Moldovan companies are now beyond the stage of being satisfied with basic information provision and demand more sophisticated business services:

“By consultancy, we do not mean the publication of reports on abstract matters, but the delivery of specialised services that can significantly improve the quality of our management and provide us with tools for dealing with taxes and other issues.”

A constraint to the ability of the existing providers to be responsive to entrepreneurs’ demands is simply that most such organisations tend to be located in Chişinău. They are almost non-existent in Bălţi and other rural or more remote areas of Moldova.

Issues: The responsiveness to SME demands for services is rated close to “satisfactory”. Nevertheless, entrepreneurs think that the supply of these services needs to reflect the fact that firms’ needs are changing and becoming more sophisticated. The demand for business services will not be met effectively so long as the advisory services remain concentrated in the capital city and focused on the agricultural sector.

Human Capital

24. Rating given to the skills, experience and quality of the staff providing advisory services	3.0
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The skills, experience and quality of the staff operating in this sector are rated “satisfactory”. At the same time, the general perception, particularly when the participants discuss the issue of having to pay for the services rendered, is that the quality of the human resources in such organisations, based on their skills and experience, are not entirely adequate. The reasons advanced as to why this may be the case, include:

“The lack of qualified staff and relatively low salaries do not attract good experts.”

“Consultancy firms are unable to hire the best consultants because they cannot afford to pay their wages. As a result, the most skilled people have to keep other jobs ... the result is that their commitment is lower.”

With regard to the public provision of business advisory services at national and local level, the entrepreneurs participating in the focus groups think that the State does not always employ people with the skills to implement SME development policies:

“Experienced and well-trained people are [often] ignored, despite the obvious difficulties in finding skilled people for the strategic field of economic development.”

Issues: Despite giving a “satisfactory” rating for the skills, experience and quality to those delivering advisory services, the discussion reveals a strong perception that there is need for substantial improvement in this area. There is a perception that both the demand and willingness to pay for such services need to increase, in order to attract well-qualified staff to this sector.

Continuity of Provision

25. Rating given to the continuity of advisory services available	2.8
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The issue of continuity of business advisory services available emerges as an important issue. A key concern of the entrepreneurs was that there is neither the infrastructure nor the institutions to provide sufficient support to the SME sector development:

“We have very good intentions but few practical achievements. Last week ... over 40 entrepreneurs from our region [Tighina] indicated that they expected regional authorities to set-up business advisory service ... Creating new business, management courses and specialised training ... have to be the priorities for such a centre. We do not have access to such services.”

A recurring theme is that participants think that the public authorities lack relevant information on the SME sector, as well as the knowledge of the problems faced by the private sector:

“I have repeatedly asked the Ministry of Economy ... for information and never received relevant information. I had the impression that it has a very narrow focus and ... interest. This may explain why the State does not have its own network of business advisory agencies.”

The key on-going concern regarding the continuity of provision of business advisory services relates to the financial sustainability of these organisations. The international donor community has been active in supporting various SME development programmes, however, it remains to be seen whether these will be sufficiently well established to continue delivering assistance to start-ups and early growth firms.

Issues: Most of the advisory service provision comes from the private sector or from the international community. Private sector provision tends to focus on the capital city and to target established firms that are able to pay commercial fees. Public provision of advisory services is expected to become independent of donor funding by charging for their services. It remains unclear if, when and how this will happen. There is little State provision of business advisory services at national, regional or local level.

3.7. Business Incubators

The issues examined under this heading were:

26. Experience with business incubators and importance to new entrepreneurs and existing SMEs.
27. The efficiency of the government policy and programme encouraging business incubators.
28. The state of the business incubators' governance structures.
29. The locations, the infrastructure and facilities of business incubators.
30. The extent to which the business incubators' activities are focussed on the needs of the local entrepreneurs.
31. The extent to which the operating conditions, services and charges are transparent and clear.

Experience of Business Incubators

26. Rating given to the business incubators' importance to new entrepreneurs and existing SMEs	2.8
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Since only one business incubator is active in Moldova and the participants in the research did not have direct experience of it, the views and perceptions reported in this section should be treated as being no more than indicative. The SME representatives participating in the research rate the importance of business incubators to new and existing entrepreneurs close to “satisfactory”, although in reality, most of them make it clear in the discussions that they have “heard” very little about them:

“We do not know much about incubators. I have read somewhere about them but I have no idea what they do. They do not exist in our country.”

“Business incubators represent an example or a kind of School of Good Management. We anticipate the Bălți incubator to be replicated in other regions ... to provide good practice to others throughout the country.”

There is a consensus that business incubators could have a positive impact on business development in Moldova, especially on start-ups and early growth SMEs. Nevertheless, the scope for joining business incubators is regarded as very limited at present.

Issues: Entrepreneurs are convinced that they could benefit from business incubators but there is presently very little relevant information about them. Where such information exists, it could be disseminated to SME stakeholders such as local authorities and the wider SMEs sector.

Government Policy

27. Rating given to the efficiency of the government policy encouraging business incubators	2.1
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The perception, based on the focus group discussions, is that there is also little information about the Government policy for business incubators. The participants were not aware of a policy on business incubators or even of good practice information, for example, based on the experience of the first and only business incubator in the country. By contrast, some of the entrepreneurs participating in the research are aware of the experience of business incubators in Central and Eastern European countries and are impressed with the way others have been able to establish business incubators.

Issues: There is a distinct lack of information on the policy towards business incubators in Moldova. The experience of the Bălți business incubator should be evaluated and good practice disseminated.

Governance Structures; Locations, the infrastructure and facilities; Focus on Needs; Transparency

Due to the lack of specific knowledge by participants, no feedback was obtained on these issues.

Chapter 4.

ANALYSIS AND ASSESSMENT

This chapter presents the OECD-EBRD analysis and assessment of the six dimensions of good practice for the business environment based on the research undertaken. It reviews the current situation in each of these areas, takes into account OECD and EBRD studies and analyses of good practice, and the private sector views, based on the preceding qualitative research with the owners and managers of SMEs. The assessment leads to a series of recommendations by the OECD and EBRD, presented in Chapter 1.

4.1. Implementation of the Institutional Framework for SME Policy

The Situation on the Institutional Framework

The most important institution dealing with SME development is the *Ministry of Economy*. In 1997, a specialised Department for Small Businesses was established within the Ministry to develop and co-ordinate national policy on small business development and support. The department was subsequently reorganised in 1999 into the Department for Support of Small Businesses but the staff complement and functions remained unchanged. In 2002, the Department for SMEs was converted into the *Division for SMEs*, with a planned increase in the number of employees to 10 by 2005. Given that the State administration is in the process of being downsized, it is unclear whether this target will be attained.

The functions of the new Division for SMEs are as follows:

- Analyse SME developments and effectiveness of support measures.
- Develop proposals for new laws to stimulate small businesses and private initiative, improve the legislative framework (including the legal, economic and institutional mechanisms).
- Encourage creation of SMEs infrastructure (economic, legal, statistical, etc.).
- Encourage financial and fiscal support systems for small businesses.
- Develop training programmes targeted at small business owners and managers.
- Collaborate with relevant stakeholders in identifying measures to support small businesses.

The institutional instability with respect to the key organisations responsible for SME policy development in Moldova appears to be attributed to the fact that frequent changes in Government were typically followed by the introduction of new programmes regarding the structure of the Ministry of Economy, which in turn affected the degree of continuity of SME activities.

The fact that the resource base for SME activities remains limited and uncertain means that the latest institutional structure similarly risks being unable to influence SME development in a proactive and continuing manner. The Division for SMEs aims to create an *Agency for Small Business Development* by 2005, with the objective of ensuring the efficient monitoring and implementation of SME programmes, as well as the promotion of effective policies to support and develop the private sector. It is not clear at this stage if this Agency will be created, or indeed whether it will have adequate resources and capacity to undertake its expected remit.

The *Chamber of Licensing* and the *Chamber of Registration* perform a number of regulatory functions with respect to the enterprise sector. As the name implies, the Chamber of Registration deals with company registration, issues state registration certificates and deals with the National Register. The Chamber of Licensing issues licences for different types of entrepreneurial activity. There is no institutional connection between the Ministry of Economy and the two Chambers, however, they are expected to co-ordinate their programmes and policies in the field of SME on a regular basis. Based on a Government Decision, the Ministry of Economy plays the leading role in co-ordinating activities relating to SME development.

Several other ministries have an influence on SME development, such as the Ministry of Finance, the Customs Department, the Department of Privatisation, the Ministry of Industry, the Ministry of Labour and Social Protection and the Ministry of Education. Although they do not participate in the direct formulation and implementation of policies on SME development, it is nevertheless important that the SME Division co-ordinates policy development with the relevant governmental agencies and ministries.

Responsibility for the development and implementation of regional policies for small business development is allocated to 11 County Council *Departments for SME Development* (plus an autonomous region, known also as the Gagauz Yeri administrative territory), formed by a 1999 Government Decision reforming the territorial administration. The Departments for SME Development receive support from the County Councils, according to their respective financial capacity and the level of political commitment to strengthening SME activities at the regional level. The fact that, for example Tighina, Lapusna and Chişinău Counties, set aside (modest) financial resources is a positive development. Tighina County has gone as far as supporting an SME Consulting Centre focusing on its region. As a rule, these departments are not subordinated to the Ministry of Economy, which has only a general role in co-ordination, programming and guiding their activities.

In August 2001, the Moldovan Government approved a *State Programme to Support SMEs (2002 – 2005) “State Programme”*. This programme stipulates a number of policies and actions (see below) designed to increase SMEs’ share of the national economy. The State Programme argued that national policies: “... must create a stable and favourable framework for the development of micro-enterprises and small enterprises” (Ministry of Economy, 2001, p.1). By adopting the State Programme, the Ministry of Economy’s Division for SMEs was mandated to co-ordinate the fulfilment of the measures with other relevant institutions and to present annual progress reports. The State Programme sets out six components in need of support:

- Creation of a business environment favourable to the development of small businesses.
- Investment support for small enterprises through improved financial instruments.
- Improvement and development of the infrastructure for the support of small businesses.
- Training for small enterprises.
- Development of a culture of entrepreneurship among small businesses.
- Integration of the Intellectual Property system to support the development of small businesses.

An Action Plan has also been prepared to accomplish the State Programme. In addition, the Government intends to develop a *Strategy of Economic Growth and Poverty Reduction (SEGPR)* in 2003, including the promotion of new policies to stimulate SME development by ensuring favourable conditions for economic growth, increasing the employment rate and improving living standards. The strategy has been drafted with the participation of civil society, including consultation with NGOs and international organisations such as the World Bank, IMF, UNDP and TACIS.

Assessment

The Moldovan Government has sought to develop an institutional framework for SMEs. The Ministry of Economy has been assigned the responsibility for this area of activity, leading ultimately to the creation of a Division for SMEs, albeit with limited staff and resources to implement SME policies and

programmes. However, there has been a good deal of institutional change and reform in recent years resulting in institutional instability. Given this context, the SME owners and managers participating in the research do not yet perceive that Government has assigned clear organisational responsibility for the development of the SME sector and are highly critical of the effectiveness of the institutions designed to support them.

The Ministry for Economy has been assigned the leading role in co-ordinating activities relating to SME development. This requires the ministry to co-operate closely with the Chamber of Licensing and the Chamber of Registration in ensuring that their functioning improves over time, with respect to the enterprise sector. In addition, several other ministries have a direct bearing on SME development, such as the Ministry of Finance, Department of Privatisation, Ministry of Industry, etc. The Ministry of Economy must be active in ensuring that the policy promoted by these agencies and ministries operate to the benefit of small enterprises. There is little evidence that this is happening at present.

Partly as a result of the limited staff and financial resources at the Ministry of Economy's disposal, the creation of an Agency for Small Business Development is being planned, whose role would be to implement SME policies, strategies and programmes, thus assisting the development of private enterprise. Although this seems a positive development, experience elsewhere in SEE suggests that for such organisations to work effectively, they need to have a clear rationale and relationship with the Ministry they report to, secured funding for the medium term (for both operational and programming) and the right balance of skills and experience in order to fulfil their mandate. It is not at all certain that these issues have been adequately considered, resulting in the danger that Moldova may repeat the mistakes of other countries in SEE or fail to use the substantial body of good practice that has built up.

There is no shortage of national programmes (e.g. State Programme to Support SMEs, 2002 – 2005, strategies (e.g. Strategy of Economic Growth and Poverty Reduction), action plans (e.g. Action Plan linked to the State Programme for SMEs), etc. designed to assist economic development, including a focus on small enterprise development. Rather, the issue is the degree to which these activities are integrated, co-ordinated, implemented, resourced, monitored and evaluated. The feedback obtained from SMEs and experts suggests that despite the existence of the national programmes and action plans, the Government SME policy is perceived to be not adequately articulated and focused on issues that are not necessarily the entrepreneurs' priorities. Thus the framework to guide the development of the SME sector is considered to be inappropriate.

A further issue of importance, linked to perceptions associated with the Government's existing SME documents, is that the current level of co-operation and communication between the SME sector and specialised department of the Ministry of Economy is non-existent. The result is that policies for small business support are thought to be created by public officials, without appropriate consultation with SME stakeholders. Entrepreneurs, particularly those located outside the capital city, perceive that they are largely neglected by Government. Consideration needs to be given to the development of representative and effective mechanisms to obtain feedback on policies, strategies and other significant developments affecting enterprises.

Entrepreneurs in Moldova are highly critical of public officials at national, regional and local level. There is a strong perception that they do not yet possess the constructive attitude or the skills and knowledge to assist the development of the SME sector. This lack of confidence is reflected in the fact that entrepreneurs do not even consider that they are adequately informed of the institutions, policies and programmes that exist in Moldova to assist them to establish and grow their businesses. Public officials' understanding of the role of entrepreneurship and enterprise development should be enhanced.

4.2. Implementation of the Rule of Law and the Regulatory Environment

The Situation on the Rule of Law and the Regulatory Environment

New businesses must register at the *Chamber of Registration*, which is subordinated to the Department of Information Technology. In creating a specialised body for registering companies, the state assigned to the Chamber of Registration the task of simplifying existing procedures and of ensuring that the registration of enterprises is carried out in the National Register. In theory, after submitting all necessary documentation, firms are registered quickly. In theory it is also possible for entrepreneurs to submit the registration papers by mail, but according to feedback in practice, this is not the case.

Aside from the formal procedures for company registration, the law on *Registration of Enterprises and Organisations* stipulates the procedures for modifying the foundation documents, maintaining a unified database of all registered entities by the Chamber, as well as the process for de-registering firms. The company registration procedure should last on average 10 days from the moment that all the necessary papers are submitted to the Chamber of Registration. All the documents for registration are supposed to be completed at the Chamber and the expenses for this procedure officially amount to 250 lei (€17) for the registration of an individual enterprise and 500 lei (€34) for the registration of a Limited Liability Company. In emergency situations, it is possible to register enterprises within 3 days for double the fee.

However, according to a World Bank study on the costs of doing business (ARIA, 2002), the registration of new companies lasted on average 23 days and the costs amounted to €141 on average. Approximately 60% of the SMEs participating in the research felt that the registration procedure had become increasingly difficult during the preceding year; they spend 19% more time just to ensure they comply with the new registration requirements; and the procedures for obtaining licenses or permits last on average 29 days.

According to the legislation, in addition to the business registration procedure, enterprises must also obtain licenses for certain types of activities. The existing Law on Licensing includes 57 activities that are subject to licensing, in comparison with 300 activities in 1995. In 2002, a new licensing procedure was approved under which, the Chamber of Licensing was expected to replace the 23 state bodies that had this responsibility. This positive reform does not appear to have been implemented effectively, since most firms applying for licenses or registration must still apply to those same bodies for additional papers or information. The *Chamber of Licensing* also created a single national *Registry of Licenses*, which includes information on all types of licenses in Moldova. The official set of documents requested by the Chamber of Licensing ranges from 4 to 21 mandatory documents, depending on the type of activity. The Government's efforts to simplify licensing and unify the process within a single institution have yet to deliver the benefits expected by small businesses since the establishment of the Chamber of Licensing has not eliminated the need for entrepreneurs to deal with broadly the same range of bodies as before. The most positive aspect of the reform is that the licenses are normally valid for up to five years, resulting in time and money savings to enterprises.

Moldova has 30 *certificate-insuring and inspection bodies* and over 100 specialised laboratories accredited by the Licensing Chamber. The complex range of governmental institutions include: the Ministry of Finance (state tax service); the Ministry of Environment and Territorial Development (State Inspection of Construction and State Environmental Inspection); the Ministry of Health (State Sanitary Service, Pharmaceutical State Inspection); the Ministry of Agriculture and Processing Industry (State Veterinarian Inspection, Seed Inspection, Selection and Production, Cereal Products, Supervision of Alcoholic Production); the Department for Technical Control, Standardisation and Metrology; the Department of Civil Protection and Emergency Situations; the Department for Statistics and Sociology and the Department for Combating Corruption and Organised Crime.

The Government had made some progress in reducing the number of inspections. Governmental Decision (No.1081 / 2000) on the *Co-ordination of Monitoring of Firm Activities*, provided for the simplification

and reduction of the number of controls and the creation of a register of inspections. However, the most essential problem remains, namely that there are 20 types of controls performed by bodies such as the Veterinarian, Sanitary, Fire Inspections, Municipal Police and the newly created Department for Combating Corruption and Organised Crime. Unfortunately, the Governmental Decision was suspended in December 2002.

The procedures for de-registering enterprises remain complex, lengthy and expensive (ARIA, 2002). The Bankruptcy Law adopted in 1996 and amended in 2002 determines the bankruptcy procedure. Despite the recent changes in legislation, the bankruptcy procedure remains lengthy and costly, discouraging entrepreneurs from going down this path.

There is no official programme for simplification of the business environment in Moldova at present.

An excessive regulatory environment generates scope for rent-seeking behaviour. Officials can find various ways of extracting rents for such things as license extension, acceleration of procedures and generally using any pretext to slow down or impede the licensing process. According to research (Transparency International, 2002) approximately 33% of companies paid bribes in 1999 and 38% did so in 2002. It is recognised that: “corruption has penetrated the State structures and has become a way of life at both central and local levels.” (Ministry of Internal Affairs, letter, 2000). According to the Transparency International Corruption Index, Moldova is amongst the countries with a high index of corruption (2.6 on a scale between 0 and 10, with the latter representing a lack of corruption). It is ranked 76th out of 90 surveyed states, after the Ukraine.

In November 1999, the Government adopted (Decision Nr. 1017) a *State Programme to Fight Criminality, Corruption and Nepotism* for the period 1999 – 2002 and a new programme to curb corruption and criminality is being developed by the Ministry of Internal Affairs for the period 2003 – 2005. Successive Governments have developed their own initiatives (in 1998, 1999, 2001 and 2003) in an attempt to reduce the pervasive impact of this phenomenon, but with little apparent impact as far as entrepreneurs are concerned.

Assessment

SMEs operate in an unclear and unstable regulatory framework. The excessive number of laws, governmental decisions, regulations and other rules, often unclear and contradictory in nature, make it very difficult for entrepreneurs seeking to set-up new businesses, and indeed established small business, to maintain their operations. In summary, the procedures for registering enterprises and issuing permits, licences and certificates are bureaucratic, time-consuming, expensive and are often associated with corrupt practices.

Government has made efforts to tackle this situation through reforms such as the introduction of the Chamber of Licensing and the Chamber of Registration, and the associated Registration of Enterprises and Organisations. Despite the official targets for registration, licensing and the associated costs of doing so, the reforms have had unintended effects. Rather than having a “one-stop-shop”, entrepreneurs must not only go to the new Chambers but also, just as they had to prior to the introduction of the reforms, the various ministries and government agencies. The result is that the reforms are even less transparent and more time, cost and effort is required. The “one-stop-shop” concept may not have worked out in Moldova but this does not detract from its potential, if appropriately designed and effectively implemented.

The degree of over-regulation that exists is complemented by a degree of over-complexity with respect to certification and inspection institutions. Given the Government’s wider efforts to streamline government administration, these bodies are in need of evaluation and rationalisation. SMEs view the controls and inspections regimes as being both unpredictable and punitive. The level of complexity and inconsistency involved in the registration, regulatory and inspection systems, combined with the lack of success with the previous package of reforms calls for Government leadership and commitment in order to simplify the business environment. Experience elsewhere in SEE suggests that a way forward would be

to establish an Inter-Ministerial Business Simplification Task Force to ensure appropriate reform design and effective implementation. This would need to be backed-up with political commitment, funding and technical assistance in order to make progress.

Successive anti-corruption plans and programmes have been developed in Moldova, however, apparently corruption remains pervasive and the associated cost to businesses is enormous. The private sector remains sceptical about the level of success achieved thus far. In particular there are doubts about the willingness of the various levels of public administration to really stamp-out corrupt practices. This issue, combined with the extreme estimated levels of the grey economy, creates an almost intolerable burden for enterprises, especially due to the consequent unfair competition that legally established small firms suffer from. More attention needs to be focused on both of these issues.

The business community feels largely cut out of the process of regulatory and legal reform. There is currently no mechanism for regularly obtaining feedback on draft new laws or proposed reforms to existing laws, even though this is increasingly becoming standard practice elsewhere in the SEE region. Consultation with SMEs and their representatives on new laws that have direct impact on SME activities is rare. On the occasions when it does occur, there is little confidence that entrepreneurs' views will be considered seriously. Government should implement mechanisms to consult with private sector representatives about legal and regulatory changes as a matter of course, since these directly affect businesses. This would also help to overcome the perception that Government is not actively engaged in reducing regulatory barriers to doing business.

4.3. Implementation of Tax Policy for Small Businesses

The Situation on Taxation Policy for Smaller Businesses

The *Ministry of Finance* is responsible for tax law, policy and administration. The Moldovan fiscal system is determined by legislation such as the Tax law, the State Budget law (for the relevant year), Local Taxes law, etc. Since January 1998, Moldova has sought to implement a new tax system (as well as accounting system) that is more in tune with international standards and practices.

Fiscal policies can stimulate the expansion of economic activity. According to official data, the *overall tax burden* has declined from 34% in 1995 to about 26% in 2000 (Department for Statistics and Sociology, www.statistica.md). Nevertheless, according to the Centre for Market Research, the tax burden on small enterprises is relatively higher than in other sectors of the national economy (2002, p.33).

Enterprises pay a variety of taxes and duties stipulated by the law on Local Taxes (186 / 1994), such as: corporate tax (25%), value added tax (20%), excise tax, other national taxes (such as customs duties, road tax, etc.), and local taxes and duties (such as real estate, territory development, commercial units, passenger transportation, natural resources, hotels, advertisement, markets, etc.). This amounts to a complex fiscal environment, which is particularly difficult for small enterprises to keep abreast of, and comply with.

VAT is paid on goods and services at every phase of circulation from the manufacturer to the final consumer. Firms whose revenue in the previous 12 months exceeded MD Lei 100,000 (about €7,225) are required to register for VAT. The new fiscal invoicing for VAT has contributed to an improvement in record keeping, but not the procedures for obtaining VAT refunds. The overall process remains complicated, requiring a large amount of documentation before VAT refunds are made, with negative consequences for the cash flow for firms because of the delays.

Employee contributions/salaries are also subject to taxation. According to the Tax Code, income tax is progressive: 10% for salaries of MDL 0-12,180 (€880), 15% for salaries of MDL 12,180-16,200 (€880 - €1,170), and 25% for salaries of more than MDL 16,200 (€1,170). All residents are required to submit an annual income tax declaration (Tax Code, Art.83).

The *reporting system* is complicated and imposes an additional compliance burden on small enterprises. There are different timeframes and reporting frequencies involved, as shown in table 4-1.

Table 4-1. **Moldovan Fiscal Reporting Requirements**

Monthly	Deadlines	Reporting to:
On salary / income	By the 10th	Regional tax office
On income tax withheld at the payment source	By the 30th	Regional tax office
On VAT statement	By the 30th	Regional tax office
Quarterly	Deadlines	Reporting to:
Tax on water	By the 20th	"Aqua" / Regional tax office
On local taxes and tax collections	By the 20th	Regional tax office
On salaries / income	By the 10th	Regional tax office
On real estate	By the 30th	Regional tax office
On social insurance contributions	By 16th, 20th	National territorial cash box
Balance with appendices	By the 25th	Department of statistics
Annual	Deadlines	Reporting to:
On income tax withheld from physical entities	By the 30th of January	Regional tax office
On income tax withheld from legal entities	By the 30th of January	Regional tax office
Income tax statement	By the 31st of March	Regional tax office
Balance with appendices	By the 25th of March	Department of statistics

These reporting requirements amount to a great deal of paperwork for enterprises. Micro enterprises typically complete 400 forms annually in order to comply with the complex rules and procedures. Many SMEs are forced to hire full-time accountants to be sure that they do not unintentionally fall foul of government requirements.

Tax Code (Art. 49) stipulates that *SMEs can obtain a tax holiday* for a period of up to three years, if the average annual number of employees does not exceed 19 and the annual turnover does not exceed MDL 3 million (€217,000). If the above criteria are met, SMEs may sign an agreement with the State Taxation Service enabling them to benefit from the incentive, however, a minimum of 80% of the tax benefit must be reinvested on products, services and job creation. At the end of the three-year period, SMEs have the right to a 35% reduction in income tax for a further period of two years, as long as the number of employees increases by at least 20% compared to the previous year. Small enterprises with *foreign investment* have the right to a 50% reduction of the income tax for a period of five years as long as the foreign investment exceeds €225,000 and over 50% of the gross income is generated from trading in products and services.

Despite this tax incentive, the number of SMEs applying for this facility still remains very low. Few entrepreneurs get as far as signing agreements with the State Taxation Service, thus failing to take advantage of these incentives. It appears that the main reasons include a lack of knowledge and information about this facility, low levels of professionalism amongst tax inspectors and occasionally, an active attempt to complicate the application process. This situation needs to be tackled as a matter of urgency.

The *grey economy* is estimated to represent about 60-65% of Gross Domestic Product (GDP), according to Transparency International (2002). The same source maintains that the most important obstacles to business development are tax regulations, corruption and unpredictable changes in regulations. The complexity of tax regulations and the procedures for SMEs, the frequent modifications of the legislation, the corruption in the fiscal administration system and the extensive inspections affect negatively the development of small businesses and may encourage entrepreneurs to operate in the shadow economy.

Assessment

Small businesses are looking for stability, simplicity and transparency in the fiscal system (OECD-UNIDO, 1999). A simple, clear and stable tax system, with a fiscal burden that corresponds with the current

level of economic development, should be the guiding principles for the fiscal agenda. At present, this is far from being achieved in Moldova. Whilst acknowledging the progress made, such as the reduction in the tax burden and the introduction of the patent tax, the enterprises participating in the research were exceedingly critical of the tax system, highlighting an urgent need for assessment and reform of the fiscal system and administration.

A number of observations suffice to highlight the problems faced by enterprises in Moldova, especially small enterprises, resulting in undue compliance costs:

- The fiscal system changes very often, resulting in great business uncertainty for enterprises.
- The number of taxes affecting small businesses is excessively large and requires streamlining.
- The taxes involve either pre-payment or frequent payment, adding to the burden of small enterprises and affecting cash flow. Pre-paid taxes operate irrespective of the trading situation of new or recently established enterprises, thus jeopardising viability of certain enterprises.
- The slow and bureaucratic VAT refund system potentially jeopardises the viability of vulnerable firms.
- The statistical and tax information/monitoring/reporting gathering process is excessive and in need of streamlining.
- SME tax incentives are systematically not taken-up by SMEs due to lack of information, lack of training and/or obstruction and bureaucracy.
- The tax rules and regulations are ambiguous, resulting in lack of transparency that can be abused. The practice of issuing “internal rules” for inspectorates adds to the lack of transparency.
- There is a deep mistrust of fiscal authorities, especially when inspections are made. This is because of the expectations of fines that are certain to follow, regardless of the merits of the situation.
- There is almost no consultation between enterprises and the Government on tax policy and tax administration. Firms typically find out about changes when these are printed in the “Monitorul Oficial”. Not all changes are published and openly available; some are retroactive in nature.
- There is insufficient co-ordination between tax policy and other aspects of economic policy relating to SME development.
- The grey economy is extensive and is partly intensified by the problems highlighted above. The degree of unfair competition that results vis-à-vis companies operating legally, is a major factor inhibiting more dynamic business development and job creation in the formal economy.

It should be noted that the government is making some efforts to improve the situation, as illustrated by the introduction of the patent tax. The problems are emphasised by the lack of good governance in the relevant state institutions as well as the ineffective tax administration infrastructure.

4.4. Implementation of Financial Instruments for Fostering Small Businesses

The Situation on Financial Instruments

In a difficult economic environment characterised by a tough investment climate, a poor track record with reforms and slow progress in enterprise restructuring, the financial sector stands out as a relatively well performing part of the economy. The sector has benefited from improved banking regulation and sound monetary policies that have seen the exchange rate stabilise and inflation fall to single digit figures. Nevertheless, the level of financial intermediation remains low, and the range of financial services available to entrepreneurs is limited. Domestic credit is a modest 30% of GDP, with a mere 17.6% of GDP going to the private sector (see table 4-2).

The financial sector is dominated by the 16 commercial banks, and in particular by the five largest banks which account for over 70% of banking sector assets. Most of the larger banks originally were Moldovan branches of the specialised banks of the former Soviet Union. The foreign presence in the banking system is still low, even though the banking system has been opened to foreign competition. Only two subsidiaries of foreign banks are active in the country, Banca Comerciala Romana (a full subsidiary of the Romanian bank) and Unibank (fully owned by Petrocommerce, Russia).

Table 4-2. Domestic Credit (in % of GDP)

	1997	1998	1999	2000	2001	2002
Domestic Credit	22.9	28.8	25.6	22.7	25.4	29.7
Domestic Credit to Private Sector	6.1	12.3	10.6	11.4	13.7	17.6

Source: IMF.

Buoyed by falling interest rates and high liquidity, local commercial banks have stepped up their lending activities considerably over the last few years. Their loan portfolio has grown by 37.6% in 2001 and a further 34% in 2002. However, it is estimated that only 12% of the banks loan portfolio is directed to SMEs and that these loans are almost completely concentrated around the capital city of Chişinău.

Commercial SME finance: A number of commercial banks are actively lending to SMEs, including *Moldova-Agroindbank (MAIB)*, *Victoriabank*, *Eximbank*, *Mobiasbanca*, *Banca Sociala*, *Banca de Economi*, and *Moldindconbank*. In banks like MAIB, the SME business now accounts for close to 50% of total lending. However, many of them rely on international financial institutions to support their SME business and benefit from dedicated SME credit lines. MAIB and Victoriabank, for example, have received SME credit lines from the EBRD worth €16.5 million and €7.2 million respectively. The two lines are fully disbursed and were used to provide medium-term financing to more than 90 enterprises, at an average loan size of €263,000.

Trade finance: Trade finance is available from *Victoriabank*, *MAIB*, *Moldindconbank* and *Mobiasbanca*. These four banks participate as issuing banks in the EBRD trade facilitation programme and can provide documented credit to Moldovan import and export companies. The total commitment to the four banks under the programme amounts to just over €7 million.

Micro-finance: With the support of the EBRD, banks like MAIB, *Universal Bank* and *Victoriabank* have expanded into micro-finance, but their programmes are small and not yet well established. Under the Swiss-Micro Finance Programme, a total of 696 loans were disbursed by these banks (and Mobiasbank) between 1996 and 2001. The Programme was affected by the Russian crisis, though even before this crisis the number of loans disbursed per month had reached a maximum of only 48 loans for all partner banks. Arrears were high and after the completion of the Programme only MAIB continued lending to micro-enterprises, although with limited scale and outreach. Most commercial banks do not have the experience or the technology to effectively serve micro-enterprises.

The only financial institution explicitly targeting micro-enterprises is the *Micro Enterprise Company (MEC)*. Owned by IFIs¹, bilateral donors and related investors, MEC operates as a finance company since the high minimum capital requirements for banks in Moldova would make it commercially impossible to run it as a bank. It currently operates in seven regional centres and extends 271 loans per month on average. Between its creation in December 1999 and end 2002, it extended 2,304 loans of USD 2,973 average. In volume terms, the lending business is split almost equally between micro loans (less than USD 10,000) and small loans (greater than USD 10,000), but micro-loans account for over 90 per cent of loan decisions. The basic terms offered by MEC are shown in table 4-3. The inability to operate as a bank greatly limits MEC's access to non-IFI sources of finance (the only alternative is to borrow on the local interbank market) and jeopardises its prospects to become self-sustainable in the long run.

Rural finance: In rural areas, credit is available from the Corporation for Rural Financing from Moldova (MMA), the main financing institution of the Savings and Credit Associations serving private farmers, business co-operatives and individual farming enterprises. MMA has benefited from special credit lines offered by the World Bank and the International Fund for Agricultural Development (IFAD) through the

Rural Financing and Development of Small Enterprises project and by USAID/CNFA within the *Private Farmer Crediting Programme*. Table 4-3 shows the indicative terms offered through these programmes.

Table 4-3. Credit Terms Available from Micro and Rural Finance Institutions

Product	Term	Interest rate
MEC		
Lei 0 – 70,000	Up to 12 months	2.3 – 3.0% monthly
USD 100 – 500	Up to 12 months	2.5% monthly
USD 2,000 – 10,000	Up to 36 months	20 – 23% annually
USD 30,000 – 100,000	Up to 24 months	12 – 19% annually
Rural Finance and Development Project	12 - 36 months	16% annually
Private Farmer Crediting Programme	42 months	15% annually
Commercial banks		
Lei (equiv. USD 5,000-10,000)		18 - 35% annually
Lei (equiv. 10,000-100,000)		16 - 30% annually
USD 5,000-10,000		11 - 18% annually
USD 5,000-100,000		10 - 16% annually

Source: EBRD, MEC and IDIS "Viitorul".

Leasing: Some Moldovan banks, such as MAIB and Victoriabank, have started to explore the leasing market or have established leasing subsidiaries. However, the leasing market is still extremely small and the regulatory and institutional underpinnings are lacking. An EBRD technical co-operation project to establish the legal basis for leasing is under way, but progressing slowly. Similar constraints are holding back the mortgage market.

Equity financing: Venture capital could in principle be provided through two donor-supported regional venture funds, the Western NIS Enterprise Fund (WNISEF) and the Danube Fund, but neither currently has substantial investments in Moldova. Their activities are affected by the limited opportunities in the small Moldavian market (relative to fund management costs), the difficult business environment for investors, poor management standards in local companies and the lack of exit opportunities.

Assessment

The recent drop in interest rates has made commercial finance more affordable, but commercial sources of credit still play a small, if growing role in meeting the capital needs of SMEs. In fact, as interest rates did not come down as the result of competition, but because of administrative pressure from the central bank on commercial banks, this has actually had a negative impact on the banks' willingness to lend to the enterprise sector.

The lending policies of major banks remain prudent and the choice of financial products is limited. Lending is restricted to short tenors, with a narrow focus on specific sectors or enterprises and strict collateral requirements. Banks maintain that their lending policies reflect the high borrower risk and the paucity of credible and well thought through business plans. While there is truth in these claims, the success of IFI-sponsored projects shows that there are also bottlenecks on the supply side. They have to do with a lack of credit skills in Moldovan banks, particularly when it comes to micro-lending, but also with shortcomings in the legal and regulatory framework. The provision of specialised products such as leasing, mortgage lending or venture capital in particular, is hampered by the lack of an adequate legal basis and the difficult Moldovan investment climate.

With its strong focus on collateral when assessing the risk related to individual loans, the National Bank provides a strong incentive for banks to ask for "classic" collateral such as real estate, cars, etc. Not only are entrepreneurs often unable to offer or unwilling to come up with such collateral (many fear that the

comparatively influential banks may later prefer to take away the collateral rather than receiving the money back), the transaction costs produced by the provision of such collateral are extraordinary high in Moldova. In particular:

- Each agreement must be separately notarised to be legally valid. That means that a borrower, regardless of the size of the loan, must together with the spouse see a notary and separately notarise all individual agreements. Following this, a state fee for the notarisation must be paid into an account at a specific bank, which costs again time and money.
- To make a security agreement for a car legally valid, a certificate must be obtained from a state authority (the registration department of a ministry), confirming that the car is not stolen or otherwise unavailable for repossession. Obtaining a certificate can take quite a number of days and frequently requires paying a “fee” to accelerate the process.

These procedures make it extremely unattractive for entrepreneurs to initiate a loan request. Since the fixed costs are large, the burden is disproportionate for smaller borrowers.

The slow progress in structural and institutional reforms is reflected in the EBRD’s assessment of the banking sector. The EBRD produces an annual assessment of progress in transition in the form of a series of transition indicators, which cover, *inter alia*, banking reform, interest rate liberalisation and securities markets and non-bank financial institutions. Scores range from 1 (little or no progress from the central planning starting point) to 4+ (standards equivalent to those of a well-functioning market economy). The Moldovan score reproduced in table 4-4. shows that there has been little progress on financial sector reform since 1997, although the sector has grown and restructured and is clearly stronger than five years ago. The table also shows that the Moldovan financial sector lags behind the regional average of all transition countries.

Table 4-4. EBRD Transition Score of Financial Sector Reform

	1997	1998	1999	2000	2001	2002	Regional score (2002)
Banking reform and interest rate liberalisation	2.0	2.3	2.3	2.3	2.3	2.3	2.7
Securities markets and non-bank financial institutions	2.0	2.0	2.0	2.0	2.0	2.0	2.2

Source: EBRD.

IFI schemes and government programmes such as the State Fund for the Support of Small Businesses have to some extent helped in easing these constraints, but businesses continue to complain about insufficient access to financial products. The difficulty in accessing financing forces many SMEs to resort to internal (if available) or informal sources of finance.

4.5. Implementation of Advisory Services to New and Small Businesses

The Situation on Advisory Services

A range of organisations provide business advisory services to entrepreneurs, potential entrepreneurs or business managers in order to promote start-ups and assist growing SMEs. The business *advisory services* provided by private consultancies and public agencies typically include the following:

- Business consulting advice.
- Access to the Internet and commercial databases.

- Information and analysis on international markets and companies.
- Training on such issues as human resource management, accountancy, marketing, IT, etc.
- Business plan development.
- Consultancy on issues, such as taxation, start-ups, law, accountancy, etc.

A full complement of services is on offer in the Chişinău area, but can be much more limited elsewhere. In regions such as Bălţi, in the north, consulting services may even be completely absent. In certain areas, there is not even general business information on offer, such as on the legislative framework for SMEs. This gap in provision increases entrepreneurs' dependence on civil servants to supply them with effective support and advice.

Business advisory centres / consultancy firms supply services to small enterprises on a commercial basis, such as:

- Moldo-American Centre for Private Initiative (MACIP), which seeks to provide management assistance and business advice to entrepreneurs of private enterprises.
- Agency for Enterprise Restructuring and Assistance (ARIA), which is a management school as well as offering business consultancy services in various SEE countries, including Moldova.
- Moldova Business Centre, which converted into a private company and now charges fees for the provision of business services.
- Business Support Centre "PRO-BIZNET" Ltd., which is providing services to private entrepreneurs including consulting, training and business information.

Most of these business advisory centres were initially created with resources and technical assistance provided by the international donor community. They were established to focus specifically on start-ups and early growth SMEs but since most are no longer receiving financial support from the original donors, they are struggling to achieve *financial sustainability*. Part of the problem is the lack of demand for advisory services that are provided on a commercial basis. Entrepreneurs currently underestimate the value of such services and are not used to paying for them. The provision of business advisory services needs to be focused on the needs of entrepreneurs and market proactively.

In addition to the advisory centres mentioned above, the *National Chamber of Commerce and Industry* provides business assistance at the branch level. *Country councils* are increasingly active in enterprise promotion, some even looking to establish business advisory centres in their territory. There are also a number of *training organisations, as well as legal and accounting firms* providing services to the SME sector.

Assessment

In last decade, Moldova has experienced an expansion of international / donor-funded, as well as privately provided advisory services aimed at promoting start-ups and growing SMEs. In addition to these business centres/agencies, there are other support services being provided by the Chamber of Commerce and increasingly, county councils and local authorities. Business advisory services are concentrated in the Chişinău region and many areas of the country are either under-provided or have no support at all. Improved regional coverage might be achieved through greater co-ordination in the use of national and international resources targeted at SME development. Whatever happens, great care must be taken to ensure that future business advisory services build in financial sustainability as a core objective and that overlapping with existing provision is avoided, though some competition is both inevitable and desirable.

The SMEs participating in the research view quite positively ("satisfactory") the range, efficiency and responsiveness of the services on offer. The quality of the human capital (business advisors/consultants) on offer, including the continuity of the assistance, is rated between "poor" and "satisfactory". These services are in need of improvement – entrepreneurs repeatedly point out that there are only a few organisations offering advisory services and that many of the advisors, especially public officials in county

councils and local authorities, are relatively inexperienced. Furthermore, the range of services on offer needs to be broadened and the degree of specialisation enhanced in order to meet needs.

The lack of sustainability of donor-funded initiatives is a concern. Many started by providing services free of charge and are finding it difficult to persuade entrepreneurs to pay commercial rates for their services. As donor funding is reduced in future, these service providers might disappear if they don't manage to market and improve their services in a way that is sufficiently appealing to entrepreneurs for them to pay for these services. Good practice in the SEE region suggests that introducing standards with respect to advisory services (qualifications, membership of relevant bodies, confidentiality principles, charging policies and other quality standards, such as service charters) could generate greater confidence and thus willingness on the part of entrepreneurs to use and pay for such advisory services in Moldova.

Unlike many other SEE countries, the State has chosen not to become involved in providing or co-ordinating support to new or existing SME business advisory services. The exception relates to some embryonic initiatives at the county council level. Government has a role to play in the establishment of appropriate infrastructure with respect to business advisory services, especially for start-ups. There is currently neither an institutional framework to ensure co-ordination and integration of business support initiatives nor a means for certifying and monitoring the standards of advisory services.

4.6. Implementation of Business Incubators

The business incubator is a particular form of business service that offers potential in transition economies. There appears to be a lack of understanding about what exactly are business incubators. Business incubators were generally defined as special areas for new and young developing businesses that provide such businesses with premises, infrastructure, a comprehensive range of services and support that can improve their ability to initiate and run their operations during the early developmental period. The combined features of physical facilities; focus on start-ups and SMEs and "soft" advisory and support services provided are what distinguish business incubators from other industrial centres or industrial estates (OECD-UNIDO, 1999, p.51-53).

The Current Situation on Business Incubators

The development of business incubators is at the incipient phase in Moldova. The only active institution of this nature is located in *Bălți*. It was formed in 2000 to support of 11 enterprises. The clients of this business incubator are a mixture of start-ups and established enterprises whose activities are considered to be of economy priority, such as high-tech firms. It is funded from a mixture of local authority (land and other facilities) and foreign resources, and is expected to become sustainable by the end of 2003.

The facilities offered in *Bălți* are fairly typical of other business incubators:

- Subsidised office space (50% of the normal rents) for a period of up to 18 months.
- Services such as heating, lighting, phone, fax, e-mail, photocopy services, security and sanitation.
- Legal advice as well as practical support for the registration of the enterprise.
- Management, marketing, accounting, translation, publicity, conference services, etc.

It is known that BIZPRO – Moldova, one of the business support centres, is looking to support a further business incubator in the Alfa Industrial Park, Chişinău.

It is increasingly recognised in Moldova that business incubators offer scope to support and develop small enterprises, and increase the number of start-ups and their chances of survival. Incubators can help promote a change in mentality regarding private initiative, thus assisting the development of a culture of entrepreneurship. However, there is not yet a clear governmental policy with respect to business incubators.

Assessment

Once informed of the main principles and function of business incubators, entrepreneurs quickly grasped the potential offered by business incubators and argued that potential exists in Moldova with respect to various sectors of economic activity. Nevertheless, only one business incubator exists at the time of writing and the very small size of the existing business incubator raises serious concerns about its sustainability once financial support is reduced or withdrawn.

The lack of Government policy and strategy with respect to business incubators contribute to the entrepreneurs' ignorance about the role and benefits of incubators. Entrepreneurs argue that very little information of this nature gets through to the enterprise level or to potential entrepreneurs. Any future National SME Strategy should set out the Government's position with respect to the development of business incubators and spell out a process for their implementation.

NOTE

1. Shareholders of MEC are EBRD, Western NIS Enterprise Fund, IFC, KfW/DEG, IMI AG, and the Doen Foundation.

Chapter 5.

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Chapter 6.

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Appendix 1.

OBSTACLES TO DOING BUSINESS

The main results of the Moldovan Business Environment and Enterprise Performance Survey (BEEPS) 2002 are summarised in the following table. It contains the average score assigned by respondents to each aspect of the business environment, where the scores can be interpreted as follows: 1 = no obstacle; 2 = minor obstacle; 3 = moderate obstacle; 4 = major obstacle.

Rating Of Severity Of Obstacles To Doing Business (BEEPS, 2002)

Macroeconomic instability	3.5
Economic policy uncertainty	3.3
Tax rates	3.2
Tax administration	3.1
Cost of financing	2.9
Corruption	2.6
Business licensing and permits	2.5
Access to financing	2.5
Customs and trade regulations	2.5
Organised crime	2.4
Street crime	2.4
Contract violations by customers and suppliers	2.3
Anti-competitive practices of other producers	2.3
Functioning of the judiciary	2.1
Skills and education of workers	1.8
Access to land	1.8
Title or leasing of land	1.7
Transportation	1.6
Labour regulations	1.6
Electricity	1.4
Telecommunications	1.3

Source: EBRD

Annex 1.

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The Organisation for Economic Co-operation and Development (OECD) groups 30 member countries sharing a commitment to democratic government and the market economy. With active relationships with other countries, Non-Governmental Organisations and civil society, it has a global reach. Best known for its publications and statistics, its work covers economic and social issues from macroeconomics, to trade, education, development and science and innovation. Over time the OECD's focus has broadened to include extensive contacts with non-member economies and it now maintains co-operative relations with some 70 of them. These contacts aim to further economic integration by making the OECD's experience available to other countries and enabling the OECD to profit from the insights and perspectives of non-members. (see www.oecd.org)

The European Bank of Reconstruction and Development (EBRD) was set up in 1991 to support the development of market economies in Central and Eastern Europe and the Commonwealth of Independent States following the collapse of communism. The EBRD supports the economies of its 27 countries of operations by promoting competition, privatisation and entrepreneurship. Taking into account the particular needs of countries at different stages of transition, the Bank focuses on strengthening the financial sector, developing infrastructure and supporting industry and commerce. The EBRD is the largest investor in South Eastern Europe and is also an active contributor to the Stability Pact. (see www.ebrd.com)