

SMEs LENDING IN CONDITIONS OF CRISIS IN BANKING SYSTEM

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***Abstract:** Small and Medium Enterprises have a particularly important role, as it influences on solving economic, social, technical- scientific problems and many others. Development of SMEs sector leads to prosperity increase, living standards rise and growth of competitiveness - which are significant matters for both developing and industrialized countries. Restraints with SMEs lending will strain economic path. In case of exaggerate restraints, SMEs which have at the sole of their activities credits will be in trouble, as the interest rates are high, it is difficult to contract loans and it is tough to keep up with the loan reimbursement schedule. For banks lending to SMES is a consistent and weighty source of business activity. They make double effort to keep crediting at the same level during crisis. Therefore, banking sector is also interested in reducing the negative influence of base rate rise and other banking regulations regarding crediting that have bad influence. As a rule these regulations have a tendency to tighten the lending activity, as crediting terms are tougher. The goal of this paper is to analyse all the problems SMEs face during contracting credits and to give possible ways for an efficient entrepreneurship growth.*

***Keywords:** small and medium enterprises, banking loans, economic growth, crisis.*

***JEL Classification:** Q53, Q57.*

1. Importance of SMEs development in Republic of Moldova

Economy development of every country has at the sole a broad financial system with the ultimate function to set efficient connection between the need of investments and the need of doing savings. Since 19th century financial setbacks became the star object of the economy, for years scientists were preoccupied by improving the content and the instruments of the financial system.

Moldova is considered an agrarian-industrialized economy (agriculture 13% from GDP, processing industry- 12%, the rest are services). The main macroeconomic aggregate of national accounts - GDP, which serves the formation of national economies in 2014 was about 111, 7 bn. lei, which compared to the previous year (in 2013 it made up 109.4 bn. lei) is higher by 4.6%. It also must be mentioned that Moldova's economic growth mainly relies on remittances and their impact on consumption, which in recent years are steadily falling.

Enterprises have a significant influence on GDP formation. In the last years authorities fortunately paid more attention to entrepreneurship development. Yet, there still are bottlenecks. SMEs to a great extent deal with fluctuations in activity, and require loans at certain points of their business activity. Besides that, economy itself is cyclical, financial flows are not constant. The share of SMEs in the total enterprise population comprises 97,4%, but the revenue of SMEs in the total of enterprises is 31,8% in 2014. In compliance with data from World Bank site, up to 33 percent of national income (GDP) in emerging economies is generated by SMEs. Compared to high income countries where the weight of SMEs contribution in GDP exceeds 40%. This ratio is an evidence of the fact that potential for development of Moldovan SMEs is not fully exploited.

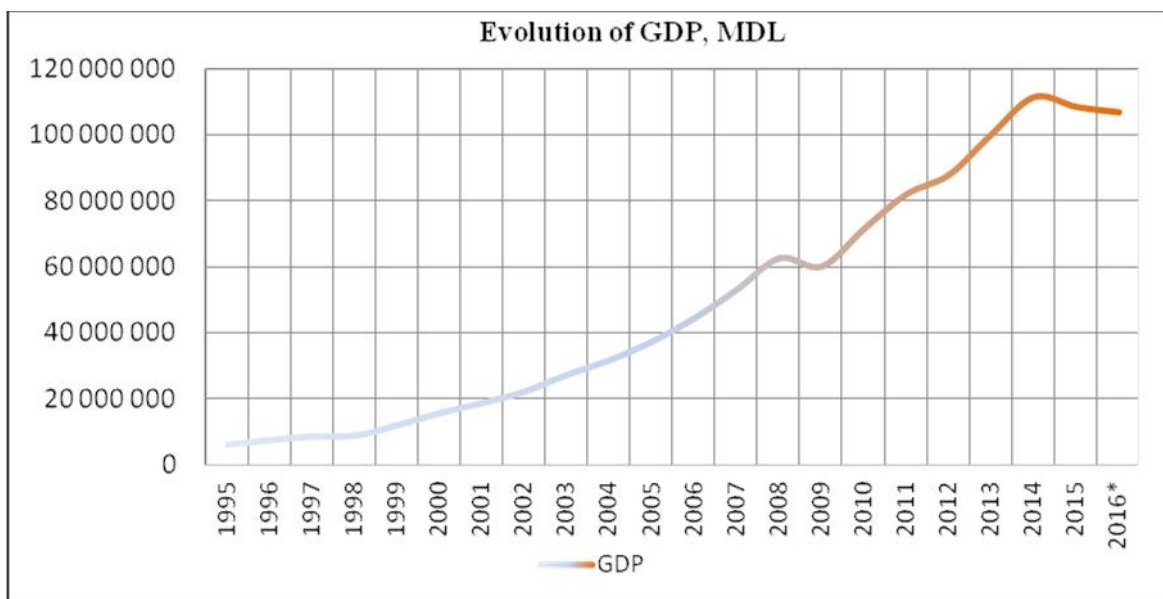
In the Republic of Moldova SMEs are intensively participating in trading (about 40% of SMEs), manufacturing of goods (about 10% of SMEs) and services, fulfilling demand on the domestic market. The number of people who work in small and medium

enterprises during the reference period are 298 400 people, covering 56.9% of the total number of employees of enterprises (Data collected from National Bureau of Statistics).

In developing countries, as Republic of Moldova, SMEs contribution to national turnover is relatively lower than its contribution to the supporting employment, which reflects a lower level of labor productivity in the SMEs sector than in big enterprises.

In hindsight, it is possible to conclude that Republic of Moldova since 1992 till now attained some economic accomplishments in entrepreneurship development. However, compared to developed countries, there is still place for improvement. These facts can be deduced from GDP results in the graph below.

The growth wasn't sustainable, as there were falls too. At the Moment Moldova is placed among the poorest countries with the lowest GDP level per capita from Europe. In the past 20 years the SMEs sector in the Republic of Moldova has improved both quantitatively and qualitatively. It is obvious, global financial and economic crisis in years 2008-2009 and 2014-2016 has had an adverse effect on SMEs.



*- forecasted data

Figure no. 1. GDP evolution in Republic of Moldova

Source: National Bureau of Statistics and the Ministry of Economy

From the graph it is observed that the decline of GDP started from the second semester of year 2014, period when banking system problems (money laundering) started. During the evolution of financial system, entrepreneurs from Republic of Moldova faced different situations. Financing (lack of it or difficult to obtain) for the enterprises is vulnerable not only due to banking system but also due to political instability. Besides, during the transition to market economy were reluctantly forgotten the methods of strategic planning and modeling in finance, for an efficient economic development.

In 2013 the Minister of Economy published the forecast of main macroeconomic indicators for the period 2014-2017. According to that, it was estimated that GDP in these years had to grow with an average annual rate of 4.5% along with structural improvements. Thus, in GDP should have grown the share of industry by 0.4 percentage points (2014 till 2017), construction - from 3.5% to 3.7% and domestic trade - from 13.5 % to 14%. Exports in this period should have increased by 8.5% annually, imports - by about 7.2% annually.

But the situation has changed. Experts from the Black Sea University Foundation predict significant impairments of the budgetary-financial situation. Even more pessimistic apprise the situation experts from the World Bank, who predict economic recession for Republic of Moldova. The World Bank's forecast for 2015 is economic downturn of about 2% and for 2016 it is foreseen a decrease by 1,5% in GDP growth. Besides the fact that, the budget deficit increased to 3.8% of GDP in 2013 to 5.4% in 2014, unless adequate measures were taken in 2015 according to World Bank, was supposed to increase to 7.1%. At the moment GDP is equal to 35890 mil. lei, which creates a deficit of 8% (3rd quarter 2015, current prices).

2. The current situation on crediting market

For Republic of Moldova, which has a developed financial and banking infrastructure, most commonly used financial instruments in national economy and in particular for small and medium enterprises sector are: bank loans, microfinance institutions, savings and loans associations (mainly used by farmers) and leasing. In order to detect the gaps in crediting mechanism, it is necessary to analyze the main components separately.

Banking sector. Crediting system analysis in Republic of Moldova reveals a tensed situation. Even if crisis started in 2014, the data showed the following facts. Credits remain the main financial resource for enterprises, just during crisis their share falls. During the last two years major changes occurred in the structure of banking institutions. The number of crediting institutions is going to be reduced by 3 banks as a consequence of the liquidation of banks with fraudulent activities: Banca de Economii, Unibank and Banca Social, which started to be performed in the 4th quarter of 2015. Moldovan banking system will operate 11 banks, from which 4 with majority private foreign capital (because of reduced capital transparency in Moldovan banking, it is quite difficult to judge which is the situation regarding banks' owners, except for some "real" foreign investors, such as: Group Societe Generale in Mobiasbanca, Gruppo Veneto Banca in Eximbank, ProCredit Holding in ProCredit Bank) and a Romanian branch - Erste Bank/BCR in BCR Chisinau, none of Moldovan banks has capital majority, or entire capital owned by the state.

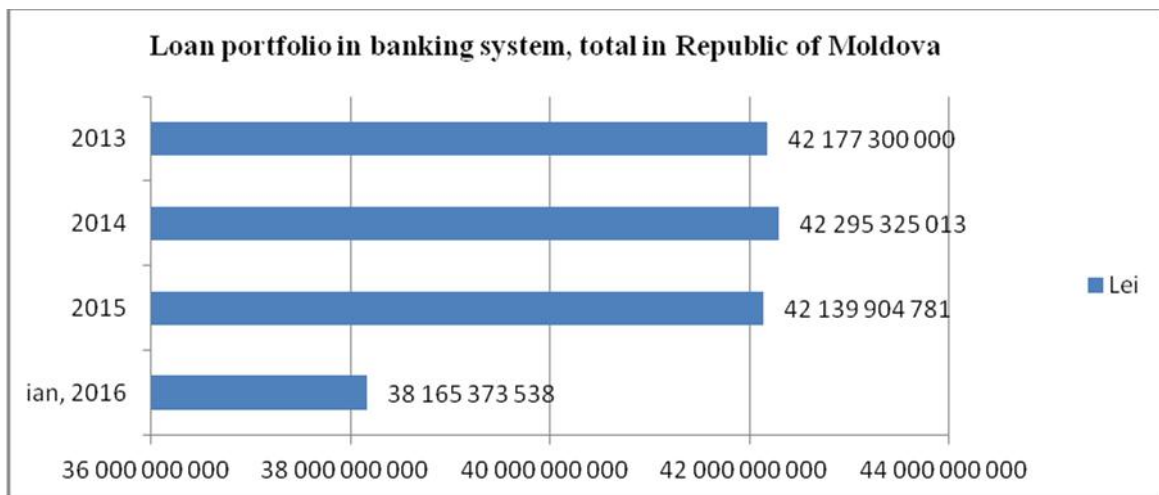


Figure no. 2. Bank credit portfolio in Republic of Moldova

Source: drafted by the author, relying on data from National Bank of Moldova

The number of banks comparing to other Eastern European countries, is smaller, therefore, the competition is also less intense. We can state an oligopolistic competition, for the top three banks Agroindbank, Moldindcombank and Victoriabank which are forming a dominant position. In recent years customers for banking services were geared towards quality and safety, manifested confidence in the banking system which, unfortunately, has recently been totally compromised and will require actions and resources to restore customers trust and confidence, that were robbed in the most callous way.

According to the data collected it is evident that the share of the bank loans is the main type of financial resource, and fulfills about 94% from credit requests. The dominant share of credit loans in the graph is a proof of how involved and what a big impact has banking sector in enterprise activity.

Table no. 1. Share of bank loans in the total

Loans by sectors:	2013	2014	Weight of each sector, %	2015
Banking sector	42177.3	42295.3	93.71	42140.0
Microfinance Institutions, mil.	1897,0	2427,5	5.38	**
Savings and loans associations, mil.	331.9	409,3	0.91	477.05*
Total private sector loans, mil.	44406,2	45132.1	100	42617,05*

*- preliminary data; **- no data for this year

Source: drafted by the author, relying on data from National Bank and National Commission for Financial Markets.

The main causes of the problems of access to finances of SMEs are the following factors:

- Many of the companies keep double accounting of the income.(underground and formal bookkeeping), striving to avoid taxes. Banks don't have enough stimuli to operate more intensive with SMEs. The riskiest and almost deprived from getting loans are startups or young enterprises with no credit history.
- SMEs environment is more uncertain and competitiveness is harsher, rates of return are high, but the risks are also high.
- Pledged collaterals and high interest rates make SMEs to refrain from contracting bank credits.

The relationship between SMES and banks is important for both sides, because legal entities represent a consistent share from customers and form 86% from the portfolio.

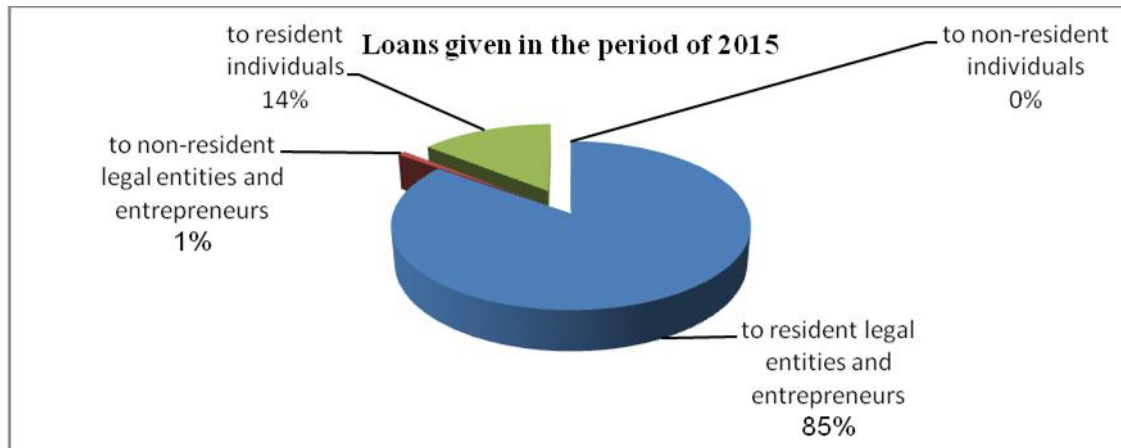


Figure no. 3. Structure of Credit portfolio for in banks

Source: drafted by the author, relying on data from National Bank of Moldova

Interest rates. National Bank of Moldova lowered its base rate by 50 basis points to 19 percent on February 25th. This is thanks to the fact that inflation slowed slightly while economic activity remained weak and external risks high. The annual inflation rate was recorded at 13.4 percent in January of 2016, according to Trading Economics (<http://www.tradingeconomics.com/>).

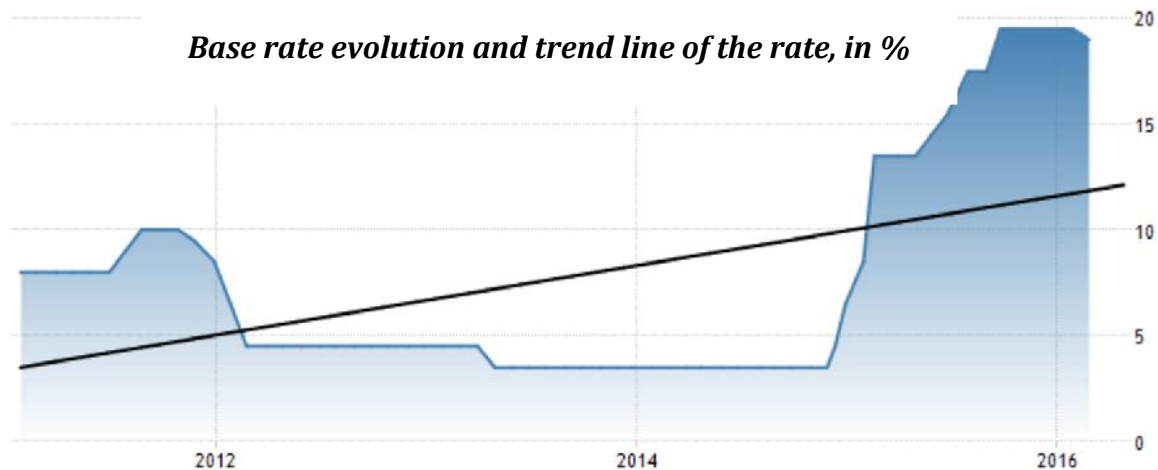


Figure no. 4. Base rate in Republic of Moldova

Source: Trading Economics (<http://www.tradingeconomics.com/>)

The previous Moldovan base rate was 19,5%. The highest registered rate was 21%, during the crisis between 2008 and 2009. The lowest interest rate amounted 3,5%. This rate was kept between 2013 and the first semester of 2014. At the end of 2014 and beginning of 2015 the rate popped up sharply, causing troubles to those who contracted loans.

The weighted average interest rates on new loans given to entities in national currency, starting from 2013 varied between 6,2% and 22,17%, depending on term. Credits in foreign currency weren't so affected. In the previous year due to banking crisis, many of the rates were recalculated, so that at the beginning of the year 2015 many of the SMEs were forced to close their credits and tighten their activity. This is one of the causes of the decline in credit portfolio in the banking system. Money from banks was replaced with resources from microfinance institutions or pawn services. This is typical for crisis periods.

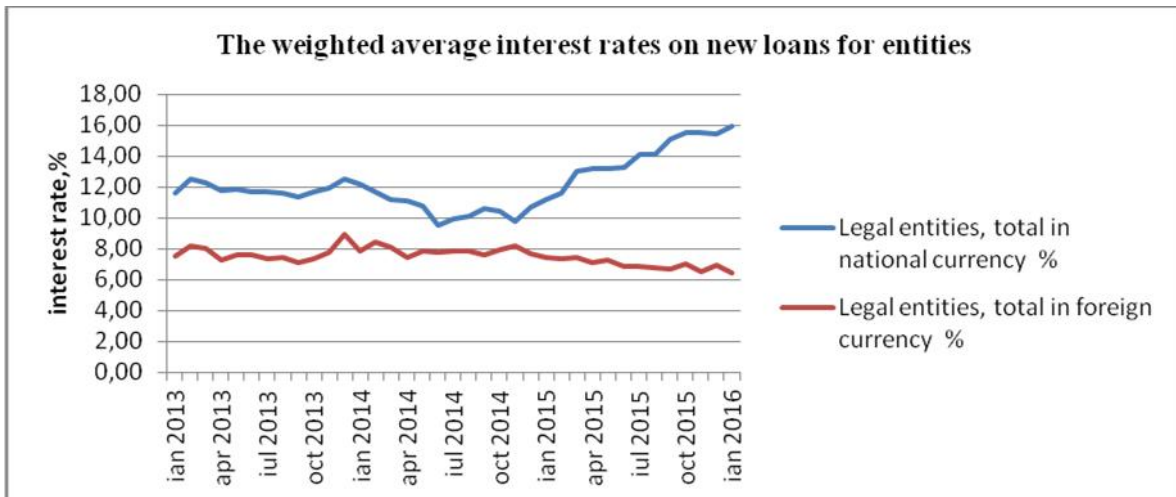


Figure no. 5. Weighted average interest rate in banking system

Source: drafted by the author, relying on data from National Bank of Moldova

If we compare the base rate to the weighted average interest rates from commercial banks, we observe an unusual gap. The difference between the base rate and the commercial banks interest rate starting with 2014 is approximately between 3-5%. Base rate exceeds interest rates. This is explained by the fact that deposits are contracted at a lower rate than the base rate, so commercial banks can afford to reduce the percentage for crediting. National Bank of Moldova set the rate so high with the purpose to sterilize the money supply in order to stop inflation process.

Nonbank financial sector with the main representatives: microfinance institutions and saving and loan agencies.

Microfinancing activities develop in a very fast pace. This can be extracted from the fact that the number of the enterprises in this field raised with approximately 16 units or 19% during 2014, reaching the number of 112 organizations in the 3rd quarter of 2015. The number of loan contracts also raised, the majority of them are for consumption, construction, and other purposes (according to accounting classification). Pursuant to the data provided by the Credit History Bureau (Î.M. „Biroul De Credit” S.R.L), their database grew by 4 %, the number of people with positive credit history also grew with about 29%. This growth may be due to severe conditions in banking system. Some legal entities migrate from banking system to microfinancial organizations. SMEs prefer fast, easy to obtain credits, even if the interest rates are higher. The rate of financing at microfinance institutions was around at 22% before 2015. In the last year it rose to 26% till 32%.

In the Saving And Loan Agencies field, it is also registered an evolution of the mean value of the loan per the beneficiary member in the period 2010-2014. This is an evidence of the continuous demand of loans offered by Saving And Loan Agencies, which are mainly used in countryside, approximately 90% are used in agriculture. The financing rate in Saving And Loan Agencies varies from 17,9 to 26% .

Even if the interest rates are high, the urgent need of financial resources in SMEs makes entrepreneurs acquire loans even with very expensive price.

3. Conclusions and possible ways for efficient SMEs growth

During the transitional period crossed by Moldova's economy, most SMEs do not have sufficient reserves to finance their businesses, and do not always have the opportunity to turn to bank loans. According to World Bank, Republic of Moldova is among the countries with the smallest share in GDP of domestic credit to private sector – 37,1%

(Ukraine- 76,3% ,Romania -31.2%, Czech Republic -50,4%, Japan-187,6%). This indicates that the access to financing is limited and SMEs can't grow in order to raise their productivity and competitiveness.

Causes of the bottlenecks are a couple: high interest rates, risky, uncertain business environment, regulatory barriers and excessive bureaucracy of state bodies, underground economy, and incapacity to return credit tranches on time. In our country the rate of bank nonperforming loans to total gross loans is equal to 14,4% (Ukraine- 24,3% ,Romania - 13,9%, Czech Republic -5,6%, Japan-1,6%).

However, Moldovan banks make some efforts to keep the same size of credit portfolio. But this is not enough for achieving SMEs growth. It is necessary to improve the pace of contracting a credit by reducing bureaucracy, establishing preferential terms in crediting and by supporting entrepreneurs by affordable and convenient interest rates. Public authorities also showed their support in SMEs in financial development. There are different programs and policies, for example: Pare1+1- with the goal to attract remittances into the economy; National Program for Economic Empowerment of Youth, special fund for Loans Guarantee and consultancy from foreign experts. Innovative financing schemes can be found both in the national and regional programs. Through these programs it is possible to obtain loans or grants from the state for creation of new businesses and subsidizing certain types of activity, considered important for the economy. There are also platforms that help SMEs to build a better entrepreneurial profile, to be more credible for creditors and more competitive on the market. But national authorities still need to rethink some parts. In order to stimulate them it is necessary to promote awareness of SMEs development and do keep track of SMEs growth stage and to educate/guide entrepreneurs in financial decision making. The government must maintain political sphere, banking system in good functionality and to avoid disrupting natural development path on the small and medium enterprises.

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