



APRACA FinServAccess Programme
**Assessment of Enabling Conditions of
Financial Services in Cambodia**



An APRACA FinServAccess Publication with the Special Sponsorship of
the International Fund for Agricultural Development (IFAD)

APRACA FinServAccess Publication: 2013/1

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An APRACA FinServAccess Publication with the Special Sponsorship of
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Published by: Asia-Pacific Rural and Agricultural Credit Association (APRACA)

Distribution: For copies, write to:

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Circulation: Sofia Champanand

E-copy: The report in PDF can also be downloaded from the APRACA website.

ISBN 978-616-394-230-2

This report is published by APRACA under the auspices of the IFAD-supported APRACA FinServAccess Project.

Opinions expressed by the experts and documenters do not necessarily represent the official views of APRACA or of IFAD.

This report is published during the incumbencies of Mr. Kim Vada (APRACA Chairman), Mr. Shitangshu Kumar Sur Chowdhury (APRACA Vice-Chairman), Mr. Won-Sik Noh (APRACA Secretary General) and Dr. Marlowe U. Aquino (FinServAccess Project Manager).

Message

The development of Cambodia towards innovative and sustainable agriculture has created its niche in the ASEAN Economic Community. Cambodia's realization to work closely with development organizations, the government and its people resulted to a new trend in localized socio-economic development.

Through the various development programs and support services coming from international and national organizations, Cambodians' lives gradually improved. One of the projects assisting the country is the International Fund for Agricultural Development (IFAD) Grant Project – FinServAccess implemented by the Asia-Pacific Rural and Agricultural Credit Association (APRACA). The project goal is to enhance the access of the rural poor-particularly smallholder farm households and agri-related rural entrepreneurs, including women and rural youth to sustainable financial services through policy dialogues, replication of best practices, capacity building of different stakeholders and knowledge sharing in rural finance.

In response, there is a need to assess the capability of its target project countries – Bangladesh, Myanmar, Nepal and Cambodia in order that appropriate interventions will be provided. The assessment and updating of Cambodia's rural financial condition provided better understanding on how these are intertwined to function in a holistic, collaborative and complementary manner while providing the necessary rural finance programs and services and those that need to access them to achieve their aspirations in making the lives of people more productive and profitable especially those engaged in agriculture.

The Assessment Report is very timely because the country is now preparing itself to become one of the prime movers of the ASEAN Economic Community. Rural and agricultural finance will surely be one of the influencing factors to aid the country in achieving this important challenge.

As part of the National Bank of Cambodia and the present Chairman of APRACA, we are grateful that this assessment was done for us to review, reflect further on the findings and develop appropriate plans and implement relevant actions to strengthen further our efforts to the Cambodian people.

Congratulations to the research team for an excellent job!

Thank you!

Kim Vada
Chairman
APRACA

Acknowledgment

This study was undertaken in support of the FinServAccess Project of the APRACA and IFAD. The authors wish to acknowledge the invaluable contributions of the following people in the conduct of this study:

Mr. Won-Sik Noh, APRACA Secretary General, for his support to this Assessment Project;

Dr. Marlowe U. Aquino, Project Manager of FinServAccess, for overall coordination of the study, identification of the local consultant and contact persons in Cambodia, and logistical support;

Leang Khim, the study's local consultant, for identifying the key institutions and respondents to be interviewed, arranging the field interviews and survey, providing research assistance, logistical support, and for graciously touring the authors around Phnom Penh;

Dr. Bun Mony, Chief Executive Officer of Sathapana Limited, for allowing access to their company's resources including staff support, transportation, and a venue for the interview of farmers, which made the conduct of the field work much easier and convenient;

Ly Sophy, for helping conduct the field interview with farmer respondents, and for encoding and processing the data gathered;

All the respondents – officers of NGOs, MFIs, banks, government offices, research institutions and others from the private sector – who generously made time for the interviews; and

Their families, who unfailingly serve as sources of inspiration from which the researchers/authors draw encouragement and motivation.

Jovita M. Corpuz
Ferdinand L. Paguia
Researchers

Executive Summary

The Kingdom of Cambodia, as it was officially named after the general elections of 1993, began the difficult process of restoration in 1998, when some measure of political stability began to take shape following decades of war and conflict among its people. Huge amounts of financial aid from donor countries and international organizations started to pour in to assist the country in its path to recovery. Despite its traumatic experience, Cambodia's economy started to pick up at a quicker pace than expected, growing by nearly 10% per year from 1998-2008 (World Bank, 2013). In spite of its impressive growth, Cambodia is still classified as a low income country by the World Bank with a 2012 GDP of USD 14.06 billion (current) and per capita GNI of USD 2,360 (Purchasing Power Parity). Poverty persists particularly in rural areas where about 90% of the poor are residing and dependent on agriculture for their livelihood (World Bank, 2013). Many are either landless or own small tracts of land that are good only for subsistence farming. Of the total employed population, 71% are engaged in agriculture. Agricultural output likewise constitutes about 35.6% of GDP (ADB, 2013).

Development of the agriculture sector is one of the main pillars of the Rectangular Strategy for Growth, Employment, Equity and Efficiency Phase II which serves as the socio-economic policy agenda of the Royal Government of Cambodia. Agriculture is envisioned to serve as a foundation for economic growth and as a tool for accelerating poverty reduction and improving the living standards of the Cambodian people. Since rice continues to be the main crop and source of livelihood among the rural population, the National Policy for Paddy Commercialization and Export was officially adopted in June 2010 to promote the export of rice. The target is to produce a paddy surplus of more than four (4) million tons and rice export of at least one (1) million ton by 2015. Credit is one of the measures identified for achieving this target. Specific interventions include provision of micro-credit to rice producers, and loans for the purchase and processing of paddy.

Borrowing constitutes a major aspect in the livelihood of the rural populace, particularly among agricultural households. Many need to borrow to purchase production inputs or help them tide over the period between planting and harvest when cash is scarce. Based on the results of the 2012 Socio-Economic Survey of Cambodia, 40% of total households in the country have outstanding debt. Borrowing incidence is also higher in rural areas (43%) compared to Phnom Penh (13.4%). For the agriculture sector, an even greater number of people have outstanding debt (44%) compared to the general population. However, the National Bank of Cambodia (NBC) reports that only 13% of Cambodia's population has access to formal financial services while 84% of micro, small and medium enterprises are served by the informal financial system (NBC Annual Report, 2012).

This study was therefore commissioned to look into the enabling conditions of financial services in Cambodia. Its main objective is to assess the state of rural and agricultural finance in Cambodia, particularly with regard to improving access to credit by small agricultural households. The following are the major findings of the study:

Improved Performance and Outreach of Microfinance

In the financial system of Cambodia, microfinance is the instrument used to provide the financing needs of the poor. Microfinance has performed much better than banks in providing financial services especially to the agriculture sector. Microfinance institutions (MFIs) and non-government organizations (NGOs) providing microfinance services are more geographically dispersed than banks allowing them to extend their operations up to the village level. Majority of the loans released by MFIs went to the agriculture sector (39%) whereas loans by banks to the sector was only 10% of its total loans in 2012. Surprisingly, loan portfolio quality of MFIs are also much better than banks despite allocating majority

of their loans for agriculture, which is perceived to be a risky sector by banks. From 2008-2012, the average ratio of non-performing loans to total loan released by banks was 3.2% compared to only 1% for MFIs. This finding suggests that the risks posed by agriculture is only weakly correlated with loan portfolio quality. What might be more important is how risks are managed by MFIs.

Enabling Finance Policy and Regulatory Environment

The improving performance of MFIs can be attributed partly to an enabling finance policy and regulatory environment that, among others, provide microfinance operators such as unregistered NGOs the opportunity to be upgraded into MFI and eventually commercial bank status. Under Cambodia's financial system, the NBC oversees the supervision and regulation of both bank and non-bank financial service providers including NGO-MFIs. This increases investor confidence and, consequently, their capacity to access funds at reasonable rates from local and international financing institutions. This, in turn, enables them to expand their services and reach more clients. As of December 31, 2012, there are 32 commercial banks, seven (7) specialized banks, four (4) representative offices of foreign banks, 35 microfinance institutions (MFIs) – of which seven (7) are licensed deposit-taking institutions, and 33 credit operators (registered NGOs) falling under the supervision and regulation of the NBC.

Institutionalized Credit Information Sharing

Credit information sharing was institutionalized in the country when the Credit Bureau of Cambodia (CBC) was established and started operating on March 2013. The NBC requires all banks and MFIs under its supervision to share information regarding the credit history of their borrowers. Hence, the CBC serves as a repository of credit information on borrowers available for access by banks and MFIs. It is a critical financial infrastructure for improving transparency and risk management which is expected to encourage more lending to the unbanked and under-banked sectors, particularly SMEs and agriculture. Through the CBC, banks and MFIs could more efficiently assess credit risk and reduce lending costs, especially in conducting credit investigations.

Strengthening the Role of Cooperatives as Financial Intermediaries

The government through the Ministry of Agriculture, Fishery and Forestry (MAFF) plays an important role in strengthening the capacity of farmer organizations and agricultural cooperatives to secure and effectively utilize loans from formal financial institutions. The MAFF provides a series of training to farmers in preparation for their organization as a farmer group. In addition, the MAFF helps facilitate access to credit of farmers through the following activities: (i) facilitation of contract farming schemes between farmer groups and the private sector; (ii) provision of support to farmer coops in borrowing from the Rural Development Bank (RDB) of Cambodia, MFIs or NGOs through linkage and technical assistance in business plan preparation; (iii) partnership with local companies and international donor organizations/development institutions like JICA, IFAD and ADB to facilitate provision of technical and financial assistance to farmer cooperatives. The recently enacted Law on Agricultural Cooperatives is expected to provide a better enabling environment for cooperative development.

Lending by Government at Concessionary Rates

Pricing of loans are generally based on market rates. However, the government – through the state-owned Rural Development Bank (RDB) – may implement credit programs with concessionary rates in support of priority policies or programs. The RDB is currently implementing credit programs in support of the Rice Export Policy with an interest rate of 5% per annum for rice miller associations, and 7% per annum for other banks or MFIs for rice production as against a maximum interest of 3% per month (or 36% per annum) of MFIs depending on loan size. The Ministry of Rural Development (MRD) is likewise implementing a credit program that provides loans to individual farmers, farmer groups or cooperatives to finance agricultural production or other livelihood activities albeit in selected provinces

only. In the event of market failure, lending by government to target beneficiaries or sectors is justified. However, lending at concessionary rates might serve as a disincentive for private sector lending. This might be an acceptable short-term measure, i.e. until the targeted volume of rice production or export is attained, but not as a long-term measure, not unless the government can sustain funding for a long period of time.

Issues and Constraints to Credit Access

Lack of collateral. Collateral is generally not being required for group loans particularly by MFIs. However, the amount of loans that could be borrowed under group lending is very limited (typically 250-300 USD). It is not enough to provide the total credit requirements of the farmer for production. Bigger loans could be had individually but requires collateral already. For agriculture, land titles (either hard or soft titles) are generally the accepted forms of collateral. Unfortunately, ownership of private property – including land – was abolished and certificates of ownership such as land titles were destroyed during the Khmer Rouge regime. Consequently, landlessness and insecure land tenure is still pervasive in Cambodia. Among the poor, very few have formal or legal land titles.

Weak financial literacy among farmer organizations and agri-SMEs. Weak knowledge and understanding of financial literacy leads to the inability of many farmers to prepare a viable business plan and poor financial recording system of many agricultural SMEs. In turn, this provides banks or MFIs with a weak basis for properly assessing the project in terms of the cashflow, projected income, and repayment capacity of borrowers, among other things.

Credit pollution. Borrowing from multiple sources, which might result in credit pollution or over-indebtedness is a long-standing issue in agricultural finance in Cambodia. Poor farmer borrowers, who typically avail themselves of micro-loans through group lending, do not receive the amount they need for agricultural production from just one source. Hence, they need to borrow more from other sources. Some banks and MFIs are therefore very cautious in lending to borrowers who may just use the loans to pay existing debts. However, the operationalization of the credit bureau in 2012 is expected to minimize the incidence of credit pollution.

Heavy dependence on foreign capital. There are no restrictions as to how much foreign investors may own in a local enterprise. Foreign investors may be allowed full ownership and control over an NGO, MFI or bank. Capital flight is always a potential threat in an economy that is heavily dependent on foreign capital and borrowing. Massive withdrawal of capital could lead to another financial crisis for Cambodia given the scale of operations of the financial sector in the country's economy. Fortunately, steps are being initiated by government for MFIs and banks to mobilize deposits from the public and scale-up domestic borrowing.

Changing role of MFIs. The policy environment provides for the transformation of NGOs to MFIs under the supervision of the NBC. This is encouraged by the Cambodian Government as a means of improving access of poor borrowers to agricultural credit. But as they grow, microfinance providers change their orientation from non-profit oriented entities to profit-driven financial institutions. And as they are subjected to stricter prudential regulations, the loan portfolio of MFIs may possibly shift to less risky clients and/or projects (e.g. from agriculture to industry or services, or large scale agricultural projects) or be more selective in choosing and screening their clients to the point of being restrictive. Development should therefore be balanced by social responsibility.

Inadequate credit programs for small farmers. The government does not seem to have an adequate financial facility that lends to small, individual farmers. The state-owned RDB provides loans on a wholesale basis and only to rice miller associations. The MRD lends to some farmers but only in selected pilot areas. Financing production needs of farmers is left to the private sector while the priority of the government seems to be the financing of paddy collection and processing.

Dearth of innovative financing schemes. The financial services of most microfinance operators are mostly limited to credit and deposits, except for some bigger MFIs which also provide additional services such as money exchange, inter-branch money transfer, bills payment, and ATM services. Loans are delivered either through the group lending or individual lending methodologies. Short-term, micro-loans are typically provided through the group lending approach. Collateral is usually not required as risk is covered by group guarantee. On the other hand, bigger loans with longer maturity are provided via individual lending. Collateral in the form of land titles is generally required for these loans. Microinsurance, a basic component of microfinance in other countries, is uncommon for microfinance services in Cambodia. Innovative forms of financing such as value chain financing are scarce. Integrated and supervised livelihood programs with credit components are being implemented by some NGOs but on a small scale basis only.

Restrictive/ineffective risk management practices. Policies and regulations of NBC seem to be ‘protectionist’ and risk averse. Collateral is required by NBC for loans of banks and MFIs to its borrowers. While this is prudent and will keep the financial system healthy, it may be restrictive on the part of the farmers who have no collateral (hard land titles) to offer. Since distribution and ownership of lands will take time to resolve, other means of addressing risks should be explored including the warehouse receipts system, value chain financing, integrated and supervised financing, and good credit history as certified by the credit bureau. While crop insurance is practically non-existent, there are plans for implementing a crop insurance system as provided for in the financial sector blueprint and agricultural cooperative law. Guarantee and risk-sharing schemes are being implemented by the government through MEF but have not been effective thus far.

Recommendations and Conclusion

Taking into consideration the major issues and constraints to credit access in the agriculture sector, the study recommends the following:

- a. Institutionalize a national policy and strategic action plan for agricultural finance. A profiling of farmers and estimation of their credit demand are critical inputs in this undertaking.
- b. Government to spearhead the development and piloting of innovative financing schemes (e.g. value chain financing, integrated financing, warehouse receipts system) that will facilitate access to credit of poor farmers.
- c. Strengthen coordination among government agencies, and linkage between government and the private sector, in developing policies and implementing financing programs for more efficient use of resources and optimum delivery of services to the target sectors and clients.
- d. Fast-track land distribution to agricultural households and develop a more efficient policy and regulatory framework for granting ownership of distributed lands to beneficiaries.
- e. Review the mandate of the RDB vis-à-vis the plan to establish the Agriculture Development Bank (ADB) from the point of economic efficiency. Consider upgrading the RDB from a specialized bank to an apex bank that will take care of the financing needs of the agriculture sector.
- f. Encourage more MFIs to transform into microfinance deposit-taking institutions (MDIs). This will allow them to expand their operations by mobilizing some of the deposits for lending to the agriculture sector.
- g. Strengthen the formation and development of farmer organizations and cooperatives and provide continuous training on financial literacy and new production technologies, among others, that will enhance their capacity to access and manage credit from formal sources for re-lending to small farmers and fisherfolk.

- h. Develop the necessary agricultural infrastructure in rural areas such as farm-to-market roads, irrigation, and post-harvest facilities including warehouses and other storage facilities to improve viability of the agriculture sector and encourage investment and financing by the private sector.
- i. To mitigate risks and to encourage more private lenders to extend credit to the agriculture sector, the Government should seriously consider coming up with a crop insurance program and improve the performance of its guarantee programs.

In spite of the improving performance and outreach of microfinance, access to formal credit especially by poor agricultural households is constrained by issues such as lack of collateral, weak financial literacy among farmer organizations and agri-SMEs, dearth of innovative financing schemes for small farmers and fishers, ineffective guarantee programs, and lack of crop insurance programs. While the policy and regulatory environment in Cambodia keeps the financial system healthy and enables microfinance providers to grow, it may prove restrictive to poor rural borrowers especially in the absence of innovative financing and risk management instruments that will enable them to access formal credit. The recommended measures above should be implemented holistically to maximize their impact in improving access to credit by poor agricultural households.

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CHAPTER 1

Introduction

Background and Rationale

Cambodia's history has been tainted by war with neighboring countries most notably the war with Vietnam, which gave rise to the Khmer Rouge Regime in 1975-1979. Under the dictatorship of Pol Pot, a radical social reform process anchored on an agrarian-based communist society was initiated. The underlying ideology is to convert Cambodia into a classless society, transforming the urban population into a purely rural populace working solely on agriculture. During this period, the country was isolated from foreign influence and all economic activity ceased as schools, banks, hospitals, factories and other private enterprises were forcibly closed. The local currency was abolished, all public records (including documents showing ownership of property such as land and residential titles) burned, private properties confiscated, and all forms of religion outlawed.

In 1979, the Khmer Rouge were forced to relinquish total control over Cambodia by invading Vietnamese forces. The Cambodian-Vietnamese War lasted from 1979-1991, ending only when the Paris Peace Accords were signed in 1991, and the remaining Vietnamese forces withdrew from Cambodia. In 1993, the monarchy was restored and the first general elections were held. In 1997, a coup d'état placed the seat of power in the hands of the Cambodian People's Party under the leadership of Prime Minister Hun Sen who currently remain in power. With the country attaining some semblance of political stability, Cambodia started threading the path to social and economic recovery. Through the assistance of other countries and international organizations, the economy started to pick up at a quicker pace than expected. In spite of economic recovery though, the experience under the Khmer Rouge left social and cultural imprints that remain to this day.

Majority of the population are residing in rural areas and dependent on agriculture for their livelihood. Poverty persists in rural areas as many agricultural households are either landless or own small tracts of land that are good only for subsistence farming. Borrowing constitutes a major aspect in the livelihood of the rural populace, particularly among agricultural households. Many need to borrow to purchase production inputs or help them tide over the period between planting and harvest when cash is scarce. Based on the results of the 2012 Socio-Economic Survey¹ of Cambodia, 40% of total households in the country have outstanding debt. Borrowing incidence though is much lower in Phnom Penh than in rural areas. Only 13.4% of people living in Phnom Penh have outstanding debt compared to 43% in rural areas.

For the agriculture sector, an even greater number of people have outstanding debt (44%) compared to the general population. Also, more people in the agriculture sector – whether in Phnom Penh or in rural areas – have outstanding debt. The proportion of people with outstanding debt to the total working population in agriculture is 38.5% for Phnom Penh and 44.2% in rural areas. More people also borrow from formal than informal sources. Of the total agricultural households with outstanding debt, 57% borrow from formal sources while 43% borrow from informal sources.

¹ The 2012 Socio-Economic Survey of Cambodia is not yet published nor its results officially released as of the time of interview/ data gathering. The relevant data on credit/borrowing incidence used in the discussion was requested from the Ministry of Planning-National Institute of Statistics.

Over the last decade, the Cambodian economy has been robust, growing rapidly at 6-10% per annum. The financial sector has also been growing, with more outstanding loans and higher assets of banks and microfinance institutions. However, only 13% of Cambodia's population has access to formal financial services while 84% of micro, small and medium enterprises are served by the informal financial system (NBC Annual Report, 2012).

Why is there no congruence between access to rural credit and growth in the economy? Is this a problem of governance? Is the financial structure adequate to move credit funds to the rural areas? Or is there an issue of capital shortage? This study was commissioned to look into the enabling conditions of financial services in Cambodia.

Objectives of the study

The general objective of the study is to assess the state of rural and agricultural finance in Cambodia, particularly with regard to improving access to credit by small agricultural households. The following are the specific objectives of the study:

- (i) Review the existing policies and plans on rural and agricultural finance within the context of national development plans of Cambodia;
- (ii) Assess the performance of private financial service providers and government financing programs with regard to improving access of small agricultural households to credit; and
- (iii) Identify the prevailing issues and constraints to credit access by small agricultural households, and recommend measures for addressing them.

Methodology

To gather the information required for accomplishing the objectives of the study, primary and secondary data collection methods were used, namely: (i) desk review of existing literature including recent studies, papers, reports, articles primarily through internet searches; (ii) conduct of field visits to undertake: key informant interviews (KIIs) with selected financial service providers and relevant government financial and non-financial institutions, and one-on-one interviews with sample farmer and fisherfolk borrowers.

A total of four (4) microfinance deposit-taking institutions (MFIs that are also licensed to take deposits), four (4) NGOs with microfinance services, two (2) banks with microfinance services, one (1) private moneylender, five (5) government institutions, three (3) other relevant institutions from the private sector, and 21 sample farmer and fisherfolk borrowers/non-borrowers were interviewed during the field visit conducted from August 15-29, 2013.

Organization of the report

The succeeding Chapters after the Introduction (Chapter 1) are organized as follows: Chapter 2 provides an overview of the socio-economic conditions in Cambodia. Chapter 3 discusses the rural and agricultural finance policy and regulatory environment. Chapter 4 presents the state of rural and agricultural finance, and outreach of financial services to small agricultural households. Chapter 5 discusses the role that government plays in rural and agricultural finance. Chapter 6 presents the status and reviews the performance of government-initiated financing programs for the agriculture sector. Chapter 7 analyzes the identified issues and constraints to credit access. Chapter 8 discusses the major findings of the study and recommends measures for improving the credit delivery system in agriculture. Chapter 9 summarizes and concludes the study.

CHAPTER 2

Socio-economic conditions

Socio-economic condition and poverty situation

The Kingdom of Cambodia, as it was officially named after the general elections of 1993, began the difficult process of restoration in 1998, when some measure of political stability began to take shape following decades of war and conflict among its people. Huge amounts of financial aid from donor countries and international organizations started to pour in to assist the country in its path to recovery. Despite its traumatic experience, Cambodia responded positively, posting substantial economic gains recognized as among the fastest growing economy worldwide. Its economy grew by nearly 10% per year from 1998-2008 (World Bank, 2013). While GDP growth was almost nil (0.1%) in 2009 because of the global economic downturn, it rebounded with a 6.8% growth from 2010-2012 (Asian Development Bank, 2013). In 2012, the economy grew by 7.2%, its highest growth over the past five (5) years (2008-2012). Growth was driven mainly by higher inflows of foreign direct investments. On the demand side, consumption expanded by 9.5% and made the biggest contribution to GDP growth. On the production side, the services sector was the main source of growth as it increased by 8%. Growth in the industry sector slowed down compared to the previous year but still managed to increase by 9%. On the other hand, agricultural production increased by 4% despite floods and dry weather in some areas, mainly due to increases in paddy rice production (4.3%) and fisheries (6%) [ADB, Asian Development Outlook 2013].

In spite of its impressive growth, Cambodia is still classified as a low income country by the World Bank. As of 2012, it has a GDP of USD 14.06 billion (current) and per capita GNI of USD 2,360 (Purchasing Power Parity). The country's population increased by 1.7% in 2012, amounting to a total of 14.86 million, of which 22% are residing in urban areas and 78% in rural areas (ADB Key Indicators for Asia and the Pacific). Poverty incidence declined significantly from 35% (of the total population) in 2004 to 20% in 2011. Nonetheless, poverty largely remains a rural phenomenon as 90% of the poor are living in the countryside (World Bank, 2013). Of the total employed population, 71% are engaged in agriculture. Agricultural output constitutes about 35.6% of GDP (at current prices), second only to the services sector (40.1) followed by the industry sector (24.3%) [ADB, 2013]. At 2000 constant price, however, the share of agriculture to GDP dropped to 27.5% while that of the industry sector increased to 31.1%. The services sector increased slightly to 41.4% based on the estimates of Cambodia's National Institute of Statistics (NIS) under the Ministry of Planning.

Table 1 provides a summary of the key socio-economic indicators for Cambodia:

Table 1. Key economic indicators of Cambodia (2012)

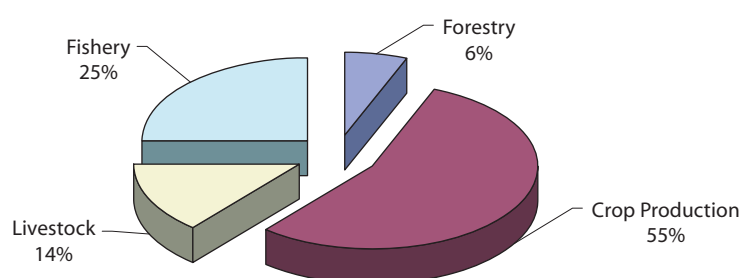
Population	14.86 million
Annual population growth rate	1.7 (2011-2012)
	1.5 (2010-2012)
Urban, in % of population	22
Rural, in % of population	78
GDP, in billion USD	14.06
Per capita GNI, atlas method, in USD	820 (2011)
Per capita GNI, PPP method, in USD	2,360
GDP structure, at current prices (in %)	
Agriculture	35.6
Industry	24.3
Services	40.1
GDP structure, at constant prices (in %)	
Agriculture	27.5
Industry	31.1
Services	41.4
CPI (% change per year)	2.9
Unemployment rate, in %	0.2 (2011)
Labor force by sector, in %	
Agriculture	71
Manufacturing	9
Mining	1
Others	19
CPI (% change per year)	2.9
Poverty Incidence, in % of population (2011)	20

Sources: Ministry of Planning-NIS, Asian Development Bank, World Bank

Agriculture sector profile

Although Cambodia's economy is mainly driven by the services and industry sectors, the output of the agriculture sector still constitutes a significant portion of total output at 27.5% of GDP. Moreover, almost three-fourths (71%) of the employed populace are engaged in agricultural livelihood activities. By sub-sector, the Ministry of Agriculture, Fishery and Forestry (MAFF) in Cambodia reported that more than half (55%) of agricultural output came from crop production while fishery contributed one-fourth (25%), followed by livestock (14%) and forestry (6%) [Figure 1].

Figure 1. Composition of sub-sectors in agriculture (2012)



Source: MAFF Annual Report 2012

Rice continues to be the main crop and source of livelihood among the rural population. Of the 4.4 million hectares cultivated for all types of crops, more than 3 million hectares or 68% is devoted to rice production. About 21% is cultivated for the four (4) other main crops, namely: maize, cassava, mung bean, soya bean and other subsidiary and industrial crops. This is followed by area cultivated for rubber (6%) and permanent crops (4%) which include high value crops such as cashew, banana, oil palm, coconut, mangoes, among others (Table 2).

Table 2. Areas cultivated, by type of crop

Type of crop	Crops planted	Size of area cultivated (in hectares)
1. Rice	Wet & dry rice crops	3,007,545
2. Subsidiary & Industrial	Maize, cassava, sweet potatoes, vegetables, all kinds of bean, sesame, sugar cane, tobacco etc.	912,883
3. Permanent	Cashew, banana, oil palm, coconut, mangoes, coffee, durian, pepper, orange, and other fruit etc.	193,751
4. Rubber		280,355
Total		4,394,534

Source: MAFF Annual Report 2012

Private ownership of land in Cambodia was officially recognized in 1989 (Cambodia 2010 Socio-Economic Survey). Farming households were invited by the government to apply for a title to the land they cultivated. Accordingly, households with agriculture as their main occupation received land according to household size and other relevant characteristics. Based on the 2010 CSES survey results, the estimated number of households having agricultural land accounted for 72% of all households in 2010. Almost half of these households (50%) owned less than one (1) hectare of land. About 77% owned less than two (2) hectares while 90% owned less than three (3) hectares.

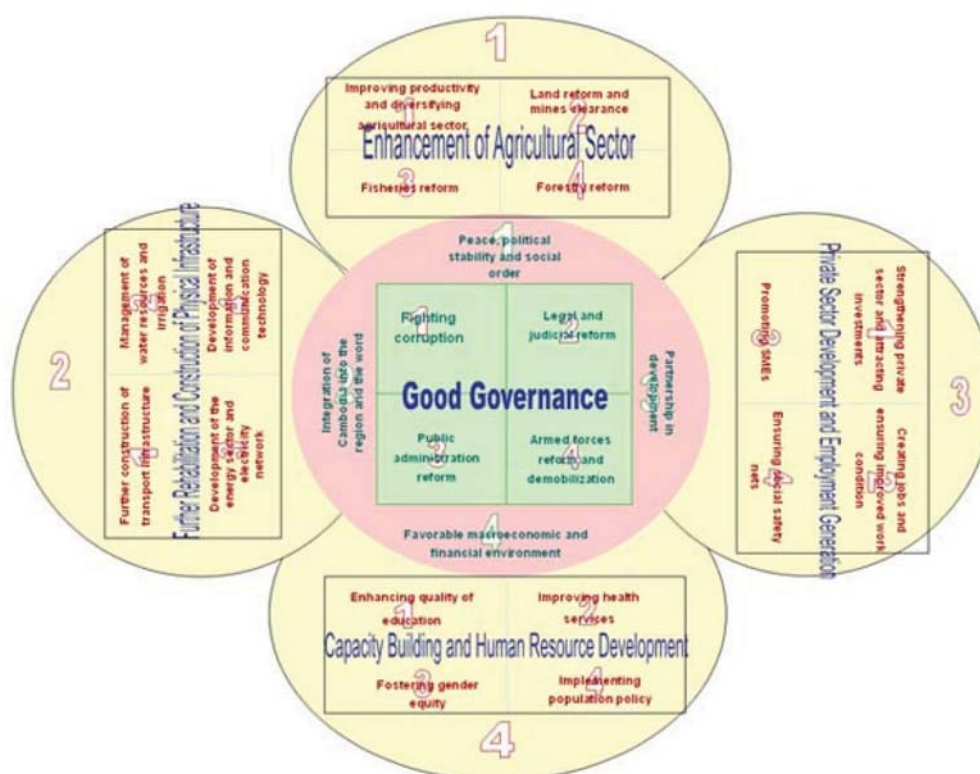
Role of finance in agricultural policies and plans

The Rectangular Strategy for Growth, Employment, Equity and Efficiency Phase II is the socio-economic policy agenda of the Royal Government of Cambodia. It was announced by the Prime Minister on 26 September 2008 during the First Cabinet Meeting of the Fourth Legislature of the National Assembly. The Rectangular Strategy identifies four (4) strategic "growth rectangles", one of which is enhancement of the agriculture sector. This, in turn, covers four (4) measures, namely: (i) improving agricultural productivity and diversification; (ii) land reform and clearing of mines; (iii) fisheries reform; and (iv) forestry reform (Figure 2).

To improve agricultural productivity and diversification, an integrated approach is being espoused through a package of services which include expansion of rural credit and microfinance together with proper use of improved agricultural inputs, agricultural extension, research and development, construction and maintenance of rural infrastructure, particularly irrigation, agricultural market development, organization of farmer communities, and better management of agricultural land.

Development of the agriculture sector is one of the main pillars of the Rectangular Strategy Phase II. Agriculture is envisioned to serve as a foundation for economic growth and as a tool for accelerating poverty reduction and improving the living standards of the Cambodian people. The strategies adopted for attaining this vision are productivity enhancement, diversification, and agricultural commercialization (transformation from subsistence to commercial agriculture) as embodied in the Agriculture Strategic Development Plan (ASDP) 2009-2013.

Figure 2. The rectangular strategy for growth, employment, equity and efficiency



Source: CDC-CRDB at <http://www.cdc-crdb.gov.kh>

To this end, the *National Policy for Paddy Commercialization and Export* was officially promulgated on June 25, 2010. Being the country’s most important agricultural commodity, the promotion of rice export is being prioritized. However, the successful implementation of the rice export policy is expected to eventually pave the way for the export promotion of other agricultural commodities. The vision is to transform Cambodia into a ‘rice basket’ and a major rice-exporting country in the global market. The target is to produce a paddy surplus of more than four (4) million tons and rice export of at least one (1) million ton by 2015. Strategies for attaining this target are classified into short-term and medium- to long-term.

The short-term strategy aims to promote paddy production to meet market demand and rice export by shifting from informal export of paddy to formal rice export. Credit is one of several measures identified under this strategy. Specific interventions include provision of micro-credit to rice producers, and loans for the purchase and processing of paddy. Other financing interventions include recapitalization of state-owned financial institutions, and provision of incentives to commercial banks to increase agricultural loan portfolio, particularly the development of credit guarantee schemes and risk-sharing facilities.

The medium- to long-term strategy focuses on enhancing the competitiveness of the rice sector. The provision of medium- to long-term credit is again identified as one of the measures together with promotion of production technology; management of soil fertility, water, seeds and fertilizers; organization of farmer associations; quality rice processing; establishment and/or repair of relevant physical infrastructure; trade facilitation; and exploration of market opportunities.

The Ministry of Agriculture, Fishery and Forestry (MAFF) had prepared a detailed action plan for implementing the abovementioned policy measures, which it subdivided into four (4) major policy measures on: (i) rice productivity; (ii) paddy collection and processing; (iii) export facilitation; and

(iv) marketing. Credit, in particular, plays a prominent role in the policy measures on rice productivity, and paddy collection and processing. Provision of micro-credit is identified as a short-term measure for increasing rice productivity. On the other hand, several short-term measures were identified for financing paddy collection and processing, namely: recapitalization of the Rural Development Bank, infusion of additional capital for the Agriculture Development and Support Fund, and development of guarantee and risk-sharing facilities to encourage lending by commercial banks for this purpose. Medium- to long-term measures were also identified for financing paddy collection and processing such as creation of new financial instruments and leverage mechanism for financing (Table 3).

The total paddy production in 2012 was 9.3 million metric tons (MT) – or an average yield of 3 million MT per hectare of which about 4.7 million MT of paddy or about 3 million MT of milled rice is surplus production and targeted for export. For the year 2012, 205,717 MT of rice was exported to 57 countries. From January to September 2013, the volume of rice exports already reached 266,123 MT², exceeding rice exports for the entire year of 2012. Nonetheless, rice exported by Cambodia accounts for less than 1% (0.70) of total volume of rice exported globally which is projected to reach 38.33 million MT at the end of 2013. Rice exports in the world market is now dominated by India with 9.3 million MT, accounting for 24% of total rice exports, followed by Thailand with 8 million MT (20.5%) and Vietnam with 7.8 million MT (20%).³

² Based on the article by Oryza entitled “Cambodia exports 266,123 tons rice Jan-Sep, 2013, up 106% from last year”, 08 October 2013.

³ Based on the World Rice Trade Report of the United States Department of Agriculture (USDA) Foreign Agricultural Service (FAS).

Table 3. Short-term, and medium- to long-term policy measures for credit in support of the paddy production and rice export policy

Policy measures	Short-term	Medium- to long-term	Target period	Institution responsible
1. Rice productivity	Promote micro-credit for agriculture	None specified	None specified	MEF and NBC
2. Paddy collection & processing	Recapitalize the Rural Development Bank (RDB) with an additional amount of USD 7 million (from USD 13 million to USD 20 million).	Develop new financing instruments such as operating lease, financial lease, warehouse receipt system, and centralized credit information in order to diversify collateral types and scope of financial operations.	By end-2010 or, at the latest, in early 2011 (for short-term measures)	MEF and NBC
	Double the capital of the Agriculture Support Development Fund (ADSF) from USD 18 million to USD 36 million.		By end-2011, at the latest (for short-term measures)	MEF and NBC
3. Export facilitation	Develop a credit guarantee scheme to guarantee loans from commercial banks to companies and paddy collectors.	Consider the establishment of the Agriculture Development Bank (ADB) to support and promote agricultural production and processing.	By end-2011, at the latest (for short-term measures)	MEF and NBC
	Cooperate with development partners to set-up a risk-sharing facility to encourage commercial banks to extend loans for agricultural processing activities and small and medium enterprises (SMEs), in general.		By end-2011, at the latest (for short-term measures)	MEF and NBC
4. Marketing	None specified	None specified		
	None specified	None specified		

Source: Policy Paper on the Promotion of Paddy Production and Rice Export

CHAPTER 3

Rural and Agricultural Finance Policy and Regulatory Framework

Development of Cambodia's financial system

Just like everything else in the country, the financial system started to rebuild itself after the Khmer Rouge Regime ended in 1979. After being non-existent from 1975-1979, the National Bank of Cambodia (NBC) was re-established on October 10, 1979 as the People's Bank of Cambodia. It was a slow and difficult process as the bank started without financial, human and physical resources since suspected 'intellectuals' were killed, the NBC building was demolished, and all official documents destroyed. Fortunately, financial and technical assistance from foreign countries and organizations started to come in to help re-establish the country's financial system.

During the 1980s, the financial system in Cambodia took on a mono-banking structure with the People's Bank of Cambodia functioning as: (i) the monetary authority; (ii) national treasury of government; and (iii) provider of banking services including credit, deposits, and payment. Starting 1989, the bank's network of 20 provincial and municipal offices had been transformed into specialized banks operating with fiscal and monetary autonomy under the supervision of the People's Bank of Cambodia. In 1990, the role of the bank was streamlined further as its treasury function was transferred to the Ministry of Economy and Finance (MEF). The signing of the Paris Peace Accord on October 23, 1991 initiated a paradigm shift which transformed the country's economic regime from that of a centrally-planned economy to a free-market economy. In the financial sector, this translated to the transformation of the mono-banking system to the two-tier banking system which separated commercial-banking functions from the People's Bank of Cambodia. Further, the resulting policy environment provided for the establishment of commercial banks under local laws or as foreign bank's branches. Consequently, the first private commercial bank was established in 1991 as a joint venture between the People's Bank of Cambodia and the Siam Commercial Bank of Thailand.

In February 8, 1992, a law was promulgated officially changing the name (and functions) of the People's Bank of Cambodia to the National Bank of Cambodia (NBC) as it is presently called. These reforms enabled the NBC to focus on its role of providing direction and supervision to the banking system. The role of the NBC as the central bank of Cambodia was further refined following the enactment of the Law on the Organization and Conduction of the National Bank of Cambodia (Central Banking Law) on January 26, 1996. This law specified that the principal mission of the National Bank of Cambodia is to "determine and direct the monetary policy aimed at maintaining price stability". Badiola (2007) cites that the period of political stability allowed the financial sector to further develop. In 1999, the Law on Banking and Financial Institutions (Banking Law) was promulgated, introducing more appropriate definitions for banking activities and a refined legal framework for banks. It also allowed microfinance institutions (MFIs) to undertake financial operations under the supervision of NBC. In 2000, the Government embarked on a comprehensive bank restructuring program with the assistance of the International Monetary Fund (IMF) to enhance public confidence in the banking system.

Current policy and regulatory environment for the financial sector

• Financial structure

Today, the NBC continues to strengthen its role as the monetary authority as well as the supervisory and regulatory body for the banking sector. NBC's main functions are to: (i) formulate and implement monetary policy aimed at maintaining price stability and successful economic development; (ii) act as the sole issuer of the national currency; (iii) act as the supervisory authority for the banking and financial system; and (iv) oversee the payment system.

Financial service providers in Cambodia generally consists of banks, microfinance institutions (MFIs), and NGOs providing financial services. Banks are classified into commercial and specialized banks (banks with only one banking function, usually lending services). On the other hand, non-bank financial service providers are classified into licensed MFIs and registered credit operators (mostly NGOs providing financial services). MFIs may further be granted the license to operate as a deposit-taking institution by the NBC. The differences among registered NGOs, licensed MFIs, and MFIs that are further licensed to take deposits from the public represents a hierarchy for development of financial services and will be discussed in succeeding sections on microfinance.

As of December 31, 2012, there are 32 commercial banks, seven (7) specialized banks, four (4) representative offices of foreign banks, 35 microfinance institutions (MFIs) – of which seven (7) are licensed deposit-taking institutions, and 33 credit operators (registered NGOs) falling under the supervision and regulation of the NBC.

• Current policy environment and significant developments

Political stability, economic growth, and a policy and regulatory environment conducive for private sector investment greatly benefited the financial services sector. Recent developments in policy and regulation were intended to further inspire confidence in the country's financial system. The NBC is granted the authority to supervise and regulate even non-bank financial service providers (e.g. NGOs). Even the operations of money changers and, recently, pawnshops, are being supervised and regulated by the Ministry of Finance. This policy environment encourages the private sector to invest or provide financing to such NGOs, confident that their assets and interests are well protected. This, in turn, serves as an incentive for more NGOs to be registered by the NBC and eventually granted a license to operate as an MFI. Further, there are no restrictions as to how much foreign investors may own in a local enterprise. In fact, full ownership of an NGO, MFI or bank may be granted to foreign investors. Among banks, foreign share of paid up capital was 73% and Cambodian share was 27% in 2012. This proportion is likewise similar among MFIs, with foreign share of paid up capital even higher at 76% and Cambodian share at 24% (NBC, Annual Report 2012).

Policies on Interest Rate and Collateral. The NBC has also issued *prakas* (regulations) on collateral and interest rate, two (2) lending terms that most borrowers are concerned about. Banks and MFIs are mandated by the NBC to require collateral for their loans. For agriculture, land title is the usual form of collateral required. There are two (2) types of collateral with regard to land titles, namely: hard or soft. Land titles issued by the national government are considered 'hard' collateral while certification of ownership issued by the village or commune chiefs are considered 'soft' collateral. Usually, only MFIs honor the soft title as collateral. Nonetheless, collateral, whether hard or soft land titles, are only used as 'emotional pressure' to the borrower. In case of non-repayment by the borrower, land titles can be acquired by MFIs or banks but cannot be sold. The law prohibits MFIs or banks from selling acquired lands; only landowners and the juridical courts can sell these properties.

Pricing of loans are generally based on market rates. The interest structure is basically composed of three (3) components: costs of funds, operational and administrative costs, and profit margin. However,

the government – through the state-owned Rural Development Bank (RDB) – may implement credit programs with concessionary rates in support of priority policies or programs. The RDB, as an example, is currently implementing credit programs in support of the Rice Export Policy with an interest rate of 5% per annum for rice miller associations, and 7% per annum for other banks or MFIs for rice production. A Prakas was also issued by the NBC in 2001 to strengthen transparency in interest rate setting which resulted in a change from the ‘flat rate method’ where interest is based on initial loan principal, to the ‘declining method’ where interest is based on remaining principal balance.

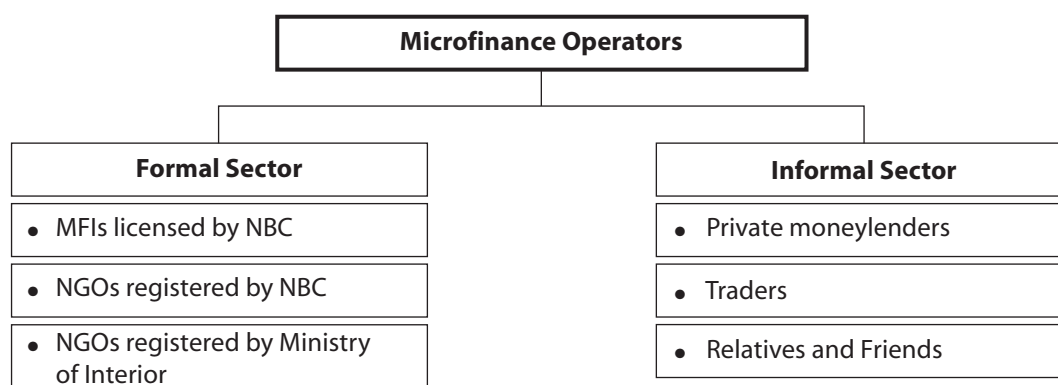
● **Microfinance: Main instrument for financial support to the poor**

In the financial system of Cambodia, microfinance is the instrument used to provide the financing needs of the poor. The roots of microfinance in Cambodia can be traced back during the 1990s when international donor organizations and NGOs provided a package of assistance (social work, health, financing, etc.) for the purpose of improving the livelihood of the poor. Funds for microfinance was part of the package provided by international NGOs and donor organizations. Local NGOs were used as lending conduits to finance the working capital requirements of small businesses and agricultural production.

As microfinance activities progressed, the government of Cambodia recognized its importance as a vehicle for delivering financial services to the poor and a critical instrument for both economic growth and poverty alleviation. Consequently, the Credit Committee for Rural Development (CCRD) was formed in February 1995 to develop the appropriate policies and programs for the microfinance sector. In 1997, the CCRD prepared a policy paper on “Policy and Strategies in Microfinance Sector.” The Financial Sector Development Plan for 2001-2010 elevated microfinance as part of the banking sector. This provided the basis for the introduction of regulations in microfinance to further strengthen the role of microfinance operators in economic development and poverty alleviation. On November 26, 2007, the Policy and Strategies in Microfinance Sector was officially promulgated by the Prime Minister in accordance with the updated Financial Sector Development Strategy for 2006-2015. It is envisioned to strengthen the legal and regulatory framework, and ensure the efficiency, sustainability, and transparency of the microfinance sector.

Microfinance services in Cambodia is being provided by both the formal and informal sectors composed as follows: (i) MFIs licensed by the NBC; (ii) credit operators registered by the NBC; (iii) NGOs not registered by the NBC but registered by the Ministry of Interior; and (iv) informal lenders such as unofficial moneylenders, traders, relatives and friends that provide loans in their respective communities. To make the distinctions clearer, it should be noted that most microfinance operators started out as NGOs registered under the Ministry of Interior. As the scale and scope of their operations increase, they are required to either be registered or licensed under the NBC (Figure 3).

Figure 3. Microfinance providers in Cambodia



The following are regulations set by NBC for registration and licensing of microfinance operators:

(i) Registration of microfinance operators with NBC

Article 3 of Prakas No. B7-02-49 Pro Kor of February 25, 2002 on the Registration and Licensing of Microfinance Institutions cites the following:

Registration with the National Bank of Cambodia is compulsory for all non-government organizations (NGOs), associations and other entities engaged in microfinance, if they meet one of the following conditions:

- (a) *For those engaged in credit:*
 - *Their loan portfolio outstanding is equal to or greater than KHR (riel) 100 million.*
- (b) *For those engaged in savings mobilization:*
 - *The savings mobilized from the general public amount to KHR 1 million or more, or*
 - *The number of depositors is 100 or more.*

Further, Article 6 states that *microfinance operators denied registration by NBC or whose registration is cancelled by NBC shall cease all microfinance activity within three (3) months of being informed by the NBC.*

(ii) Licensing of microfinance operators with NBC

Article 8 of Prakas No. B7-02-49 Pro Kor of February 25, 2002 on the Registration and Licensing of Microfinance Institutions cites the following:

Licensing is compulsory for all microfinance institutions, if they meet one of the following conditions:

- (a) *For those engaged in credit:*
 - *Their loan portfolio outstanding is equal to or greater than KHR 1,000 million, or*
 - *They have 1,000 borrowers or more.*
- (b) *For those engaged in savings mobilization:*
 - *The savings mobilized from the general public amount to KHR 100 million or more, or*
 - *The number of depositors is 1,000 or more.*

(iii) Licensing of microfinance deposit-taking institutions with NBC

Article 2 of Prakas No. B7-07-163 Pro Kor of December 13, 2007 on the Licensing of Microfinance Deposit Taking Institutions cites the following:

An Institution requesting a license to collect deposits from the public shall have the following qualifications:

- (a) *Hold a license to carry out microfinance operations from the National Bank of Cambodia for a duration of no less than three (3) years;*
- (b) *Have a good financial condition and sound management as judged by the internal rating of the National Bank of Cambodia, at a safety level for at least two years before submitting the application;*
- (c) *Have a minimum paid up capital equal to 10,000 million riels;*
- (d) *Have an effective Management Information System (MIS);*
- (e) *Implement NBC's uniform chart of accounts; and*
- (f) *Have sustainable profitability of at least two consecutive years in primary operations.*

Article 3 of the same Prakas cites the following:

After receiving a license to collect deposits from the National Bank of Cambodia, the Institution shall meet the following requirements:

- (a) An Institution can only collect savings and fixed deposits if the amount of savings of an individual client shall not exceed 3% of Institution's net worth;*
- (b) An Institution cannot lend to an individual client at a rate exceeding 2%, nor to a group of related clients at a rate exceeding 3% of Institution's networth;*
- (c) An Institution shall maintain at all times a solvency ratio of not less than 15% of the Institution's net worth;*
- (d) An Institution shall have a liquidity ratio of at least 50%;*
- (e) An Institution shall permanently deposit the capital guarantee of at least 10% of its registered capital into an account maintained with the National Bank of Cambodia; and*
- (f) An Institution shall deposit the reserve requirement of at least 8% of its client deposits into an account maintained with the National Bank of Cambodia.*

(iv) Licensing of banks with NBC

Article 7 of Prakas No. B7-08-193 Pro Kor of September 19, 2008 on the New Capital Requirements and Criteria for Licensing Approval of Banks cites the following:

Article 1 of the Prakas B7-00-39 dated February 09, 2000 on Commercial Banks' Minimum Capital is replaced by the following article:

"Commercial banks locally incorporated as companies which have at least one (1) influential shareholder as a bank or financial institution with a rating "investment grade", extended by a reputable rating agency, must have minimum capital equal to at least KHR 50,000,000,000 (fifty billion)."

"Commercial banks having shareholders as individuals or companies, must have a minimum capital of at least KHR 150,000,000,000 (one hundred fifty billion)."

Article 8 of the same Prakas cites the following:

Article 4 of the Prakas B7-00-05 dated January 11, 2000 on the Licensing of Rural Credit Specialized Banks is replaced by the following article:

"Specialized banks locally incorporated as companies which have at least one (1) influential shareholder as a bank or financial institution with a rating "investment grade", extended by a reputable rating agency, must have minimum capital equal to at least KHR 10,000,000,000 (ten billion)."

"Specialized banks having shareholders as individuals or companies, must have a minimum capital of at least KHR 30,000,000,000 (thirty billion)."

Table 4 provides a summary of the registration and licensing requirements of NBC as provided in the abovementioned prakas. These regulations form part of an enabling policy environment which provides for the growth and development of the microfinance sector. In such an environment, an NGO providing microfinance services has the opportunity to be upgraded into a licensed MFI and eventually a commercial bank (Figure 4). A fine example is that of ACLEDA Bank, one of the pioneering microfinance operators during the 1990s and is presently the largest commercial bank and microfinance provider in Cambodia. ACLEDA started in 1993 as an NGO offering microfinance services. It became a specialized bank in 2000 with assets of less than USD 3 million. In 2003, it was upgraded to commercial bank status. ACLEDA now has total assets of USD 2 billion. It has 238 branches as well as offices in Myanmar and Lao PDR. Loans released by ACLEDA constitute 18.5% of the entire loans of the banking

system in Cambodia while savings constitute 18%. As microfinance providers go up the ladder from being NGOs to MFIs to commercial banks, they also increase their capacity to attract funds from local and international creditors as investor confidence also increases. The financial services they are allowed to provide to the public also expands as they develop. MFIs, for instance, could expand their services to include deposit-taking once they obtain their license as microfinance deposit-taking institutions (MDIs) from NBC. Commercial banks are of course authorized to provide a wide array of financial services, compared to only loans and deposits by MDIs.

As MFIs gain access to more capital from creditors, they can likewise increase their outreach to more new borrowers (those that still have no access to formal finance) and provide funds for the so-called “missing middle” in microfinance or existing borrowers with bigger capital requirements to expand their businesses and scale of operations.

Table 4. Key requirements for regulation and licensing of microfinance providers

Transition process	Regulation required	Loans ¹		Savings ²		Capital (in million KHR) ³
		Amount (in million KHR)	No. of borrowers	Amount (in million KHR)	No. of depositors	
1. Unregistered NGO to registered NGO	Registration	= or >100	None required	= or >1	= or >100	
2. NGO to MFI	Licensing	= or >1,000	1,000	= or >100	= or > 1,000	= or >250
3. MFI to MDI ⁴	Licensing					10,000
4. MFI/MDI to Bank	Licensing					
• Commercial Bank						
~ Investment grade						50,000
~ Non-investment grade						150,000
• Specialized Bank						
~ Investment grade						10,000
~ Non-investment grade						30,000

¹ Loan portfolio outstanding

² Savings mobilized

³ Minimum capital required

⁴ Microfinance deposit-taking institution

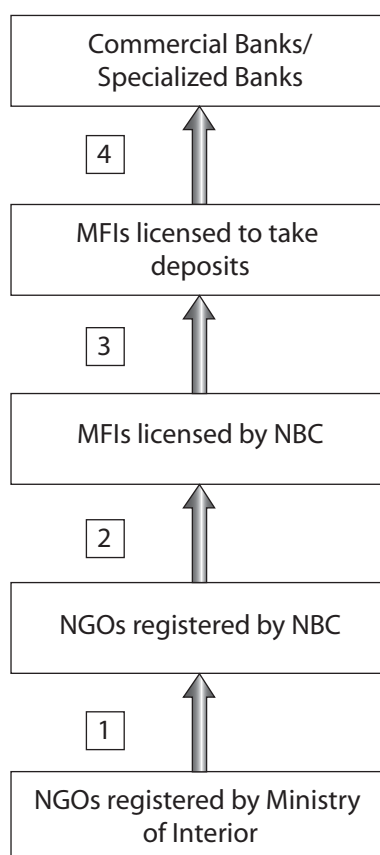
Gray-shaded areas mean there are no requirements for either registration or licensing.

Source: National Bank of Cambodia

• Credit Bureau of Cambodia

The government of Cambodia recognizes the importance of a credit information sharing system. On 24 May 2011, the NBC issued a Prakas on Credit Information Sharing, requiring all banks and MFIs to share information regarding the credit history of their borrowers in preparation for the establishment of a credit bureau. Further, all financial institutions under the supervision of the NBC were given nine (9) months to change their system, if needed, in order to conform to the requirements of the credit bureau. On 3 January 2013, the Credit Bureau of Cambodia (CBC) received its license to operate from the NBC. It officially started operations on 19 March 2013.

The CBC serves as a repository of credit information on borrowers available for access by banks and MFIs. It is a critical financial infrastructure for improving transparency and risk management which is expected to encourage more lending to the unbanked and under-banked sectors, particularly SMEs and agriculture. Through the CBC, banks and MFIs could more efficiently assess credit risk and reduce lending costs, especially in conducting credit investigations. They will also be able to ‘weed out’ good

Figure 4. Phases of development for microfinance providers

borrowers from bad borrowers, enabling those with good credit track record avail of financing. Overall, an efficiently functioning credit sharing information system addresses the issue of multiple-borrowing and prevent over-indebtedness in the financial system. This contributes significantly to an improved credit rating for the country.

As of 26 August 2013, the CBC has a total of 85 member banks and MFIs which own 51% of the CBC while 49% is owned by VEDA, a private company which developed the credit information sharing system and operates the CBC. There are currently 2.5 million borrowers entered into the system with USD 2.7 million loans. Information provided by CBC includes 181 fields including amount of previous loans of the borrower, payment history, defaults, etc. (The complete list of information on all 181 fields was classified, according to CBC.) The CBC gets around 11,000 to 17,000 credit inquiries in a day. Fees charged to bank and MFIs are as follows:

- (i) USD 0.18 for loans up to USD 500;
- (ii) USD 2.50 for loans above USD 500 to USD 10,000; and
- (iii) USD 3.50 for loans above USD 10,000.

The average is about USD 1.0 per inquiry. For individuals, they may access their credit history free of charge once a year and USD 0.5 for succeeding usage within the year. CBC spends about USD 1.5 million a year to operate the credit bureau.

The establishment of a credit bureau in Cambodia has had its share of struggles especially in the early stages of its development. The concept of a credit bureau was first proposed by NBC and the Asian Development Bank (ADB) in 2006. It was launched in the same year. It was voluntary, i.e. there was no

legislation that required banks and MFIs to join. Mainly for this reason, the system failed and the credit bureau was shut down in 2008. In 2009, the NBC together with the IFC and the Association of Banks in Cambodia proposed for the establishment of a re-invented credit bureau. This initiative was supported by legislation which required all banks and MFIs under the supervision of the NBC to participate and supply data on their borrowers on a monthly basis, for every credit line, or loans that they release. Non-compliance would result in revocation of their license and payment of penalties. The new credit bureau started loading historical data in 2010.

The CBC is mandated by NBC to run it as a business, i.e. stakeholders should get enough dividends. Taking into account the lessons learned in the initial efforts to establish a credit bureau in Cambodia, Mr. Garry Wood, CEO of CBC states "If the CBC is run by government, it will fail. If it's voluntary, it's going to fail".

● **Other Significant Policy Developments**

With the emergence of the money and securities markets, Cambodia's financial system has entered an era of specialization. Cambodia's stock market was officially launched in July 2011, and trading began in April 2012. The Law on the Issuance and Trading of Non-Governmental Securities has established the Securities and Exchange Commission of Cambodia to act as regulator of the securities market and market participants. The NBC likewise supported the development of interbank and money markets with the preparation of a book entry system for the purchase, sale, and custody of securities. Accordingly, procedures for the issuance of securities was developed in cooperation with banks to determine the characteristics of the negotiable certificates of deposit, which will be issued in the near future.

When conditions are favorable and the prerequisite infrastructure and regulatory frameworks for money market development have been put in place, government securities will also be issued. A government securities market is essential for implementing monetary policy parallel with the promotion of the Cambodian riel.

The NBC also granted a license to the first financial leasing company in Cambodia. The NBC also issued three (3) new prakas in 2012, namely:

(i) *Prakas on the Maintenance of Reserve Requirement Against Commercial Banks' Deposits and Borrowings*

Increases the reserve requirement rate from 12% to 12.5% on foreign currency deposits in support of a healthy and sustainable growth in the banking system.

(ii) *Prakas on Prudential Limits and Regulatory Requirements Applicable to Banking and Financial Institutions Trading in Securities*

Restricts banking and financial institutions from holding and trading in securities *more than 20% of their networth*, while microfinance institutions and financial leasing companies are *totally* prohibited from holding and trading in securities. The objective is to maintain safe and sound investment practices in light of increasing market risks.

(iii) *Prakas on Prudential Rules and Risk Management Requirements Applicable for Banking and Financial Institutions Acting as Cash Settlement Agents Related to Securities*

Requires cash settlement banks to separate cash settlement accounts from regular transaction accounts in order to minimize risks that may occur from cash settlement transactions with regular banking transactions. Thus, cash settlement banks are prohibited from lending in any form that serves the purpose of settlement and securities trading. They are likewise required to implement prudential rules related to liquidity, effective and proper governance, and internal control.

Other important developments include the diversification of the insurance sector to include life and micro-insurance products; the growing availability and use of electronic transfer for banking intermediation (e.g. mobile banking, ATMs); and other developments on regulation of money exchanges, pawn businesses, trusts, leasing, pensions, and collective investment schemes.

• **Financial Sector Development Strategy 2011-2020**

The Financial Sector Development Strategy (FSDS) 2011-2020 was officially adopted by the government of Cambodia on 6 July 2012. It is the updated version of the FSDS 2006-2015 in response to changing economic, social and political conditions in Cambodia. The objective of the FSDS 2011-2020 is to *“develop a sound financial sector that can contribute to poverty reduction by supporting economic growth and increasing poor people’s access to finance.”*

The FSDS 2011-2020 intends to address the following key challenges:

- (i) emerging risks and challenges from external shocks that could jeopardize Cambodia’s achievements to date;
- (ii) internal risks caused by delays in implementing critical reforms that could impact financial stability;
- (iii) weak policy coordination which causes delays in addressing gaps in the legal and regulatory framework, and in upgrading institutional infrastructure to keep up with rapid developments in the industry;
- (iv) upgrading of financial sector human resources and sustaining these improvements;
- (v) harmonization of relevant legal and regulatory frameworks to keep pace with developments in the financial sector, and;
- (vi) collaboration of concerned authorities in order to avoid interconnected risks that could damage the whole economy.

To address these challenges, the FSDS 2011-2020 has outlined several strategies. The following are some key strategies for critical sub-sectors in the finance industry:

- (i) Promote use of the riel and eventual de-dollarization of the economy as long-term goals of the government through the establishment of sound monetary policy and supporting market infrastructure. The National Bank of Cambodia must also explore new monetary policy tools to ensure financial stability and economic growth, build internal capacity, and gain greater autonomy in designing and implementing monetary policy;
- (ii) Being the financial sector’s most critical segment, the priorities identified for the banking sub-sector are the following: (a) maintain monetary and financial stability; (b) address constraints that prevent rapid development; and (c) intensify resource mobilization and enhance efficiency of resource allocation through development of a money market;
- (iii) Strengthen microfinance as government’s instrument for providing the poor with affordable financial services to increase their income, and help reduce poverty. The goal over the coming decade is for microfinance to further develop so it could cover a greater number of low-income people;
- (iv) For the insurance sector, key strategies identified are to continue implementation of the action plan specified in the FSDS 2001-2010; develop new insurance products; and enhance regulation and supervisory capacity in line with the Insurance Core Principles of the International Association of Insurance Supervisors, of which Cambodia is a member;
- (v) In support of the recent establishment of the stock market, the Securities and Exchange Commission of Cambodia should follow the core principles of the International Organization of Securities Commissions. Among others, development of a successful securities market will require supporting infrastructure and facilitation of access to the payment system. In turn, the development and operation of the payment system must be demand-led, provide support, and facilitate market operators’ access.

CHAPTER 4

State of Rural and Agricultural Finance and Extent of outreach

State of rural and agricultural finance in Cambodia

In Cambodia, nearly 1.23 million out of 3.08 million total households, or 40% of total households, have outstanding debt (2012 Socio-economic survey). Borrowing incidence though is considerably lower in Phnom Penh than all other areas as only 13.4% of people living in Phnom Penh have outstanding debt compared to 43% in all other areas. In terms of population, the proportion of people with outstanding debt relative to the population age 18 and above (18 is generally considered the legal age when people can borrow) is 64% in Cambodia – 18% in Phnom Penh, and much higher in all other areas at 70% (Table 5). Of the 21 farmers interviewed who have borrowed at least once from SATHAPANA – a microfinance deposit-taking institution (MDI), 12 said they regularly borrow from SATHAPANA while nine (9) said they borrowed just once or rarely borrowed. Thirteen respondents also have outstanding loans with SATHAPANA.

With regard to borrowing source, more people seem to be getting their loans from formal sources than informal sources. Of the 1,226,539 households with outstanding debt, 58% borrow from formal sources while only 42% borrow from informal sources. Loans from formal sources come from either banks or NGOs. Nearly one-third (32%) borrow from NGOs while more than one-fourth (26%) borrow from banks. For the informal sector, lenders are more diverse but are dominated by private moneylenders (19%) and relatives (16%). Other informal lenders include friends, neighbours, traders, landlords, and employers, among others (Table 6).

For the agriculture sector, data on the number of working population with outstanding debts as a proportion of the total working population for the sector is supplied. The proportion of people with outstanding debt to total population in the agriculture sector (44%) is greater than the proportion of people with outstanding debt to total population in Cambodia (40%). About 1.97 million out of 4.46 million people (44.2%) have outstanding debts. For Phnom Penh, borrowing incidence for the agriculture sector is much higher (38.5%) than for all other sectors (13.3%). Nonetheless, the proportion of people with outstanding debts in areas outside of Phnom Penh (44.2%) are still higher (Table 7).

The proportion of people borrowing from formal and informal sources in the agriculture sector pretty much follows the same trend as that of the general population. Of the 1,970,657 people with outstanding debt, 57% borrow from formal sources while 43% borrow from informal sources. NGOs are still the topmost source of credit (33.5%) again followed by banks (23%). The breakdown for the type of informal lenders is not provided for the agriculture sector (Table 8). Of the 21 farmer-borrowers of SATHAPANA, only three (3) have also borrowed from informal sources, from their families or friends. Nonetheless, all of them said that they preferred borrowing from formal sources mainly because of the lower interest rates.

Table 5. Number of households and population with outstanding debts in Cambodia (Phnom Penh and other areas)

(As of 31 December 2012)

Area	No. of households			No. of population		
	W/ outstanding debt	Total households	% to total households	W/ outstanding debt ¹	Population age 18 & over	% to total population
1. Phnom Penh	44,028	329,221	13.4	200,327	1,089,519	18.4
2. All Others	1,182,512	2,753,224	43.0	5,486,856	7,812,812	70.2
Total	1,226,539	3,082,445	39.8	5,678,875	8,902,331	63.8

¹ Estimated by multiplying the number of households with outstanding debt with the estimated average number of members per household (4.55 for Phnom Penh, 4.64 for all other areas, for an overall average of 4.63 in Cambodia).

Source: 2012 Socio-Economic Survey of Cambodia (unofficial results)

Table 6. Number of households and population with outstanding debts in Cambodia by lender/borrowing source (formal and informal)

(As of 31 December 2012)

Lender/borrowing source	Households		Population	
	Number	% to total	Number ¹	% to total
1. Formal	708,821	57.8	3,281,840	57.8
1.1 Banks	321,506	26.2	1,488,573	26.2
1.2 NGOs	387,315	31.6	1,793,267	31.6
2. Informal	517,719	42.2	2,397,038	42.2
2.1 Relatives	198,486	16.2	918,988	16.2
2.2 Friends/Neighbours	63,878	5.2	295,755	5.2
2.3 Moneylenders	229,312	18.7	1,061,713	18.7
2.4 Traders	8,642	0.7	41,011	0.7
2.5 Landlords	1,045	0.1	4,836	0.1
2.6 Employers	892	0.1	4,128	0.1
2.7 Others	15,466	1.3	71,607	1.3
Total	1,226,539	100.0	5,678,878	100.0

¹ Estimated by multiplying the number of households with outstanding debt with the estimated average number of members per household which is 4.63.

Source: 2012 Socio-Economic Survey of Cambodia (unofficial results)

Table 7. Number of working population and households with outstanding debts in the agriculture sector in Cambodia (Phnom Penh and other areas)

(As of 31 December 2012)

Area	No. of working population in agriculture			No. of agricultural households		
	W/ outstanding debt	Total working population	% to total working population	W/ outstanding debt ¹	Total agri- households	% to total agri- households
1. Phnom Penh	20,109	52,206	38.5	4,343	26,838	16.2
2. All others	1,950,549	4,408,940	44.2	421,285	2,020,622	20.8
Total	1,970,657	4,461,146	44.2	425,628	2,047,460	20.8

¹ Estimated by dividing the number of working population with outstanding debt, by the estimated average number of members per household (4.55 for Phnom Penh, 4.64 for all other areas, for an overall average of 4.63 in Cambodia).

Source: 2012 Socio-Economic Survey of Cambodia (unofficial results)

Table 8. Number of working population and households with outstanding debts in the agriculture sector in Cambodia, by lender/borrowing source (formal and informal)

(As of 31 December 2012)

Lender/borrowing source	Working population		Households	
	Number	% to total	Number ¹	% to total
1. Formal	1,119,214	56.8	241,731	56.8
1.1 Banks	459,296	23.3	99,200	23.3
1.2 NGOs	659,918	33.5	142,531	33.5
2. Informal ²	851,444	43.2	183,897	43.2
Total	1,970,657	100.0	425,628	100.0

¹ Estimated by dividing the number of working population with outstanding debt, by the estimated average number of members per household which is 4.63 in Cambodia.

² Breakdown as to types of informal lenders were not provided by the survey.

Source: 2012 Socio-Economic Survey of Cambodia (unofficial results)

Performance of the financial sector

• Performance of the banking sector

Number of Bank Offices and Staff. The total number of bank offices increased by 8% from 421 in 2011 to 455 in 2012. The increase in number of offices came solely from the commercial banking sub-sector which increased from 414 to 448. The number of specialized banks remained the same at seven (7) and are all located in Phnom Penh. On the other hand, the number of commercial banks increased by 18 in Phnom Penh and 16 in provincial areas (Table 9). The number of staff also increased from 12,051 in 2011 to 13,467 in 2012, thus providing employment to an additional 1,416 people in 2012.

Table 9. Number of bank offices

(As of 31 December 2012)

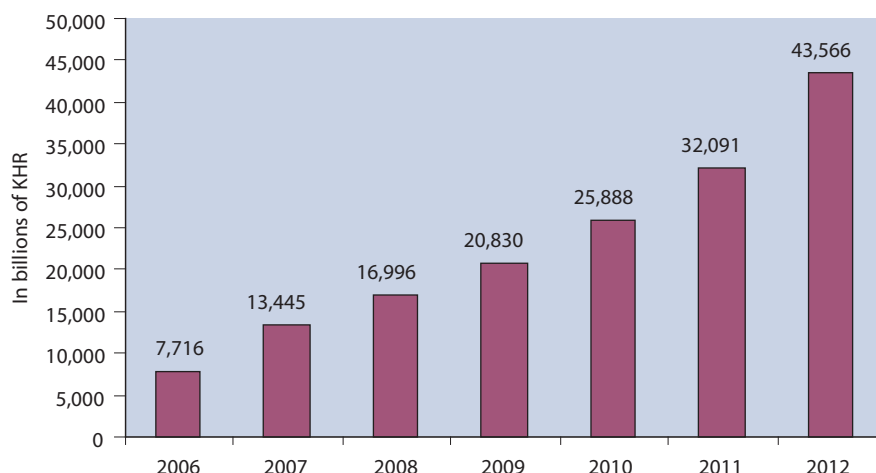
Type of bank	2012			2011		
	Total	Phnom Penh	Provincial	Total	Phnom Penh	Provincial
1. Commercial	448	141	307	414	123	291
2. Specialized	7	7	0	7	7	0
Total	455	148	307	421	130	291

Source: National Bank of Cambodia

Assets. Total assets of the banking sector have been consistently increasing since 2006, reaching 43.57 trillion KHR in 2012 (Figure 5). Correspondingly, 2012 also posted a 37.3% asset growth, the highest recorded increase since 2008. The Asset-to-GDP Ratio or the proportion of total assets to the country's GDP has likewise been on an uptrend since 2006. From more than one-fourth (26%) in 2006, Asset-to-GDP Ratio ballooned to more than three-fourths at almost 77% of GDP (Figure 6). This indicates the scale of operations and the extent of the banking sector's contribution and importance to the country's economic performance. Conversely, this likewise indicates the risk and consequence to the economy should there be a financial crisis, and hence, the importance of keeping the financial system healthy.

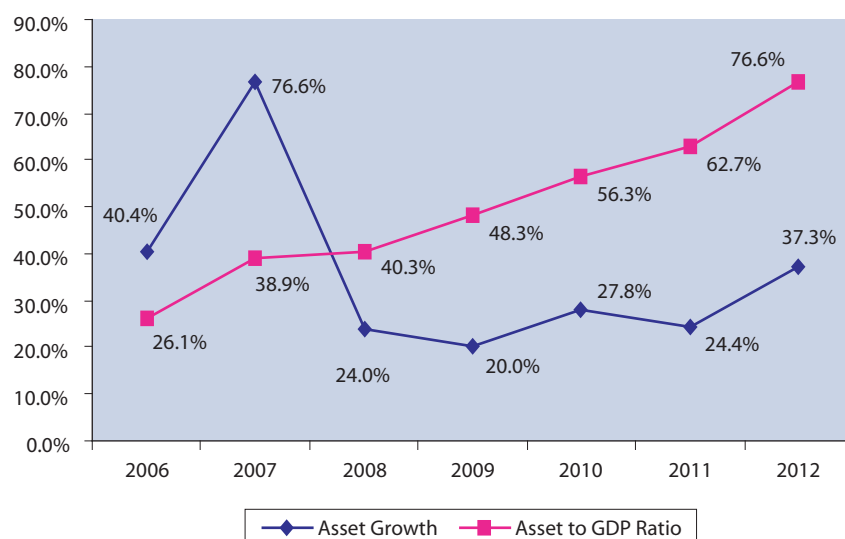
Figure 5. Total assets of the banking sector

(As of 31 December 2012)



Source: National Bank of Cambodia

Figure 6. Asset growth and asset to GDP ratio of the banking sector (2006 to 2012)

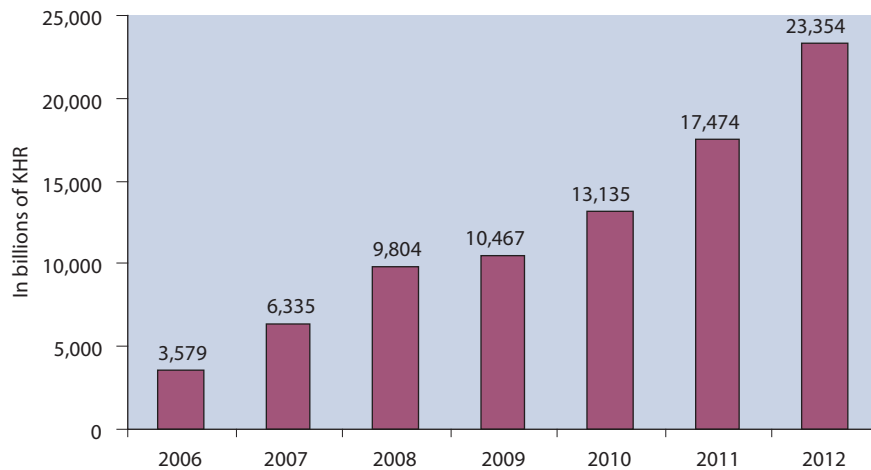


Source: National Bank of Cambodia

Loans. Loans released by the banking sector have also been increasing since 2006, reaching 23.35 trillion KHR in 2012 (Figure 7). However, growth in loans released have not been as consistent during the said period. From an 83% increase in 2007, credit growth plummeted to 5.2% in 2009 during the height of the global financial crisis. The banking sector recovered and posted a 28% increase the following year, and a 34% increase in 2011. In 2012, loans grew by almost the same percentage at 35%. On the other hand, the share of bank loans has consistently increased from 12% in 2006 to 41% in 2012 (Figure 8). This is again an indication of the importance of the loans provided by the banking sector in relation to the size and performance of the economy. Loans to the agriculture sector comprised 10% of total loans released by the banking sector in 2012. Majority of loans went to wholesale trade (17%), followed by retail trade (16%), agriculture, forestry and fishery (10%), other non-financial services (10%), manufacturing (9%) and construction (8%) (Figure 9). The ratio of non-performing loans to total loan released went down significantly from 9.5% in 2006 to 3.4% in 2007. The ratio then increased to 4.4% in 2009 but has since gone down every year to 2.45% in 2012 (Figure 10).

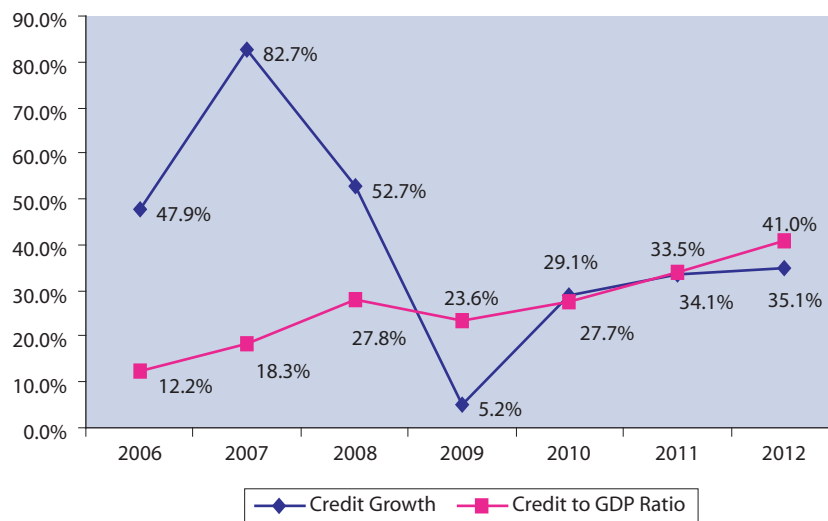
Figure 7. Loans released by the banking sector

(As of 31 December 2012)



Source: National Bank of Cambodia

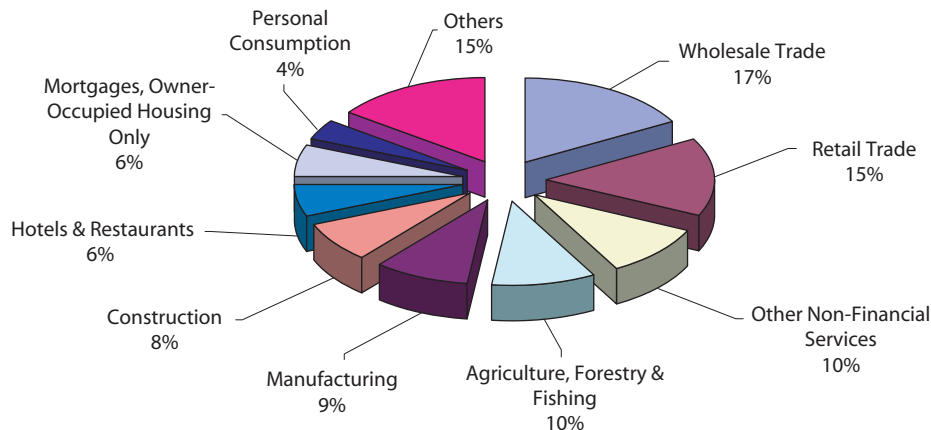
Figure 8. Credit growth and credit to GDP ratio of the banking sector (2006 to 2012)



Source: National Bank of Cambodia

Figure 9. Total loans of the banking sector, classified by type of industry

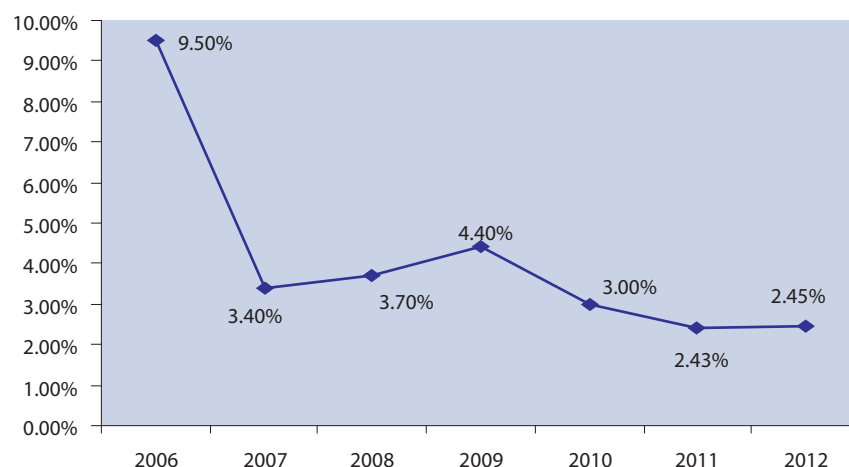
(As of 31 December 2012)



Source: National Bank of Cambodia

Figure 10. Ratio of non-performing loans to total loans of the banking sector

(As of 31 December 2012)



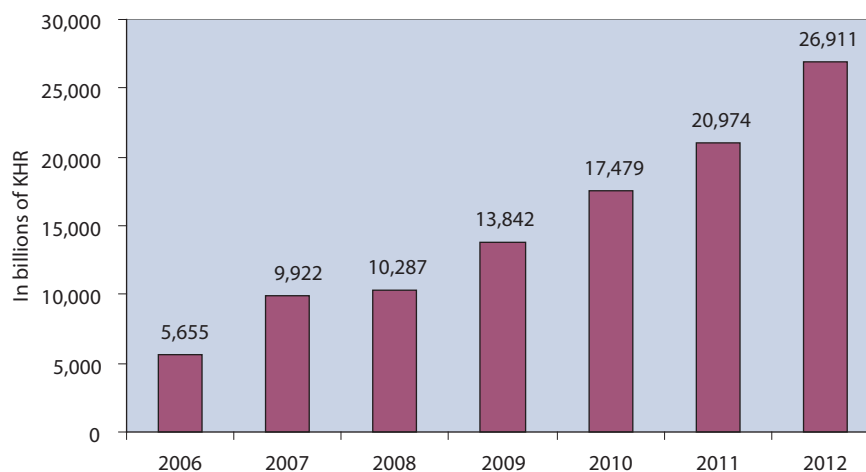
Source: National Bank of Cambodia

Deposits. As the other major service being provided by banks (the other being loans), total deposits in the banking sector has generally followed the same increasing trend as assets and credit. Total deposits increased from 5.66 trillion KHR in 2006 to almost 27 trillion KHR in 2012 (Figure 11). Deposits were also affected considerably by the global financial crisis in 2008-2009. Growth in deposits went down from 77% in 2007 to 1.7% in 2008 during the height of the crisis. It recovered and increased to 31.7% in 2009 but again went down to 20.4% in 2011. The trend was reversed in 2012 as deposits grew by almost 30%. In spite of inconsistencies in its growth, the proportion of deposits to GDP has been consistently increasing from 18% in 2006 to 47% in 2012 (Figure 12).

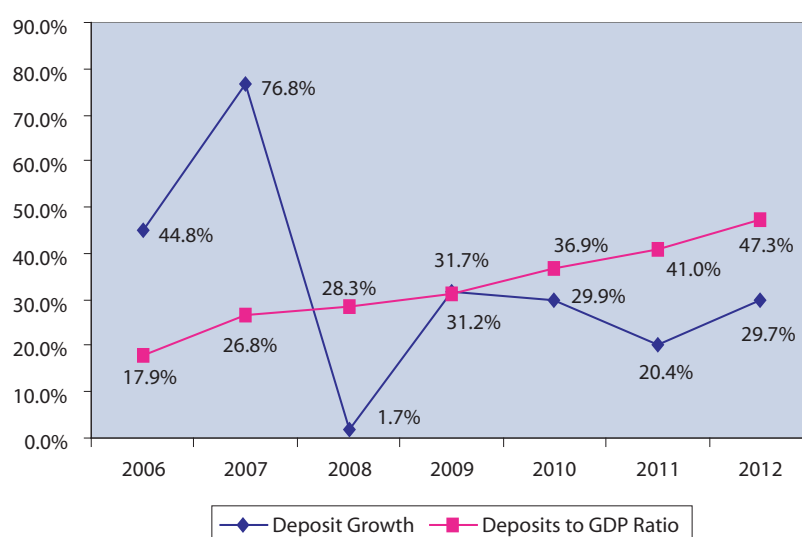
Other Accomplishments of the Banking Sector. Banks have also made efforts to increase their outreach and make their services easier and more accessible to the general public. Automated Teller Machines (ATMs) increased by 16% to a total of 681 machines in 2012. Debit cards have likewise increased by 25% amounting to a total of 957,556 accounts in 2012. Efforts have also been made to diversify financial products and services, particularly those making use of the internet and mobile banking (NBC 2012 Annual Bank Supervision Report).

Figure 11. Total deposits in the banking sector

(As of 31 December 2012)



Source: National Bank of Cambodia

Figure 12. Deposit growth and deposit to GDP ratio in the banking sector (2006 to 2012)

Source: National Bank of Cambodia

• Performance of the Microfinance Sector

Number of Offices and Staff of Microfinance Institutions. Microfinance has further improved its capacity to make its financial services more geographically accessible to the rural poor. The number of MFIs licensed by the NBC increased from only 16 in 2005 to 35 by the end of 2012. These licensed MFIs have a total of 2,176 offices including 34 head offices in Phnom Penh, 257 provincial branch offices, and 1,919 branches at the district level (Table 10.) Other smaller microfinance providers, including the 33 NGOs registered as microfinance operators by the NBC, have an even deeper geographical outreach, with 12,974 offices at the commune level, and 72,001 offices at the village level. In addition to increasing microfinance services to more poor people, an expansion of the network of microfinance providers also generate more employment. The 34 licensed MFIs alone employ a total of 12,618 people, an increase of 30% from 9,744 in 2011. This means that an additional 2,874 jobs were created in 2012.

Table 10. Number of MFI offices

(As of 31 December 2012)

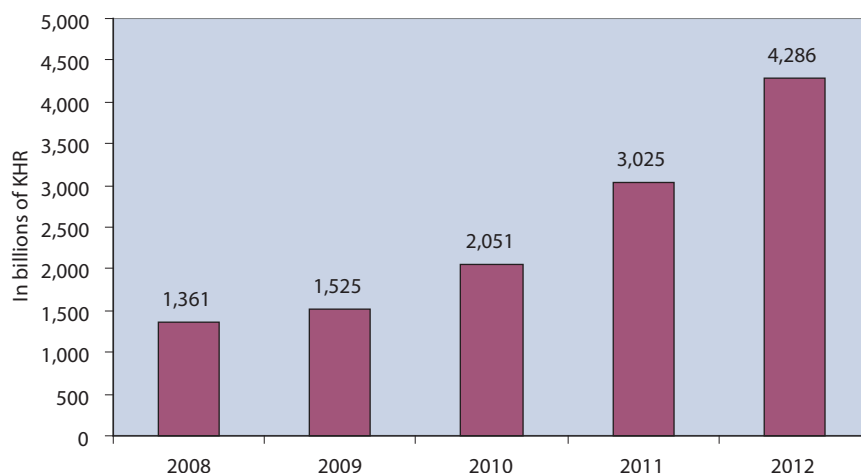
Type of MFI	Total	Head office		Branch office	
		Phnom Penh	Province	Provincial	District
1. MDI	1,424	7	0	136	1,288
2. MFI	752	27	1	121	631
Total	2,176	34	1	257	1,919

Source: National Bank of Cambodia

Assets. Like banks, total assets of MFIs have also been consistently increasing since 2008, reaching 4.29 trillion KHR in 2012 (Figure 13). This corresponds to a 42% growth which is slightly less than the 47% growth in 2011. Nonetheless, the level of growth has been increasing on the average since the 12% growth during the global financial crisis in 2009 but has not quite reached its 87% level in 2008, its highest in the last five (5) years (Figure 14).

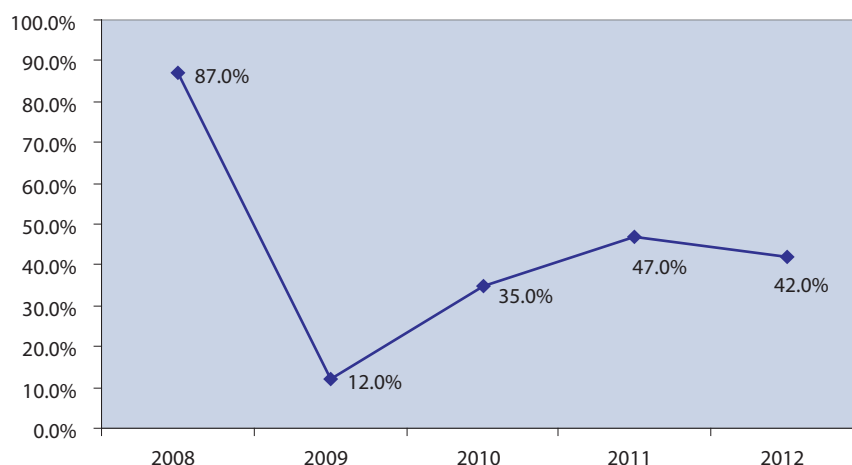
Figure 13. Total assets of MFIs

(As of 31 December 2012)



Source: National Bank of Cambodia

Figure 14. Asset growth and asset to GDP ratio of MFIs (2008 to 2012)



Source: National Bank of Cambodia

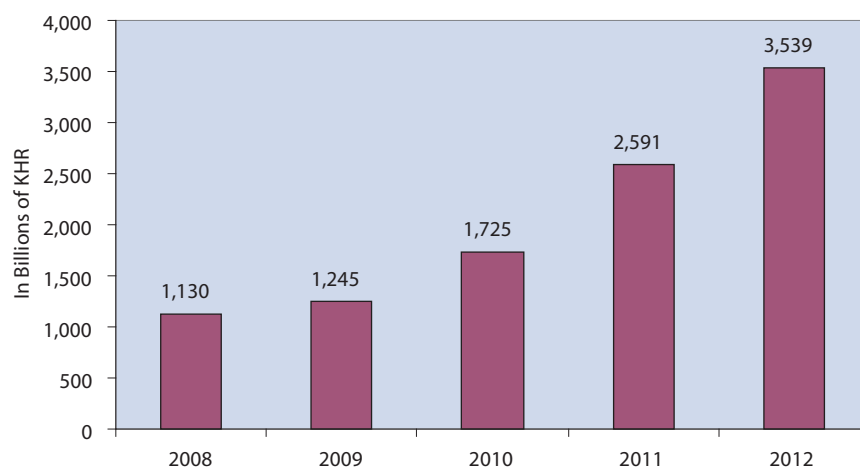
Loans. Loans released by MFIs have been increasing for the past five (5) years. From 1.13 trillion KHR in 2008, loans released increased to 3.54 trillion KHR in 2012 (Figure 15). However, the growth rate for loans released by MFIs have been inconsistent during the said period. From a 79.5% increase in 2008, credit growth went down significantly to 7.8% in 2009 during the global financial crisis. As the sector recovered, loans grew by 42.5% in 2010 and by 51% in 2011 but again slowed down in 2012, with a growth of 38% (Figure 16). With the increase in loans, the number of borrowers likewise increased by 14% from 1,141,913 in 2011 to 1,301,680 in 2012 (Table 11). It should also be noted that 82.6% of borrowers, or 1,075,181, are composed of women reflecting the original intent of microfinance to provide additional means of livelihood to households through women.

In contrast to banks, majority of the loans released by MFIs went to the agriculture sector (39%) whereas loans by banks to the sector was only 10% of its total loans in 2012. Other sectors or industries financed by MFIs include trade and commerce (24%), households (15%), services (10%), transportation (5%), construction (4%), and others (3%) (Figure 17). MFIs have also been performing much better than banks in terms of loan portfolio quality. From 2008-2012, the average ratio of non-performing loans to total

loan released by banks was 3.2% compared to only 1% for MFIs. The highest during the said period was at 2.8% in 2009 due to the financial crisis. It went down to 1.2% in 2010 and further to 0.3% in 2012 (Figure 18). This is validated by the 21 farmers interviewed, 17 of which said they paid on or before loan maturity and did not have existing past-due loans. The remaining four (4) respondents said they were sometimes delayed but only for one (1) or two (2) days.

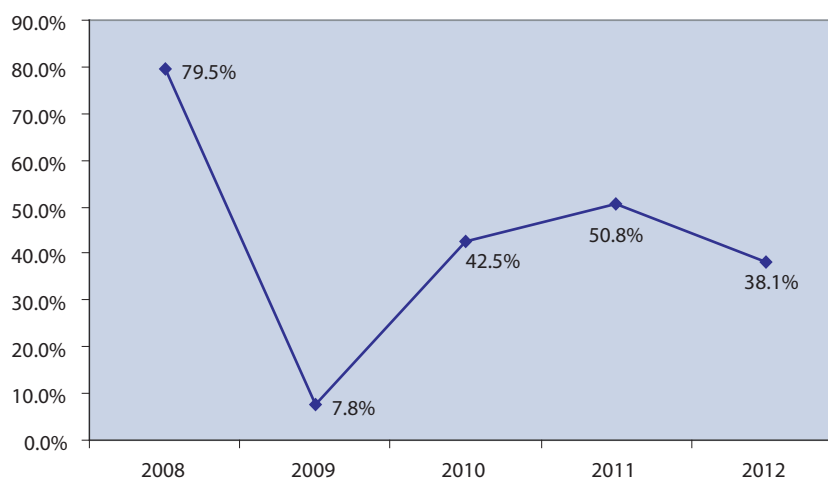
Figure 15. Loans released by MFIs

(As of 31 December 2012)



Source: National Bank of Cambodia

Figure 16. Growth of loans by MFIs (2008 to 2012)



Source: National Bank of Cambodia

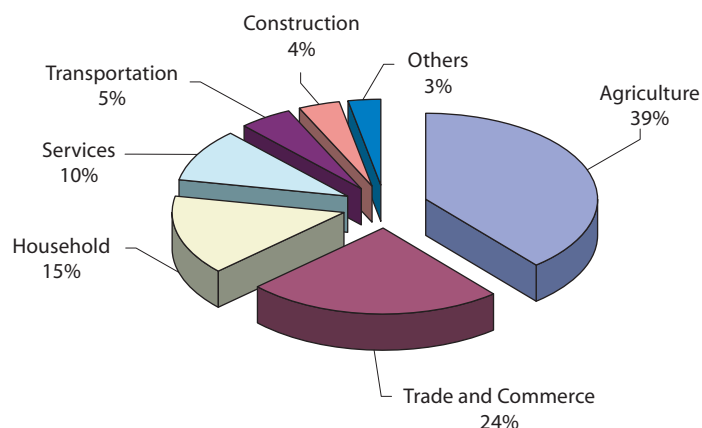
Table 11. Loans released and number of borrowers of MFIs (2011 and 2012)

	2011	2012	% Change
Loans Released (In billion KHR)	2,591	3,539	38
No. of Borrowers	1,141,913	1,301,680	14

Source: National Bank of Cambodia

Figure 17. Total loans of MFIs, classified by type of industry

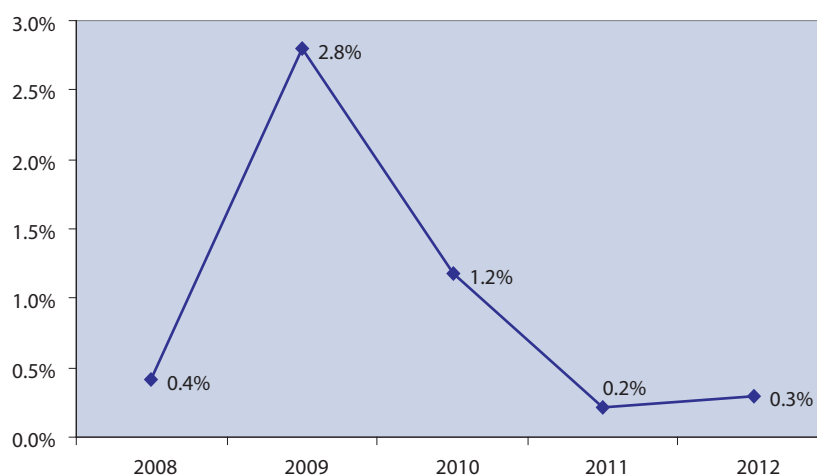
(As of 31 December 2012)



Source: National Bank of Cambodia

Figure 18. Ratio of non-performing loans to total loans of MFIs

(As of 31 December 2012)

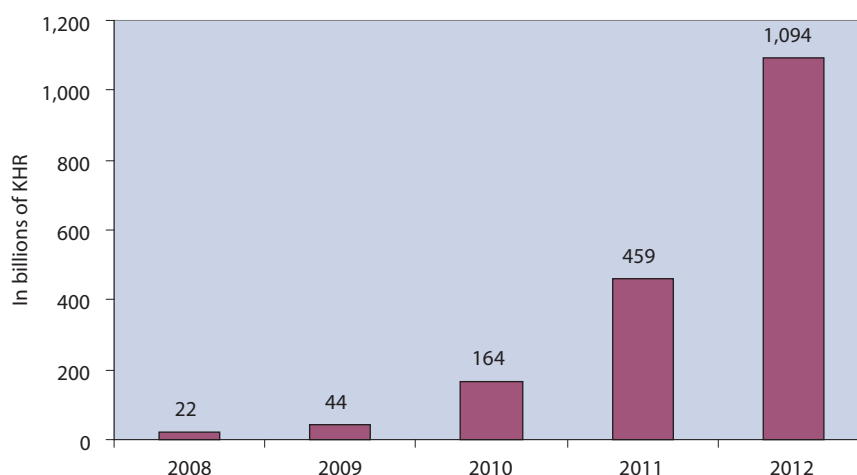


Source: National Bank of Cambodia

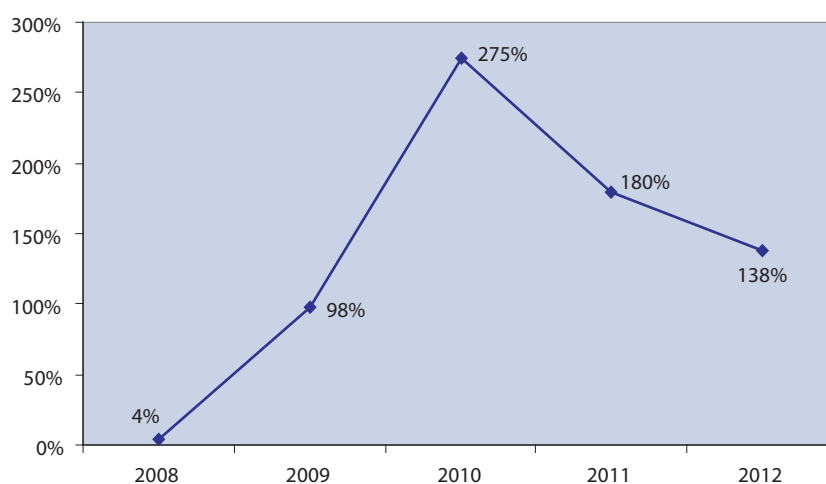
Deposits. The deposits generated by MFIs amounted to almost 1.1 trillion KHR in 2012 from only 22 billion KHR in 2008 (Figure 19). This is still much lower compared to the total deposits generated by banks which amounted to 27 trillion KHR in 2012. However, it should be noted that MFIs were only recently provided the opportunity to apply for a license to take deposits from the public and so far, there are only seven (7) licensed microfinance deposit-taking institutions (MDIs). What is worth noting though is the initial response of the public to the introduction of this financial service, as evidenced by the outstanding growth in deposits averaging nearly 140% over the past five (5) years, peaking at 275% in 2010. Further, if the dismal 4% growth in 2008 due to the financial crisis were to be disregarded, average growth will increase to 173% (Figure 20). By contrast, growth in deposits by banks over the past seven (7) years averaged 34%, peaking at 77% in 2007. Disregarding the 1.7% growth in 2009, average growth would have reached 39%. As of end-December 2012, the number of depositors reached 1,301,680, a 14% increase from the previous year (Table 12). However, from the phenomenal 275% growth in 2010, the rate of growth declined to 180% in 2011 and further to 138% in 2012.

Figure 19. Total deposits in MFIs

(As of 31 December 2012)



Source: National Bank of Cambodia

Figure 20. Deposit growth in MFIs (2008 to 2012)

Source: National Bank of Cambodia

Table 12. Deposits and number of depositors of MFIs (2011 and 2012)

	2011	2012	% Change
Deposits generated (In billion KHR)	2,591	3,539	38
No. of depositors	1,141,913	1,301,680	14

Source: National Bank of Cambodia

• Performance and experience of selected MFIs and NGOs

Outreach and Extent of Coverage. Compared to most banks, microfinance providers in Cambodia have the capacity to expand outreach of financial services to a larger segment of the poor residing in rural areas. The four (4) sample microfinance institutions (MFIs) interviewed (which are also licensed microfinance deposit-taking institutions or MDIs) provide financial services up to the village level, the smallest administrative unit in the country. PRASAC has the most number of offices/branches with 167. It covers all 24 provinces of the country, 186 districts, 1,499 communes, and 10,874 villages – or 76% of

total villages in Cambodia. The Angkor Microherhvatho Kampuchea (AMK) is the second largest MDI interviewed in terms of coverage. Its 113 offices cover 22 of 24 provinces. While PRASAC covers all provinces, AMK covers more districts and communes than PRASAC at 192 and 1,560, respectively. At the village level, however, AMK covers 10,116 villages, which is less than that of PRASAC. AMRET has 99 offices and covers 18 provinces, 133 districts and 8,795 villages. On the other hand, SATHAPANA has only 65 offices but covers 22 provinces, 181 districts, 1,391 communes and 8,263 villages. ACLEDA is both the largest commercial bank and microfinance provider in Cambodia. It has 238 branches covering all 24 provinces in the country (Table 13).

Among the sample microfinance providers interviewed, ACLEDA – being the largest commercial bank in the country – naturally had the largest asset base at almost 2.0 billion USD, equity of 252 million USD, loans outstanding amounting to 1.23 billion USD, deposits of 1.52 billion USD, and net profit (after tax) of 65 million USD (Table 14).

Assets. Of the four (4) sample MDIs, PRASAC had the largest asset base valued at almost 252 million USD followed by AMRET at 177 million USD, SATHAPANA at 150 million USD and AMK at 84 million USD. The Rural Development Bank (RDB) – a specialized bank and the only state-owned bank in Cambodia – had less assets than the four (4) MDIs at 67 million USD. PRASAC again posted the highest return on assets (ROA) at 5.7% (Table 14).

Equity. In terms of equity, AMRET had the highest at 33 million USD followed by RDB with 25 million USD, SATHAPANA with 21 million USD, PRASAC with almost 20 million USD, and AMK with 14 million USD. PRASAC posted returns on equity (ROE) of nearly 50%. A distant second was AMRET with ROE of 23% (Table 14).

Loans Outstanding. Among MDIs, PRASAC again had the highest loans outstanding with 215 million USD followed by AMRET with 149 million USD, SATHAPANA with 121 million USD, and AMK with 61 million USD. RDB had loans outstanding of 55 million USD. AMRET had the most number of borrowers with 299,507 which is more than that of ACLEDA which had 240,000 borrowers and the biggest loans outstanding (1.23 billion USD). AMK came in at second with total borrowers of 291,859. Estimating the average loan size based on loans outstanding and number of borrowers, it turned out that AMK and AMRET had the lowest average loans at 210 USD and 497 USD, respectively. ACLEDA had the highest average loan size at 5,129 USD followed by SATHAPANA with 1,779 USD and PRASAC with 1,601 USD (Table 14).

Deposits. AMRET has generated the highest amount of deposits among the four (4) sample MDIs with 83.5 million USD. This is followed by SATHAPANA with 67 million USD and PRASAC with 57 million USD. Surprisingly, AMK was only able to generate 8.2 million USD deposits which is only 2 million USD higher than the deposits generated by the Credit Mutuel Kampuchea (CMK) with 6 million USD. CMK is a registered microfinance operator with the NBC that prioritizes the importance of savings more than loans. PRASAC had the most number of depositors at 131,920 followed by AMRET with 110,558. SATHAPANA had the highest amount per depositor at almost 1,400 USD followed by AMRET with 755 USD (Table 14).

Table 13. Extent of coverage, number of offices and staff of selected microfinance providers in Cambodia

(As of 31 December 2012)

Name of microfinance provider	Type	Sub-type	No. of offices/ branches	Extent of coverage			No. of staff
				Province	District	Village	
1. ACLEDA	Bank	Commercial	238	24			7,721
2. RDB	Bank	Specialized	1	1			60
3. PRASAC	MFI	MFI	167	24	186	10,874	2,135
4. SATHAPANA	MFI	MFI	65	22	181	8,263	1,710
5. AMK	MFI	MFI	113	22	192	10,116	1,187
6. AMRET	MFI	MFI	99	18	133	8,795	2,425
7. CMK	Registered NGO		18				80
8. FLDO	Registered NGO		10	9		594	92
9. CPCDO	Unregistered NGO ¹		4				100
10. CDO	Unregistered NGO ¹		3				

¹ Unregistered with NBC

Gray-shaded areas indicate that no data was provided in the Annual Reports and/or during the interviews.
Source: 2012 Annual Reports and interviews with the abovementioned microfinance providers.

Table 14. Key performance indicators of selected microfinance providers in Cambodia

(As of 31 December 2012)

Name of microfinance provider	Type	Sub-type	Assets		Equity		Loans outstanding		Deposits		Net profit after tax (in million USD)
			Amount (in million USD)	ROA (in %)	Amount (in million USD)	ROE (in %)	Amount (in million USD)	No. of borrowers	Amount (in million USD)	No. of depositors	
1. ACLEDA	Bank	Commercial	1,983.0		252.0		1,231.0	240,000	1,507.0		65.0
2. RDB	Bank	Specialized	67.0	0.75	25.0	1.94	55.0	²	1.3		0.50
3. PRASAC	MFI	MDI	251.6	5.7	19.6	48.4	214.8	134,146	57.2	131,920	11.5
4. SATHAPANA	MFI	MDI	149.6	3.1	21.3	20.6	121.3	68,195	66.7	47,676	4.0
5. AMK	MFI	MDI	84.1	3.9	13.9	19.0	61.4	291,859	8.2	29,910	
6. AMRET	MFI	MDI	176.6	4.9	33.3	23.2	148.8	299,507	83.5	110,558	7.3
7. CMK	Registered NGO						3.0		6.0		
8. FLDO	Registered NGO		0.25				0.22				
9. CPCDO	Unregistered NGO ¹		5.0				4.0	3,000	N/A	N/A	
10. CDO	Unregistered NGO ¹						0.15	1,800	N/A	N/A	

¹ Unregistered with NBC² RDB generally lends on a wholesale basis; its borrowers consist of licensed MFIs, registered credit operators, rice mill associations, paddy/rice traders, and SMEs.**Source:** 2012 Annual Reports and interviews with the abovementioned microfinance providers.

Lending Performance and Agricultural Loans Granted. Among sample banks and MDIs, a significant portion of their total loan portfolio is allocated to agriculture, namely: 80% for RDB, 78% for AMK, 34% for SATHAPANA, 32% for PRASAC, and 19% for ACLEDA. Also, 62% of AMK's clients borrowed for agricultural purposes. For ACLEDA and PRASAC, more than 40% of their clients borrowed to finance agriculture-related activities. Among the NGO microfinance operators interviewed, agricultural loans likewise constitute a significant portion of their loan portfolio. A farmer organization, the Farmer Livelihood Development Organization (FLDO) naturally had majority of their loans (90%) for agricultural activities. Another NGO, the Community Development Organization (CDO) allocated 60% of their loans for agricultural purposes (Table 15).

The overall portfolio quality of ACLEDA and the four (4) MDIs are outstanding with an average non-performing loans (NPL) to total loans ratio of only 0.22%. On the other hand, the state-owned RDB had a relatively higher NPL-to-total loan ratio of 11.13%. Although majority of their loan portfolio is allocated for agriculture, microfinance providers – particularly MDIs – are able to maintain the quality of their loan portfolio. RDB had the highest proportion of agricultural loans to total loans at 80% but it also has the highest NPL-to-total loans ratio at 11.13%. On the other hand, 78% of AMK's loan portfolio is allocated for agriculture but it only has an NPL-to-total loans ratio of 0.12% (Table 15). The conflicting information suggests that the risks posed by agriculture is only weakly correlated with loan portfolio quality. What might be more important is how risks are managed.

Agricultural Projects Financed. Agricultural loans by the sample microfinance providers were mostly used to finance the following: i) production of rice and other crops such as corn, cassava and vegetables; ii) production of high value crops such as rubber, durian, coffee, cashew, and banana, among others; iii) animal husbandry; iv) other micro and small enterprises such as trading, shop-keeping; v) collection and processing of paddy; and vi) investment in drying and processing machines (Table 15). Of the 21 farmers interviewed, 12 borrowed to purchase agricultural inputs such as seeds and fertilizers mostly for rice and vegetable production. About 10 were also engaged in livestock and used their loans to buy cow and pig stocks, ducks, feeds, and pig traps. Four (4) used their loans to buy or repair agricultural machineries and equipment.

Loan terms and conditions. Loans are generally classified into: i) micro, small or medium; or ii) group or individual loans. ACLEDA, PRASAC and SATHAPANA classify their loans using the former. Micro loans are not more than 2,500 USD for ACLEDA, 1,500 for PRASAC, and 1,000 for SATHAPANA. Small loans are less than 10,000 USD while medium loans are loans above 10,000 USD. AMK lends on a micro-scale (based on the loan amount classification of ACLEDA and PRASAC) with a maximum of 250 USD for group loans, 1,500 USD for agri-individual loans, and 2,000 USD for individual business loans. The other smaller NGO microfinance operators lends on a scale similar to that of AMK. Interest rates depend on the loan amount based on the aforementioned loan classification but generally does not exceed 3% per month. RDB lends on a wholesale basis and provides concessionary rates at 7% per annum to other MFI borrowers; and 5% per annum to rice miller associations in support of the government's rice export policy. Hard collateral is not generally required for group loans but is required for individual loans. For group loans, group guarantees substitute for collateral. Other collateral substitutes that may be required or assessed include household cashflow, business plan, and savings or deposits. Other documentary requirements may include identification card, driver's license, certificate of good moral character, and lending contract, among others. For individual agricultural loans, land title – either hard or soft – is usually required, depending on the loan amount. PRASAC, for instance, requires a hard land title for loans greater than 10,000 USD and a soft title for loans less than 10,000 USD (Table 16).

The average maximum loan amount obtained by the 21 farmer-borrowers of SATHAPANA amounted to 2,590 USD which is more than the 1,700 maximum loan amount cited by SATHAPANA. Interest rate is 1.86% on the average which is within the 1.5-3.0% interest rate range of SATHAPANA. Ten (10) said hard collateral was required namely hard land title of their houses, two (2) of which said that their cows,

Table 15. Lending performance of selected microfinance providers in Cambodia

(As of 31 December 2012)

Name of microfinance provider	Type	Sub-type	Total loans			Agricultural loans				
			Amount (in million USD)	No. of borrowers	NPL ² to total loans ratio	Amount (in million USD)	In % of total loans	No. of borrowers	In % of total borrowers	Projects/commodities financed
1. ACLEDA	Bank	Commercial	1,231.2	240,000	0.27	233.3	18.6	108,480	45.2	Production of crops (rice, corn, cashew, cassava), fisheries, animal husbandry
2. RDB	Bank	Specialized	55.0	³	11.13	44.0	80.0	³	N/A	Collection and processing of paddy; investment in dryer and processing machines; production of rubber, cassava, etc.
3. PRASAC	MFI	MDI	214.8	134,146	0.20	68.74	32.0 ⁴	>53,658	>40	Income-generating activities including rice production, trading, service and other micro & small businesses.
4. SATHAPANA	MFI	MDI	121.3	68,195	0.40	40.7	33.6			Crop production (particularly rubber, durian, coffee, banana) and animal raising
5. AMK	MFI	MDI	61.4	291,859	0.12	227,650	78.0			Crop production, trading, shop keeping
6. AMRET	MFI	MDI	148.8	299,507	0.11			185,694	62	
7. CMK	Registered NGO		3.0							
8. FLDO	Registered NGO		0.22			0.20	90.0			Crop production (rice, cassava, vegetables) and animal husbandry
9. CPCDO	Unregistered NGO ¹		4.0	3,000	<1.0	0.80	20.0	570	19	Crop production (mostly paddy) and animal husbandry
10. CDO	Unregistered NGO ¹		0.15	1,800	2.0	0.09	60.0		Majority	Crop production (corn, vegetables, rice, others)

¹ Unregistered with NBC² Non-Performing Loans (NPL) or Portfolio-at-Risk (PAR) >30 days³ RDB generally lends on a wholesale basis; its borrowers consist of licensed MFIs, registered credit operators, rice mill associations, paddy/rice traders, and SMEs.⁴ PRASAC is implementing a policy that loans allocated to agriculture should not exceed 35% of the total loan portfolio.**Source:** 2012 Annual Reports and interviews with the abovementioned microfinance providers.

Table 16. Loan terms and conditions of selected microfinance providers in Cambodia

(As of 31 December 2012)

Name of microfinance provider	Type	Sub-type	Amount (Maximum, in USD)	Interest rate (per month, %)	Collateral	Maturity	Repayment schedule	Other requirements
1. ACLEDA	Bank	Commercial	Micro: = or <2,500 Small: >2,500 to 10,000 Medium: >10,000 to 5,000,000	2.4-2.7 <2.4 0.85-2.0	Group loans: None required Individual loans: Land Title (hard or soft)			In lieu of collateral: Guarantors, Household Cashflow
2. RDB	Bank	Specialized		RDB to MFI: 7.0 per annum RDB to rice miller associations/coops: 5.0 per annum for rice production	Hard Title only			
3. PRASAC	MFI	MDI	Micro: = or <1,500 Small: >1,500 to 10,000 Medium: >10,000	<or = 2.6 <1.8-1.9 0.85-2.0	Hard title for loans >10,000; Soft title for loans <10,000			
4. SATHAPANA	MFI	MDI	Micro: = or <1,000 Small: >1,000 to 5,000 Medium: >5,000 to 200,000	1.5-3.0 ²	Land Title (Hard or Soft) ³			Business Plan
5. AMK	MFI	MDI	Group loans: Up to 250 Agri-individual loans: Up to 1,500 Business loans: Up to 2,000	3.0 1.8-3.0 Depends on loan size	Group loans: None required Individual loans: Land Title (hard or soft)			
6. AMRET	MFI	MDI	Up to 300	3.0 for group lending; 1.2-2.0 for individual lending	Group loans: None required			
7. CMK	Registered NGO		Depends on repayment capacity and savings deposited	1.5-2.5	None	18-48 months	Monthly	Savings in lieu of collateral
8. FLDO	Registered NGO		100-500	2.5	None			Group guarantee in lieu of collateral
9. CPCDO	Unregistered NGO ¹		Up to 2,000	2.5-3.0	Land Title (Hard or Soft)			ID, Driver's License, Certificate of Good Moral Character
10. CDO	Unregistered NGO ¹		Up to 250	1.5-2.5 per week (or 6-10 per month)	None	10-20 weeks	Weekly	Guarantor, Driver's License, Lending Contract

¹ Unregistered with NBC² Depending on loan size.³ Hard titles are issued by the national government while soft titles are issued by the commune or district chiefs.
Source: 2012 Annual Reports and interviews with the abovementioned microfinance providers.

machineries or motor cycles were required as additional collateral. Nine (9) said soft land titles were accepted as collateral while two (2) said no collateral was required from them. Twelve (12) said a guarantor was also required for their loans while eight (8) said no other additional securities were required.

Difficulties experienced. With regard to the loan requirements, 18 respondents did not have any major problems while three (3) cited some difficulties such as securing certificates from local authorities (e.g. soft land title), witness and photo of borrowers and that the value of the collateral required is more than the loan amount approved. On the loan amount, all except two (2) said that the loan amount was sufficient. On interest rate, 14 said the interest was not too high compared to private money lenders but would be better if it were to be further reduced. All of the respondents also did not have any complaints on collateral because they have existing properties they could put up as collateral.

- **Rural financial services delivery mechanism**

Financial products and services. Banks are authorized to provide more diverse financial services to the public. ACLEDA, for instance, offers loans and deposit services. The bank's loan products include loans for MSMEs, public housing loans, car loans, home improvement loans, and credit card loans. It also provides wholesale/corporate loans to MFIs. Outreach of services is expanded through improved distribution channels and bank infrastructure such as electronic banking, mobile phone banking, ATMs, Wireless Point of Sale (POS) Terminals, payment and payroll services. On the other hand, RDB is a specialized bank and is authorized to engage only in lending operations. It is not authorized to take deposits from the public. It provides loans on a wholesale basis to rice miller associations and MFIs. However, RDB provides capacity building to MFIs, coops and other farmer groups upon request and for a fee. Training topics include credit analysis, accounting, and contract preparation, among others. It provides capacity building to their staff as well.

The financial services of most microfinance operators are mostly limited to lending. Unless licensed by NBC, MFIs are prohibited from taking deposits from the public. Loans for agriculture, service and construction are available through group or individual lending. In addition to loans, the four (4) sample microfinance deposit-taking institutions (MDIs) also provide deposit services, money exchange, inter-branch money transfer, bills payment, and ATM services. PRASAC, the largest MFI, currently has 35 ATM machines which they target to increase to 80 in the future. Microinsurance is not a common service provided. However, some MDIs like AMK have plans of engaging in microinsurance in partnership with a local microinsurance provider. Other smaller microfinance operators like CMK offers savings and loans to clients. Its loan products include professional or livelihood loans and non-professional loans such as salary loans, student loans, home construction/improvement loans, among others. The FLDO is implementing an integrated and supervised livelihood program for poor farmers which provides a package of services which include financial assistance, technical assistance on adoption of new production technologies, training & consultancy services to farmer organizations, and marketing support to farmers in which FLDO buys farmers' produce and sells them to the market.

Credit delivery mechanism/innovative financing schemes. Microfinance services in Cambodia is delivered either through group lending or individual lending. However, the preference between the two lending methodologies varies among MFIs. SATHAPANA prefers individual lending because of unfavourable experience with group lending. They believe group lending will not work because of reasons such as borrowers living far from each other, corruption among borrowers, and ineffectiveness of joint liability for big loans. PRASAC likewise prefers individual over group lending. In fact, only 3% of its borrowers are in group lending. By contrast, AMRET prefers group lending and believes it is an effective means of reaching the poorest farmers. Group lending constitutes 38% of AMRET's loan portfolio and 75% of its total clients. AMK is also a proponent of group lending. Group loans constitute 80-90% of its loan portfolio. It believes that group lending is more appropriate and cost-effective for small loans (e.g. 250 USD) compared to individual lending.

Value chain finance is uncommon among banks and MFIs. Perhaps the closest thing to a value chain type of finance is the contract farming scheme between rice miller associations who borrow from RDB, and rice farmers who borrow from rice miller associations. In this set-up, the rice miller uses the money it borrowed from RDB to lend to a group of farmers. Upon harvest, the rice miller buys their produce minus the loan. However, RDB plans to provide credit to more players in the value chain including farmers, millers, traders, and exporters. PRASAC does not have value chain financing yet but has conducted preliminary studies for this scheme in consultation with Planet Finance, an international organization based in Europe. Called 'Agricultural Microfinance', the said value chain financing project will be conducted on a pilot basis for selected commodities/value chain industries in pilot provinces. For AMRET, it does not engage in value chain finance because they believe it is not appropriate for small scale lending and their target clients, the rural poor.

Risk management practices. Most banks and MFIs are also not engaged in microinsurance, crop insurance and credit guarantee as risk management strategies. For individual loans, credit risk is covered by hard collateral (mostly land titles) and/or a prudent loan evaluation process which usually involves requirement of guarantors, a business plan reflecting income to be generated from the project, projected cashflow, and proposed repayment schedule, among others. The establishment of the Credit Bureau of Cambodia (CBC) in 2012 is likewise a significant development in reducing risk as it allows lenders a more efficient means of checking the credit history of potential borrowers at relatively less cost and in less time. For MDIs, their expanded network and scope of operations (e.g. up to the village level) allow their clients easy access to their branches to repay their loans. In case of delayed payment of loans, MDIs could likewise immediately send their collectors to the residence of their borrowers to collect the loans. PRASAC's 173 branches, for instance, are located just 5-10 kms from the residence of their borrowers.

Banks and MFIs have also developed their own means of adapting to risks posed by climate change. For PRASAC, their credit officers evaluate the timing of planting and harvesting based on the expected onset of floods and drought. On the other hand, ACLEDA provides short-term loans, e.g. three (3) months, or structures loan schedule in a way that will avoid the expected onset of floods or drought. Meanwhile, AMRET makes sure that clients prepare their farmplan such that harvests are done before floods or drought. In addition, some MFIs like AMRET have an internal policy of not lending to projects that will spoil the environment and contribute to climate change.

For group lending, risk is chiefly covered by group guarantee via a joint liability scheme and through other means such as requirement of savings, guarantors, and assessment of household cashflow. Some smaller NGO microfinance operators have developed their own means of addressing risks. CMK, for example, requires its borrowers to have savings deposits plus contribution to an internal guarantee fund from members. Members are required to pay a guarantee fee depending on loan size and maturity. For example, for a 1,000 USD loan, borrowers have to pay a guarantee premium of about 20 USD. CDO is also implementing an internal micro-insurance-type scheme wherein borrowers have to pay an insurance premium depending on the loan size. For loans of up to 250 USD, 30,000 KHR is deducted as micro-insurance premium in case of death of the borrower. It also enforces a lending contract, i.e. that customers agree to mortgage some assets – either house or land – in case of non-repayment. The integrated, supervised program of FLDO also serves as an effective risk management scheme. Its capacity building, technical assistance, and marketing support components help address credit, performance and market risks.

CHAPTER 5

Role of Government in Rural and Agricultural Finance

In general, the main roles played by the government of Cambodia with regard to rural and agricultural development include: (i) provision of an enabling policy and regulatory environment conducive for private sector investment; (ii) infrastructure development such as farm-to-market roads, irrigation, and other agricultural facilities; (iii) provision of support services such as capacity building (e.g. training on new production technologies, other alternative livelihood opportunities), agricultural research and extension, and market support/linkage, among others; and (iv) fund mobilization from both local and foreign donors in support of priority development programs and projects. Key government agencies include the Ministry of Rural Development (MRD), Ministry of Agriculture, Fishery and Forestry (MAFF), Ministry of Economy and Finance (MEF) and the Rural Development Bank (RDB) of Cambodia.

Role of relevant government agencies

With regard to rural and agricultural finance, the government is involved in the provision and facilitation of credit. The MRD is implementing a credit program that provides loans to individual farmers, farmer groups or cooperatives to finance agricultural production (e.g. purchase of farm inputs such as fertilizers) or other livelihood activities. The program is being implemented in nine (9) provinces. MRD lends directly to farmers in three (3) provinces while its partner NGOs lend in six (6) provinces. Apart from implementing its own credit program, the MRD also helps facilitate access to credit of poor rural households through its other major functions. First, MRD prepares and submits project proposals for funding to the government and to international donor organizations. Second, infrastructure development such as creation or improvement of roads in villages and establishment of small village markets are expected to encourage MFIs or even banks to lend for agricultural production and other livelihood activities of rural households. Third, MRD has established six (6) vocational or training centers which serve as venues for training farmers on credit discipline, basic accounting, book keeping and recording as well as new production technologies and other income-generating livelihood activities.

The major functions of the MAFF involve (i) policy formulation and direction setting for the agriculture sector, including the formulation of a strategic action plan; (ii) development and implementation of priority programs in support of national policy such as the Rice Export Policy; (iii) provision of support services such as agricultural research and extension, technology transfer, infrastructure development such as irrigation, post-harvest facilities (storage, warehouses, dryers, mills, other processing facilities), and farm-to-market roads; and (iv) formation and development of agricultural cooperatives through the provision of agricultural extension support, training and technical assistance. With respect to the latter, one of the priorities is to strengthen the capacity of farmer organizations and agricultural cooperatives to secure and effectively utilize loans from formal financial institutions. The Department of Agricultural Extension (DAE) provides a series of training to farmers in preparation for their organization as a farmer group. Once formed, training is continuously provided (without charge) to strengthen their organizational capacity. Topics include preparation of business plans, basic accounting and bookkeeping, among others. Farmer groups have the option to be upgraded into 'cooperative' status later on. According to the DAE, however, it takes about 1-2 years for farmer groups to be converted to cooperatives. This is because the recently enacted Law on Agricultural Cooperatives requires cooperatives to be run as a business enterprise, i.e. they have to be viable and profitable. There are currently 14,000 farmer groups and only 437 cooperatives. There should be at least 15 members in

a cooperative. However, larger, successful cooperatives have about 200 members on the average. Cooperatives are registered in the provincial offices.

MAFF believes that the government should not compete with the private sector when it comes to financing. Instead, it helps improve access to credit of farmers through the following activities: (i) facilitation of contract farming schemes between farmer groups and the private sector; (ii) provision of support to farmer coops in borrowing from RDB, MFIs or NGOs through linkage and technical assistance in business plan preparation; (iii) partnership with local companies and international donor organizations/development institutions like JICA, IFAD and ADB to facilitate provision of technical and financial assistance to farmer cooperatives. There is no credit guarantee program and crop insurance program yet for agriculture. However, the new Law on Agricultural Cooperatives requires government to set up funds for credit guarantee and crop insurance for agricultural cooperatives. Since the Law was passed only in June 2013, DAE is still working on the implementing guidelines and delivery mechanisms for credit guarantee and crop insurance.

The main role of the MEF is to source and mobilize funding from local and international donor organizations and financing institutions in support of government programs and projects. It is also responsible for the formulation of policy guidelines, and in the monitoring and evaluation of these programs and projects. Among the financing programs (or programs with financing components) that the MEF has facilitated funding for and is currently managing are the: (i) Agricultural Support Development Fund (ASDF) funded by the government; (ii) Climate Resilient Rice Commercialization Sector Development Program with the Asian Development Bank (ADB); (iii) Risk Sharing Facility (RSF) with the World Bank International Finance Corporation (IFC); and (iv) a guarantee program funded by the government of Cambodia. These and other financing programs of the government are discussed in the following section.

Required interventions from government

Based on the interviews with Banks, MFIs, NGOs, and other key institutions from the private sector, the following are the interventions required from the government.

- (i) MAFF to produce more domestic seeds (because most seeds are imported); provide guarantee for farm produce; and invest more in value chain process;
- (ii) NBC to reduce its reserve requirement and licensing fees so MFIs can expand;
- (iii) Improve viability of agriculture sector so more MFIs will lend to farmers. Better irrigation system is needed. Currently rice only has one cropping due to inadequate irrigation; Other support services such as infrastructure, new farm technologies, automation, processing/post-harvest facilities, farm equipments should be provided;
- (iv) Provide more capacity building for farmers;
- (v) Provide a market for farmers' produce and make market information (prices of produce) available to farmers. The government should tell the farmers what to produce; i.e. what is commercially viable and profitable;
- (vi) Provide storage facilities/warehouses for rice;
- (vii) Establish a fund that NGOs could access at reasonable rates (e.g. 4-5% per annum); and
- (viii) Encourage more MFIs and NGOs to lend to the agriculture sector by providing incentives such as subsidy for rebates.

CHAPTER 6

Government Financing Programs: Status and Performance

The following are the major financing programs being implemented, managed or facilitated by the government in support of national policies and programs for the agriculture, fishery and forestry sector, particularly the rice production and export policy. These programs are funded by the national government and/or international development organizations or financing institutions.

Agricultural Support Development Fund (ASDF)

The enactment of the Amended Law on Financial Management in 2009 mandated the creation of the Agricultural Support Development Fund (ASDF) with initial capital of 18 million USD. The objective of the ASDF is to serve as a source of funding for short, medium and long-term loans to communities, associations and companies in support of projects for the development of agriculture and agro-industry. In 2011, additional capital of 18 million USD was infused into the ASDF in support of the rice export policy of the government amounting to total funding of 36 million USD (Report on Agricultural Development and Support Fund, 2011 & 2012). Loans are released through the Rural Development Bank (RDB) of Cambodia mostly to rice miller associations and rice processing companies at an interest rate of 5% per annum. Loan facilities include: (i) short term working capital loans for purchasing, storing and processing of paddy for domestic demand and export; and (ii) long term investment capital loans for strengthening, expanding and modernizing drying and processing machines (Rural Development Bank, 2012 Annual Report). For 2012, loans released amounted to almost 21 million USD, not quite reaching its target of 29.6 million USD (Table 17).

Other RDB-implemented credit programs

In addition to the ADSF, the RDB also lends to other agricultural projects and commodities using its own funds or funds sourced from other donor or financing institutions. For 2012, RDB released 54.66 million USD – from only 34.04 million USD in 2011 – under the ADSF and funds sourced from the International Fund for Agricultural Development (IFAD) and the Agence Francaise de Developpement (AFD) for the Family Rubber Plantation Program, and China Development Bank, among others.

Table 17. Loans released by ADSF, by type of loan

(As of 31 December 2012)

Loan type	Loan releases (in million USD)		Loan term	Purpose
	Target	Actual		
1. Working Capital Loan (Revolving Credit)	19.0	10.68	Short Term (1 year)	For paddy collection as inventory and rice processing for export
	4.0	2.0	1 year	For supply market collection to the owners of rice milling machines and rice processing

Table 17. Loans released by ADSF, by type of loan (continued)

(As of 31 December 2012)

Loan type	Loan releases (in million USD)		Loan term	Purpose
	Target	Actual		
2. Investment Loan	4.58	6.0	Medium and Long Term (3-5 years)	For warehouse, drying machine, processing machine, sorting machine expansion
	2.0	2.1	3-5 years	For other objectives of sub-sectors in agriculture and agro-industry
	29.58	20.78		

Source: Report on Agricultural Development and Support Fund, 2012

Climate Resilient Rice Commercialization Sector Development Program

This program, called Rice SDP in short, is a joint initiative between the Asian Development Bank (ADB) and the government of Cambodia represented by the MEF and MAFF as the executing agencies. The Rice SDP aims to support and accelerate the implementation of the Policy on the Promotion of Paddy Production and Rice Export and the Strategy on Agriculture and Water (SAW) 2010-2013. To help attain food security and rice commercialization, the Rice SDP will prioritize the following: (i) strengthening of the rice value chain; (ii) improving the legal and regulatory framework in agricultural land management; (iii) improving access to credit by paddy producers and rice millers/exporters; and (iv) enhancing paddy production and productivity through improved irrigation water use efficiency, establishment of paddy post-harvesting facilities, and paddy crop insurance pilots. The expected outcome is enhanced production of quality rice in Cambodia while preserving the country's natural resource base. The expected impact is increased net income of stakeholders along the rice value chain.⁴ Total funding for the project is 82.43 million USD of which 55 million USD is a loan from the ADB, 19.1 million USD is a grant by the ADB, and 8.33 million is the counterpart fund of the government of Cambodia. Financing was approved by ADB on 2 July 2013 and the loan signing agreement between ADB and the government of Cambodia was consummated on 26 August 2013. The Rice SDP will be implemented up to the year 2019.

Project for Agricultural Development and Economic Empowerment (PADEE)

A joint project of the MAFF and IFAD, the main objective of the PADEE Program is to enhance the livelihood of poor rural households in target areas by increasing agricultural productivity and diversification of livelihood and income sources, particularly among poor agricultural households. Pilot target areas include the 246 communes and 33 districts in five (5) provinces, namely: Kampot, Kandal, Prey Veng, Svay Rieng and Takeo. PADEE started operations on 8 June 2012 and will run for six (6) years or up to 30 June 2018. The Program has total funding of 43.2 million USD, of which 35 million is financed by IFAD (17.5 million USD in loan and 17.5 million grant), 4.7 million USD is the counterpart of the government of Cambodia, and the remaining 3.5 million USD is funded by other donor organizations such as the Food and Agriculture Organization (FAO), among others. PADEE has three (3) components, namely: Component 1 – Improved Access to Financial Service; Component 2 – Improved Access to Technology and Markets; and Component 3 – Project Coordination and Management (MAFF 2012 Annual Report).

⁴ Asian Development Bank Project Data Sheet, Climate Resilient Rice Commercialization Sector Development Program, 02 July 2013.

Under Component 1 (Improved Access to Financial Service), a group lending methodology is employed wherein farmers are required to form themselves into a group – the Improved Group Revolving Fund (IGRF) – having at least 50 members. Grant assistance is provided to the group for re-lending to its members to finance production for rice, chicken, vegetable, fish and other commodities or livelihood projects, or related training that the farmers might want to avail. Grants in the amount of 4,000 USD per year is provided for three (3) years for a total of 12,000 USD per group. However, members have to complete payment of their loans to the group before funding is provided for the succeeding year. After three (3) years, this amount will be transferred as working capital to the IGRF subject to their performance. Prior to the initial loan release, the IGRF and its members are required to: (i) open a bank account with ACLEDA, the partner bank of IFAD for this project for the release and payment of loans; undergo financial literacy training; and (iii) submit a business plan. Training on financial literacy involves basic book keeping, management and family financial planning, and establishing linkage and a relationship with partner banks or MFIs to ease transfer of funds and mainstream the group into the formal financial system after end of project implementation. The interest rate is set by IFAD at a minimum of 2% per month in order to cover the cost of operations (including payment to an internal accountant that the group is required by IFAD to hire) and have enough money left to pay dividends to its members. The long-term plan is for the IGRF to be financially viable, be converted into a cooperative, and be able to avail of financing from MFIs and banks without further assistance.

The objective of Component 2 (Improved Access to Technology and Markets) is to introduce new efficient production technologies to farmers through the provision of training and technical assistance in helping the farmers use and adopt these technologies. Initial capacity building activities for this component include training of master trainers (MTs), mobile support teams (MSTs), and commune extension workers (CEWs). With regard to the market aspect of this component, the objective is to identify 75 business people in the target areas and establish contract farming arrangements between these people and the IGRFs in order to provide a market for the produce.

Component 3 (Project Coordination and Management) is spearheaded by the MAFF and includes other government agencies and the private sector to ensure that the objectives and expected outputs of the PADEE Program are being attained.

For 2012, 356 IGRFs were established in 356 villages (one IGRF per village) distributed among 89 communes and 12 districts in the five (5) target provinces.

Risk Sharing Facility (RSF) in partnership with IDA-IFC

The RSF is part of the Cambodia Agribusiness Access to Finance Project of the International Development Association (IDA) and International Finance Corporation (IFC). The objective of the RSF is to increase the sustainable flow of credit to the agribusiness sector by addressing key bottlenecks to agribusiness SME financing particularly risks faced by banks in lending to the sector. It is expected that the project would generate commercial bank lending for about 1,000 agribusiness SME borrowers engaged in agricultural production, processing or trading. The RSF will likewise help participating financial institutions build a portfolio and client base in the targeted activities for sustainable lending to the agribusiness sector. The RSF was approved on 16 December 2010, became operational on 5 May 2011, and will terminate on 31 December 2018.

The RSF provides 50% guarantee cover to a portfolio of ‘newly originated loans’ extended by participating banks and MFIs to agribusiness. The premium or guarantee fee charged varies depending on the size of the loan. Under the proposed arrangements, IDA funds amounting to 5 million USD will be used to provide ‘first loss’ coverage (10% of total portfolio amount), while IFC amounting to 20 million USD will be used to provide ‘second loss’ coverage (40% of total portfolio amount). Thus, the 5 million USD will be leveraged 10x to generate 50 million USD of commercial bank lending to the

agribusiness sector. In case of non-repayment due to valid reasons, the RSF will reimburse 50% of the loan exposure of the bank while the remaining 50% is the banks' share of the risk. According to IDA-IFC, this risk-sharing arrangement is intended to serve as an incentive for participating banks to conduct proper borrower credit appraisal and apply strict loan underwriting criteria (including taking proper security) in establishing the loan portfolio to minimize moral hazard and adverse selection. The loans that could be included in guaranteed portfolio could be both for long-term and short-term.

As of August 2013, only one bank – the ANZ Royal Bank – has participated in the RSF. The rating provided by the World Bank with regard to 'progress towards achievement of project development objectives (PDO)' and 'overall implementation progress (IP)' is both 'unsatisfactory'. Constraints identified include limited progress of partner financing institutions in developing viable lending pipelines and in identifying new banks that will participate in the RSF. On the positive side, the World Bank notes that while actual lending has fallen short of the target volumes, loans which have been generated have had significant development impact on small and medium agribusiness SMEs⁵.

MEF Guarantee Program

The MEF is also implementing another guarantee program likewise with funding of 25 million USD from the government of Cambodia. However, this has a different scheme from the RSF. If non-performing loans (NPL) is less than 1%, the participating financial institution shoulders the risk. If NPL is more than 1%, the guarantee program bears the risk. Starting only in 2013, no bank or MFI has participated yet in this guarantee program.

MRD Credit Programs

As mentioned earlier, the MRD is implementing a credit program to finance agricultural production and other livelihood activities of individual farmers, farmer groups or cooperatives in nine (9) provinces. MRD lends to farmers in three (3) provinces while its partner NGOs lend in six (6) provinces. MRD provides loans to farmers in both group and individual loans. For individual loans, clients could borrow up to 12 million KHR with interest of 2% per month, payable within 6-18 months. For group loans, clients could borrow up to (1) million KHR with interest of 2.2% per month, payable within 6-10 months. More than 90% of clients are farmers. Portfolio-at-Risk is just over 1%. As of 31 December 2012, a total of 1.78 million USD in loans was released to 281 target villages, 108 communes, and 33 districts in nine (9) target provinces.

⁵ Based on the World Bank-IFC-IDA Project Information Document (PID) Concept Stage (Report No. AB5955) and the World Bank Implementation Status and Results (Report No. ISR 9799) on the Cambodia Agribusiness Access to Finance Project (P121809).

CHAPTER 7

Issues and Constraints to Credit Access

Constraints in credit access by small agricultural households and agricultural SMEs may be classified as those emanating from either the supply or demand sides, although not exclusively. Supply and demand are just two sides of the same coin depending on whose perspective a particular constraint is being looked at. Borrowers, for example, often complain requirements of banks as being too stringent, complex or voluminous. On the other hand, banks usually cite the inability of farmer borrowers, for instance, to meet one or more of their regular requirements. In particular, findings indicate that collateral is a crucial aspect of the credit delivery system in Cambodia. For formal lenders like banks and MFIs, *lack of collateral* by the borrower is among the major constraints to credit access. Conversely, *requirement of collateral* by banks is considered by farmer borrowers as a major constraint. Nonetheless, the field interviews with banks, MFIs, NGOs, farmer borrowers, concerned government agencies, and other stakeholders from the private sector indicate that difficulty in borrowing from formal lenders stems mainly from the inability of farmers and agribusinesses to meet the requirements.

Major constraints to credit access by agricultural households include lack of collateral, repayment capacity, inability to prepare a viable business plan, over-indebtedness, production risks (crop failure due to floods and drought), market risks (lack of market, volatile price for agricultural produce), and generally the perceived non-bankability of the agriculture sector particularly due to undeveloped or under-developed infrastructure (farm-to-market roads), irrigation, and post-harvest facilities (warehouse, cold storage) in rural areas. For agricultural SMEs, a study by IFC⁶ likewise cites limited access to finance as a key challenge. Constraints identified by SMEs include high collateral requirements, high interest rates, and delays in processing loans. The study further cites that in spite of high liquidity in Cambodia's banking system, banks find it difficult to lend to SMEs due to their poor financial records and lack of information on credit history.

Lack of collateral

Collateral is generally not being required for group loans particularly by MFIs. However, not all MFIs are proponents of the group lending methodology, as discussed in previous sections. While group loans are the primary means of providing financial services to poor households who have no land or assets to offer as collateral, the amount of loan that could be borrowed is very limited (typically 250-300 USD). It is not enough to provide the total credit requirements of the farmer for production and likewise does not provide room for expansion in the future. Bigger loans could be had individually, which usually requires collateral already. In fact, the NBC mandates banks and MFIs to require collateral for their loans.

For agriculture, land titles (either hard or soft titles) are generally the accepted forms of collateral. Unfortunately, ownership of private property – including land – was abolished and certificates of ownership such as land titles were destroyed during the Khmer Rouge regime. Consequently, landlessness and insecure land tenure is still pervasive in Cambodia. According to a study by IFAD⁷, an estimated 25% of the rural population are either landless or own less than 0.5 hectares of land. While

⁶ Understanding Cambodian Small and Medium Enterprise Needs for Financial Services and Products, International Finance Corporation (IFC) and European Union (EU), November 2010

⁷International Fund for Agricultural Development (IFAD) Performance Based Allocation System: Assessment of Sectoral Framework for Rural Development, Cambodia, August 2012.

there is some attempt by government to redistribute lands more equitably, large portions are still owned by rich landlords. Among the poor rural populace, very few have formal or legal land titles. While some are issued soft titles by local authorities, they are still vulnerable to eviction especially by big land concessionaires.

Requirement of collateral by banks is mandated by NBC. However, it may also stem from the dearth of innovative or flexible financing schemes such as value chain financing that provide other forms of security in lieu of collateral. Guarantee and risk-sharing schemes are being implemented by the government through MEF but have not been effective.

Inability to prepare a business plan

According to a study by AFD (2012)⁸, few banks have good knowledge of agriculture. Consequently, only a few have also developed financial products that respond to the specificities of the agriculture sector such as seasonality of payment and a lengthy investment period without cash flow. Therefore, requiring a business plan and financial records (for SMEs) will help banks and MFIs better understand the nature of the projects they would be financing, i.e. cashflow, projected income, repayment capacity. Inability by farmers and agricultural SMEs to prepare viable business plans and lack of organized financial recording system stems from inadequate knowledge and training on financial literacy.

Credit pollution

Borrowing from multiple sources, which might result in credit pollution or over-indebtedness is a long-standing issue in agricultural finance in Cambodia. Poor farmer borrowers, who typically avail themselves of micro-loans through group lending, do not receive the required amount of money they need to finance their production requirements from one source. Hence, they need to borrow more from other sources. Some banks and MFIs are therefore very cautious in lending to borrowers who may just use the loans to pay existing debts. However, the operationalization of the credit bureau in 2012 is expected to help weed out 'bad borrowers' from the 'good borrowers'. While this helps maintain the loan portfolio quality of lenders and keeps the financial system healthy, borrowers with loans from multiple sources find it even more difficult to borrow.

Interest rates

Interest rate being an issue is largely a matter of perspective. For loan products of MFIs, interest rates depend on the loan amount but generally does not exceed 3% per month. Majority of the farmers interviewed who borrowed from SATHAPANA said the interest was not too high compared to private money lenders which lend at 4%-5% per month, but would be better if it were to be further reduced. However, farmers borrowing from informal sources (which constitute 43% of total borrowers in the agriculture sector) will most likely complain about high interest rates charged.

Pricing of loans are generally based on market rates. The interest structure is basically composed of three (3) components: costs of funds, operational and administrative costs, and profit margin. Many MFIs source their funds from international borrowing and some have complained about the interest rate which may reach up to 15% per annum. This hikes up the cost of funds and result in higher interest rate to their borrowers as well. Measures though have been initiated by the government to bring down the cost of funds, particularly through local borrowing. Such measures include strengthening the capacity of MFIs to source deposits from the public, and establishment of a securities market that will enable banks to borrow from the public.

⁸ Creating Access to Agricultural Finance. Based on a Horizontal Study of Cambodia, Mali, Senegal, Tanzania, Thailand, and Tunisia. (2012). A Savoir Collection, Agence Francaise de Developpement (AFD).

Though financing is generally market-based, the government through the Rural Development Bank implements credit programs with concessionary rates in support of priority policies or programs such as the Rice Export Policy. RDB's credit programs charge an interest rate of 5% per annum for rice miller associations, and 7% per annum for other banks or MFIs for rice production. This may discourage banks and MFIs, which source their funds from the private sector, from lending to support rice production and export.

Heavy dependence on foreign capital

There are no restrictions as to how much foreign investors may own in a local enterprise. Therefore, foreign investors may have full ownership and control over an NGO, MFI or bank. Foreign share of paid up capital is 73% among banks and even higher for MFIs at 76%. Capital flight is always a potential threat in an economy that is heavily dependent on foreign capital and borrowing. Massive withdrawal of capital may well trigger another financial crisis for Cambodia especially considering the scale of operations of the financial sector in the country's economy. Asset-to-GDP Ratio stood at 77% of GDP, indicating the extent of the banking sector's contribution to the country's economic performance and, conversely, the risk and consequence to the economy in the event of a financial crisis. Fortunately though, steps are being initiated by government for MFIs and banks to mobilize deposits from the public and scale-up borrowing locally through the securities market.

Changing role of MFIs

The formation of MFIs was encouraged by the Cambodian Government as a means of improving access of poor borrowers to agricultural credit. But as they grow, microfinance providers have changed their orientation from non-profit oriented entities to profit-driven financial institutions. And as they are subjected to stricter prudential regulations, it is possible that MFIs will shy away from poor borrowers to big borrowers who are perceived to be less risky.

Inadequate credit programs providing production loans to farmers

The provision of micro-credit to farmers is seen as a short-term measure for increasing rice productivity. It would seem that no clear strategies have been detailed for attaining this measure, or for monitoring its progress. In any case, the government does not have the financial facility that will lend to small, individual farmers. The state-owned RDB provides loans on a wholesale basis and only to rice miller associations through the Agriculture Development Support Fund. The MRD lends to some farmers but only in selected pilot areas. Moreover, the idea of a non-financial agency engaged in direct lending to farmers runs contrary to market-oriented principles. Financing production needs of farmers is left to the private sector while the priority of the government seems to be the financing of paddy collection and processing as various short- to long-term strategies were identified in support of this measure.

Dearth of innovative financing schemes

The financial services of most microfinance operators are mostly limited to credit and deposits, except for some MDIs which also provide additional services such as money exchange, inter-branch money transfer, bills payment, and ATM services. Microinsurance, a basic component of microfinance in other countries, is uncommon for microfinance services in Cambodia. For credit, microfinance is the primary means of providing financial services to the rural poor including agricultural households. Loans are delivered either through the group lending or individual lending methodologies. Short-term, micro-loans are typically provided through the group lending approach. Collateral is usually not required as risk is covered by group guarantee. On the other hand, bigger loans with longer maturity are provided via individual lending. Collateral in the form of land titles is generally required for these loans.

Innovative forms of financing such as value chain financing or repayment based on the household cash flow are scarce. The contract farming scheme between rice miller associations who borrow from RDB and farmers who borrow from rice millers, is the only thing remotely resembling value chain finance. In this set-up, the rice miller may use the money it borrowed from RDB to lend to a group of farmers. Upon harvest, the rice miller buys their produce with the loan proceeds deducted from the payment. Integrated and supervised livelihood programs with credit components such as those implemented by IFAD and FLDO are on a small-scale basis and need to be replicated on a much wider scale if found successful.

These types of schemes will not only facilitate access to credit of poor farmers but also address risks which banks and MFIs usually cover with collateral. These schemes may serve as collateral substitutes as the services provided (marketing support, technology transfer, capacity building) will help provide security against market risks (lack of markets, low price), performance risks (low quality/quantity of produce due to inappropriate or inadequate production technologies, lack or insufficient knowledge and skills in maximizing use of such technologies to increase production, etc.), and to a certain extent credit risks (risk of non-repayment) through financial literacy training. If integrated, crop insurance and/or credit guarantee will address production risks or risk of crop failure due to natural calamities such as floods or droughts.

Risk management practices that are either restrictive or ineffective

Policies and regulations of NBC seem to be very 'protectionist' and risk averse. Collateral is required by NBC for loans of banks and MFIs to its borrowers. While this is prudent and will keep the financial system healthy, it may be restrictive on the part of the farmer-borrower, especially those without eligible assets such as lands (or hard land titles) to offer as collateral. Since distribution and ownership of lands will take time to resolve, other forms of security in lieu of collateral should be studied including the warehouse receipts system, value chain financing, integrated & supervised financing, credit guarantee, crop insurance, good credit history as certified by the credit bureau. Unfortunately, there is a lack of flexible financing schemes (e.g., value chain financing) and risk management instruments such as crop insurance programs that may serve as a substitute for collateral. However, there are plans for implementing a crop insurance system as provided for in the financial sector blueprint and agricultural cooperative law.

Guarantee and risk-sharing schemes are being implemented by the government through MEF but have not been effective thus far. Due to a variety of reasons, a guarantee scheme alone might not be sufficient to encourage banks to lend to farmers or even agribusiness SMEs. First, it may have something to do with program terms and conditions such as the risk-sharing scheme and guarantee fee charged to the bank. Second, banks may simply deem that putting their money elsewhere – not in agriculture – would be more profitable. Third, guarantee is in its infancy in Cambodia and banks are not totally convinced of its effectiveness.

A ready market for agricultural produce might even serve as better encouragement for banks to engage in agricultural lending. Better yet, credit guarantee as well as crop insurance should be included as components of a value chain financing scheme. This will address risks related to production, markets and price, performance, and credit. With regard to the latter, the establishment of the credit bureau in 2012 is a significant development in reducing credit risks as it allows lenders a more efficient means of checking the credit worthiness of potential borrowers.

Role of cooperatives in the financial delivery system

Cooperatives have an important role to play in agricultural finance. They serve as an instrument for enabling farmers to access loans from formal sources. According to MAFF, however, most farmer organizations need credit but could not borrow from banks or MFIs because they could not comply with the requirements, particularly collateral, business plan, and repayment capacity. Hence, one of the priorities of MAFF is to strengthen the capacity of farmer organizations and agricultural cooperatives to borrow from formal financial institutions. Through its Department of Agricultural Extension (DAE), MAFF provides training and technical assistance for the formation and development of farmer groups. Training provided include the preparation of business plans, basic accounting and bookkeeping, among others. Farmer groups are also encouraged to organize themselves into cooperatives to strengthen their capacity to access financial and technical support. The Law on Agricultural Cooperatives, which was enacted in June 2013, provides a framework for the development of agricultural cooperatives. The Law mandates government to facilitate the provision of financing to cooperatives through financial institutions. Further, collateral will not be required for loans of individual members as the cooperative will guarantee the loans⁹. The Law likewise requires government to set up funds for credit guarantee and crop insurance for agricultural cooperatives. According to the DAE, however, it takes time (about 1-2 years) for farmer groups to be converted to cooperatives because legally recognized cooperatives have to be viable and profitable. There are currently 14,000 farmer groups and only 437 cooperatives. The MAFF-DAE is currently working on the implementing guidelines and delivery mechanisms for the Law.

⁹ Based on the article "Cambodian parliament passes farmers' cooperative law" posted 09 May 2013, DAP News website, http://www.dap-news.com/en/index.php?option=com_content&view=article&id=10253:-cambodian-parliament-passes-farmers-cooperative-law&catid=1:local-news&Itemid=18

CHAPTER 8

Discussion and Recommendations

Agriculture and agricultural credit in the context of national development plans

Rural credit plays a crucial role in the attainment of the goals of the “Rectangular Strategy for Growth, Equity, Employment and Efficiency”; the blueprint for growth and development of the Cambodian economy. There are a number of credit programs implemented by the government but the priority seems to be the financing of paddy collection and processing in support of the government’s Rice Export Policy. As there is no available data on credit demand for various commodities, it is safe to assume that other important commodities like maize, cassava, and livestock and poultry require equal priority for credit funds. With the rise in the tourism industry, there is a lot of potential in growing other food crops/livestock to feed the tourists and the growing population.

While there is growth in outstanding loans of MFIs and banks, many farm households still cannot access loans from formal sources due largely to the lack of collateral. What must be done to improve access to rural credit?

Role of government in agricultural finance

It is laudable to note that interest rates in Cambodia are market-determined. However, under the Rice Export Policy, the Rural Development Bank lends at concessionary rate, i.e., 5% per annum to rice millers and processors as against a maximum interest of 3% per month (or 36% per annum) of MFIs depending on loan size. In the event of market failure, lending by government to target beneficiaries or sectors is justified. However, lending at concessionary rates might serve as a disincentive for private sector lending. This might be an acceptable short-term measure, i.e. until the targeted volume of rice production or export is attained, but not as a long-term measure, not unless the government can sustain funding for a long period of time.

Of particular importance is the role played by MAFF in the formation and development of agricultural cooperatives. This is one of the priorities of the MAFF and, to this end, has been continuously providing agricultural extension support through training and technical assistance, and establishing linkage with banks and MFIs. Moreover, the recently enacted Law on Agricultural Cooperatives is expected to provide a better enabling environment for cooperative development.

However, insufficient coordination among government agencies are causing overlaps or duplication of some key functions. The MEF, MRD and MAFF for instance have separately mobilized funds from international organizations to finance their respective projects. The MRD and MAFF are likewise both implementing capacity building for agricultural households and developing agricultural infrastructure such as farm-to-market roads. A more coordinated performance of functions will maximize use of resources and delivery of services to the target sectors.

Performance and outreach of MFIs

Microfinance has performed much better than banks in providing financial services to the agriculture sector. MFIs and NGOs providing microfinance are more geographically dispersed than banks. MFIs, especially the seven (7) MDIs, generally have provincial branch offices and branches up to the district

level. Their scope of operations though extend up to the village level. Other smaller microfinance providers, e.g. NGOs registered as microfinance operators by the NBC, have an even deeper geographical outreach, having offices at the commune and village levels. In addition to increasing microfinance services to more poor people, an expansion of the network of microfinance providers also generate more employment. The 34 licensed MFIs generated an additional 2,874 jobs in 2012.

Lending performance. Majority of the loans released by MFIs went to the agriculture sector (39%) whereas loans by banks to the sector was only 10% of its total loans in 2012. Surprisingly, loan portfolio quality of MFIs are also much better than banks despite allocating majority of their loans for agriculture, which is perceived to be a risky sector by banks. From 2008-2012, the average ratio of non-performing loans to total loan released by banks was 3.2% compared to only 1% for MFIs. This finding suggests that the risks posed by agriculture is only weakly correlated with loan portfolio quality. What might be more important is how risks are managed by MFIs.

Deposits. Since MFIs were granted the opportunity to take deposits from the public, the initial response was overwhelming as deposits averaged nearly 140% over the past five (5) years, peaking at 275% in 2010. By contrast, growth in deposits by banks over the past seven (7) years averaged 34%, peaking at 77% in 2007. This indicates the capacity and willingness of the poor and low-income people to save, as well as the facility offered by MDIs to encourage savings.

Enabling policy environment for MFI development

The improving performance of MFIs can be attributed partly to an enabling policy and regulatory environment that, among others, provide microfinance operators such as unregistered NGOs the opportunity to be upgraded into MFI and eventually commercial bank status. This increases investor confidence and, consequently, their capacity to access funds at reasonable rates from local and international financing institutions. This, in turn, enables them to expand their services and reach more clients. As they grow however, microfinance providers change their orientation from a non-profit oriented entity to a profit-driven financial institution. They are also subjected to stricter prudential regulations by NBC. Hence, there is a danger that they might shift their loan portfolio to less risky clients and/or projects (e.g. from agriculture to industry or services, or large scale agricultural projects) or be more selective in choosing and screening their clients to the point of being restrictive. Development should therefore be balanced by social responsibility.

Profiling of farmers and estimation of credit demand

Based on the 2012 socio-economic survey in Cambodia, 44% of the working population in the agriculture sector have outstanding debts. More people in the agriculture sector are also borrowing from formal (57%) than informal (43%) sources. These data would be much more useful if complemented with other relevant data. For instance, why is 56% of the working population in agriculture not borrowing? Maybe some don't borrow because they are financially self-sufficient. Some may need to borrow but can't meet the requirements of the banks/MFIs. Maybe some are too poor that all that they need is direct intervention like food/food allowance or start-up capital for livelihood projects.

These researchers believe that different economic groups require different government intervention to address their problems. The Cambodian Government, perhaps the MAFF or MRD, should come up with a socio-economic profile of agricultural borrowers so that government programs will fit the various needs of different economic profiles. Hence, the very poor who cannot obtain loans from formal sources will not be left out from the development "rectangle".

It is also important to determine the proportion of current non-borrowers that have plans of borrowing in the future. This information is useful in estimating effective demand for credit in agriculture. With regard to credit source, it would be useful to note the main reasons for borrowing from both formal and informal sources. Are informal sources, for instance, really the preferred lenders or formal lenders are merely inaccessible? Gathering these information will require a study that will provide a profile of farm households and their credit requirements.

While the geographic reach of most MDIs and several MFIs and NGOs extend up to the village level, it is hard to ascertain if the loans released by these microfinance providers are adequate to cover the credit requirements of the farmer-borrowers because of lack of information regarding credit requirements of agricultural households, particularly the small farming sector. Hence, there should be an in-depth study that will quantify the demand for credit in the agriculture sector. The study should also determine the appropriate financial products and services required by borrowers, and their preferred loan terms and conditions.

National level policy for agricultural finance

Following the example of the rice export policy, a national policy and strategic action plan for agricultural finance should be developed to institutionalize the plans and goals for agricultural finance. An estimation of the credit demand of agricultural households will be a critical input as it should serve as a baseline target by which performance of agricultural finance will be measured.

Need to strengthen capacity building for farmers, farmer organizations and agricultural SMEs

One of the major constraints to credit access stems from weak knowledge and understanding of financial literacy. This leads to the inability of many farmers to prepare a viable business plan and poor financial recording system of many agricultural SMEs. In turn, this provides banks or MFIs with a weak basis for properly assessing the project in terms of the cashflow, projected income, and repayment capacity of borrowers, among other things. Farmers should be organized into farmer organizations and eventually into cooperatives to shore up their capacity to access credit from formal sources. MAFF plays an important role in developing farmer groups and cooperatives particularly in the provision of training and technical assistance.

Recommendations

Taking into consideration the major issues and constraints to credit access in the agriculture sector, the study recommends the following courses of action:

- a. Institutionalize a national policy and strategic action plan for agricultural finance. It should include an estimate of the credit demand for the agriculture sector which will serve as a baseline for measuring credit delivery to the sector. It should likewise place equal importance on financing the production requirements of small farmer producers as well as those of agribusiness SMEs for purchasing and processing of paddy and other priority agricultural commodities. The regular conduct of a study that will produce a profile of agricultural borrowers and their credit needs will be a useful input in the preparation of the plan.
- b. Government to spearhead the development and piloting of innovative financing schemes that will facilitate access to credit of poor farmers and, at the same time, address various risks that banks and MFIs usually cover with collateral. Examples of such schemes include value chain financing and integrated and supervised financing. The package of financial services provided

- by these schemes (marketing support, technology transfer, capacity building, credit guarantee, crop insurance) provides security against various types of risks in the agriculture sector. Schemes that are found to be successful should be replicated on a national scale.
- c. Government to strengthen linkage with the private sector by developing and implementing the abovementioned financing schemes in partnership with international organizations and local microfinance providers including MDIs, other MFIs, and small NGOs with microfinance services. This is also one means of ensuring that, as microfinance providers develop, they will not renege on their social responsibility of catering to poor and low-income clients.
 - d. Strengthen coordination in developing policies and implementing programs among government agencies, and between government and the private sector for more efficient use of resources and optimum delivery of services to the target sectors and clients.
 - e. Fast-track land distribution to agricultural households and develop a more efficient policy and regulatory framework for granting ownership of distributed lands to beneficiaries.
 - f. Develop the legal and regulatory framework for the warehouse receipts system to address lack of collateral by agricultural SMEs and facilitate borrowing for working capital and investment loans.
 - g. The Cambodian Government should review the mandate of the Rural Development Bank (RDB) vis-à-vis its plan to establish the Agriculture Development Bank (ADB). From the point of economic efficiency, the role of the RDB must be reviewed as against the plan to put up the Agricultural Development Bank. The RDB can be transformed from a specialized bank to an apex bank that will take care of the financing needs of the agriculture sector. Its capitalization must be increased with an additional endowment from the government. It must be allowed to get deposits from the public so that eventually a bigger proportion of its loan portfolio will be internally generated. The RDB should be staffed with specially trained agricultural personnel that understand the peculiarities of the agriculture sector and thus will be able to design products and services that conform to the needs of the rural borrowers.
 - h. More MFIs must be encouraged to transform into MDIs. Financially healthy MFIs must be encouraged by the National Bank of Cambodia to transform themselves into deposit-taking institutions. This will allow them to expand their operations because aside from borrowed funds, they can mobilize some of the deposits for lending to the agriculture sector. However, the NBC should issue a Prakas imposing a limit on the proportion of deposits that can be used for lending. This will ensure the safety of the money entrusted to them by the depositors.
 - i. Strengthen capacity building for farmers, farmer organizations and cooperatives, and agricultural SMEs particularly with regard to financial literacy (business plan preparation, record keeping, basic accounting, credit discipline), as well as on new production technologies and more efficient farming practices to increase productivity.
 - j. Strengthen the formation and development of agricultural cooperatives to facilitate access to credit of farmers from banks or MFIs. MAFF should also fast-track the formulation of the policy guidelines for the recently enacted cooperative law that will provide the necessary support services (including credit guarantee and crop insurance) for the development of agricultural cooperatives.
 - k. Develop the necessary agricultural infrastructure in rural areas such as farm-to-market roads, irrigation, and post-harvest facilities including warehouses and other storage facilities to improve viability of the agriculture sector and encourage investment and financing by the private sector.
 - l. To mitigate risks and to encourage more private lenders to extend credit to the agriculture sector, the Government should seriously consider coming up with a crop insurance program and improve the performance of its guarantee programs.

CHAPTER 9

Summary and Conclusion

The microfinance sector in Cambodia is relatively well developed and provides an enabling policy and regulatory environment conducive for the development of microfinance providers. MFIs have the facility and physical infrastructure to expand their services to a greater number of poor rural and agricultural households that otherwise have limited access to banks. Nonetheless, access to credit especially by poor agricultural households remain constrained due mainly to lack of collateral, repayment capacity, inability to prepare a viable business plan, and unpaid debts with informal moneylenders.

While microfinance is the primary instrument for providing the financial needs of the poor, its products and services are limited mostly to savings and loans, except for MDIs which are licensed to take deposits. Lending methodology of microfinance is likewise confined to either group or individual lending. Micro loans are typically provided through group lending where collateral is usually not required. However, the loan amount is not adequate to cover the financing requirements for agricultural production. Bigger loans could be had through individual lending but collateral – usually in the form of land title – is already required. Banks generally require ‘hard’ titles but MFIs may accept ‘soft’ titles. Risk management practices is inflexible and is primarily covered through collateral. Credit guarantee and risk-sharing programs implemented by the government remain ineffective while a crop insurance program has yet to be implemented.

Lack of innovative financing schemes such as value chain finance that would have addressed risks such as production and market risks and effectively serve as collateral substitutes, also constrain credit access by small producers. Integrated and supervised financing programs are being implemented by some NGOs and facilitated by international organizations. However, these are small-scale and piloted in select areas. There are plans of implementing a warehouse receipts financing but there are no concrete developments as of yet.

The regulatory framework developed by NBC has been successful in keeping a healthy financial system. The institutionalization of a credit information sharing system managed by the credit bureau is a significant accomplishment as it helps banks and MFI reduce costs associated with credit investigation, maintain loan portfolio quality, and establish a pool of good borrowers. NBC requires all banks and MFIs to conform to the credit information sharing system. Another regulatory measure is the requirement of collateral for loans of banks and MFIs. While the policy and regulatory environment keeps the financial system healthy and enables microfinance to develop, it may prove restrictive to poor rural borrowers in the absence of innovative financing schemes that will enable them to access formal credit.

The recommended measures above should be implemented holistically to maximize their impact in improving access to credit by poor agricultural households. A national policy on agricultural finance and the corresponding action plan for operationalizing its strategies should be developed. Once the policy is in place, value chain financing schemes may be developed and piloted in partnership with international organizations and local microfinance providers. It is important for farmers to be organized into cooperatives as this will facilitate easier integration into the value chain. This will consolidate and elevate production from subsistence to commercial scale and gain easier access to markets. Once integrated into the chain, farmers will be able to access the necessary support services including credit and capacity building. The Agriculture Development Bank or an upgraded RDB, and MFIs will provide production loans to farmers or working capital loans to agribusiness SMEs for purchasing and processing paddy. On the other hand, MDIs and banks will provide investment loans, i.e. for post-harvest facilities and processing machines such as warehouses, cold storage, and dryers. In addition to the

inherent securities against risk in the value chain, an efficiently functioning warehouse receipts system will further increase the capacity of farmers and agricultural SMEs to access credit from formal sources.

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ANNEX 1

List of Institutions Interviewed

Name of Institution	Person/s Interviewed	Position
ACLEDA Bank	Dr. So Phonnary	Executive Vice President & group Chief Operations Officer
Amret	CHEA Phalarin	Chief Executive Officer
Angkor Mikroheranhvatho Kampuchea	Kea Borann	Chief Executive Officer
Cambodia Development Resource Institute	LUN Pide	Research Associate, Economy, Trade and Regional Cooperation Programme
Cambodia Property Career Development Organization	Huon Kunthea	Manager
Credit Bureau of Cambodia	Garry Wood	Chief Executive Officer
Credit Mutuel Kampuchea	Michel Kindbeiter	Managing Director
Farmer Livelihood Development	Keo Kim Say	Finance Manager
International Fund for Agricultural Development	Meng Sakphouseth	Country Operations Officer, Asia & the Pacific Division, Programme Management Department
Ministry of Agriculture Forestry and Fisheries, General Directorate of Agriculture	Mak Soeun, PhD	Director, Department of Agricultural Extension
Ministry of Economy and Finance	Chou Vannak	Deputy Director, Financial Industry Department, and Assistant to the Vice-Chairman of the Supreme National Economic Council
	Moeurn Sovannara	Official, Microfinance and SMEs Division
National Bank of Cambodia	Kim Vada	Director General, Banking Supervision, and Chairman of Asia-Pacific Rural and Agricultural Credit Association
	Ban Lim	Deputy Director of Legal Department, General Directorate of Supervision
	Som Kossom	Chief of MDI Supervision Division, Off-Site Supervision Department
National Institute of Statistics	Saint Lundy	Director of ICT Department, Poverty Analyst
PRASAC MFI	Sokhim Neang	SVP & Business Management Head
	Sony Say	SVP & Chief Marketing Officer

Name of Institution	Person/s Interviewed	Position
Rural Development Bank	Son Koun Thor	Chairman and CEO, Vice-Chairman of the Supreme National Economic Council, and Advisor to the Prime Minister Samdech Techo HUN SEN
	Pech Sany	Deputy Director General
	Uch Chantha	Deputy Director General & Deputy Secretary General of One Village One Product National Committee
Sathapana Limited, Maruhan Japan Group	Dr. Bun Mony	Chief Executive Officer

Photo Credit:
Dr. Marlowe U. Aquino
Project Manager
Cambodia corn farmers, Siem Reap, Cambodia
May 2013



Printed by

ASIA-PACIFIC RURAL AND AGRICULTURAL CREDIT ASSOCIATION (APRACA)

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ISBN 978-616-394-230-2