

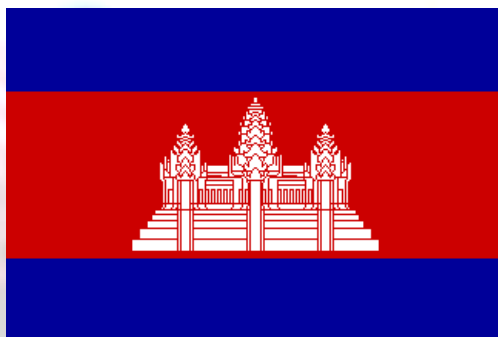
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**Aid Effectiveness Initiative**  
*Using Microfinance as a Test Case*

**COUNTRY LEVEL  
EFFECTIVENESS AND ACCOUNTABILITY REVIEW**

**CAMBODIA**



**January 2005**

*by*  
**Mark Flaming**  
**Eric Duflos**  
**Alexia Latortue**  
**Nina Nayar**  
**Jimmy Roth**



Source: The World Fact Book: <http://www.cia.gov/cia/publications/factbook/geos/cb.html>



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*January 2005*

## ACRONYMS

ABC	Association of Banks of Cambodia
AsDB	Asian Development Bank
AFD	Agence Française de Développement
AMK	Angkor Mikroheranhvatho Kampuchea
AusAID	Australian Agency for International Development
CCSF	Cambodia Community Savings Fund
CCRD	Cambodian Committee for Rural Development
CEB	Cambodia Entrepreneur Building
CGAP	Consultative Group to Assist the Poor
CLEAR	Country-level Effectiveness and Accountability Review
CMA	Cambodian Microfinance Association
CRS	Catholic Relief Services
CWS	Church World Service
DFI	development finance institution
EC	European Commission
EMT	Ennastien Moulethan Tchonnebat (now re-named AMRET)
GRET	Groupe de Recherche et d'Échanges Technologiques
GTZ	Gesellschaft für Technische Zusammenarbeit
IFAD	International Fund for Agricultural Development
IFC/MPDF	International Finance Corporation/Mekong Private Sector Development Facility
IFC	International Finance Corporation
ILO	International Labour Organization
IMF	International Monetary Fund
IT	information technology
KfW	Kreditanstalt für Wiederaufbau
MFI	microfinance institution
MIS	management information system
NBC	National Bank of Cambodia
NGO	non-governmental organization
RDB	Rural Development Bank
RGC	Royal Government of Cambodia
Sida	Swedish International Development Agency
TPC	Thaneakea Phum
UNDP	United Nations Development Programme
UNICEF	United Nations Children's Fund
USAID	United States Agency for International Development
USAID/DCA	USAID Development Credit Authority
WB	World Bank





## EXECUTIVE SUMMARY

A Country-level Effectiveness and Accountability Review (CLEAR) took place in Cambodia in October 2004 to analyze donor effectiveness in supporting microfinance. It concluded that, over the past decade, donors have achieved remarkable success in building commercially-oriented microfinance in Cambodia. As of June 2004, the leading microfinance providers were ACLEDA Bank, nine licensed microfinance institutions (MFIs), and 28 registered non-governmental organizations (NGOs). Together, these institutions held an outstanding loan portfolio of US\$ 77 million and provided services to almost 400,000 borrowers in virtually every province of the country.

Not only is microfinance flourishing, with a large number of promising retail institutions, but it is arguably the most sophisticated component of the national financial system. Microfinance in Cambodia, however, is almost completely focused on the provision of credit.

Donor successes in Cambodia to date can be attributed to a shared vision of a commercial microfinance industry characterized by sustained deployment of skilled technical expertise; performance-based contracts; highly effective support to the Cambodian government in building a regulatory and supervisory framework conducive to pro-poor financial institutions; and the ability to alter funding strategies as the industry grew and matured.

Today, the challenge for the donor community working in Cambodia is to support the successful integration of microfinance into the national financial system. Although crucial gaps exist at all three levels of the financial system (micro, meso, and macro), the meso-level requires the most urgent attention, both to consolidate retail institutions and to promote transparency. Not every donor can or should work at all three levels of the financial system. They are encouraged to support activities based on their own comparative advantage.

At the micro-level (retail financial providers), donors are encouraged to leave capital funding to private investors and concentrate on providing top-quality technical assistance to existing promising institutions. Joint donor support of new product

development (especially savings services) and innovations by strong existing institutions is recommended, although such funding should be implemented with a clear exit strategy. Support of credit components and weak financial service providers should be avoided.

At the meso-level (e.g., skilled technical service providers, auditors, credit bureaus, etc.), donors are encouraged to support a commercially-based wholesale capital market for microfinance, develop local technical expertise, support the institutional growth of the Cambodian Microfinance Association, and facilitate the exchange of debtor information among MFIs (with the ultimate goal of creating a credit bureau).

At the macro-level (e.g., government policy and regulation), donors are encouraged to concentrate on providing sustained technical assistance to the Bank Supervision Department of the National Bank of Cambodia—maintaining close coordination to avoid sending conflicting messages to the government. Donors could also support the development of a national payment system infrastructure, train judges in secured-transactions law, propose modifications to the tax system to remove disincentives for small savings accounts, and work with the government to develop a legal status for profit-making NGOs.

Finally, donors need to improve their own internal and collective effectiveness. They are encouraged to codify and use accepted principles for microfinance funding in Cambodia, invest in staff development (including permanent Cambodian staff, maintain performance-based management of microfinance programs, and develop common reporting standards for MFIs). They are also counseled to expand knowledge management, for example, by creating mechanisms that capture existing institutional knowledge of Cambodian microfinance, and share it with staff, other donors, the industry at large, etc. Donors should also translate good-practice microfinance publications into Khmer; and encourage staff to participate in local and donor knowledge networks.

## I. BACKGROUND

Early in 2002, CGAP, the Consultative Group to Assist the Poor, and a group of ministers and heads of leading development agencies, launched a unique aid effectiveness initiative using microfinance as a test case. In the initiative's first stage, April 2002–November 2003, it sponsored the Microfinance Donor Peer Reviews of 17 bilateral and multi-lateral development assistance agencies, which included three field visits. The Peer Reviews helped donor agencies look at themselves in a mirror and focus on what they could most directly influence: their own procedures, processes, practices, and systems. Top management and staff of the participating agencies appreciated the frank and actionable recommendations of the review teams. The 17 agencies are currently implementing these recommendations, with promising results.

The peer-review exercise culminated in a high-level meeting in February 2004, “Leveraging Our Comparative Advantage to Improve Aid Effectiveness,” at which the lessons learned from the reviews were synthesized, and steps for further collective action were discussed. Following the meeting, the 17 agencies issued a joint memorandum in which they endorsed five core elements of donor effectiveness in microfinance (the “aid effectiveness star”): (1) strategic clarity, (2) strong staff capacity, (3) accountability for results, (4) relevant knowledge management, and (5) appropriate instruments. The agencies also committed to a four-step program, giving CGAP and their respective organizations a mandate to deepen their aid effectiveness work.

In response, the CGAP operational team collaborated with several CGAP member donors to design a second stage of the aid effectiveness initiative: Country-level Effectiveness and Accountability Reviews, or CLEARs. These are not comprehensive sector studies, but rather focus on strategic issues relevant to donor effectiveness. The country-level reviews emphasize donor systems, communication flows, and practices against the backdrop of building financial systems that work for the poor. They strive to help donors identify gaps in the financial systems in the countries where they work and to design interventions that build on their respective comparative advantages. Country-level reviews also aspire to motivate donors to improve internal procedures and systems so that they can work more effectively with others in the field.

CLEARs bring donor aid effectiveness one step closer to field operations and stakeholders, such as national governments and practitioners, who cooperate closely with donors at the country level. The reviews incorporate three additional elements of donor effectiveness that are particularly relevant to country-level operations: (1) an agency's influence and clout in a given country; (2) its commitment to collaboration; and (3) its responsiveness to local stakeholders. Six CLEARs are planned between October 2004 and December 2006.

The first CLEAR took place in Cambodia October 3–24, 2004. A review team—comprised of Jimmy Roth of the International Labour Organization (ILO); Mark Flaming and Nina Nayar, consultants; and Eric Duflos and Alexia Latortue (CGAP) spent a total of 11 person-weeks in the country. The team interviewed over 110 people representing a broad cross-section of stakeholders, from government officials to microfinance institution managers and staff to representatives of the full spectrum of donor agencies and donor microfinance projects. In addition to holding individual interviews, the team distributed questionnaires, organized focus groups, read reports and literature on Cambodian microfinance, and made telephone calls to key informants outside the country.<sup>1</sup> During two meetings that took place in Phnom Penh October 21–22, 2004, the team briefed all stakeholders on its initial findings.

The review team and CGAP are available to discuss the recommendations outlined in this report in more detail, as well as to support donor agencies in their implementation. Follow-up support is envisioned at the country level for both joint initiatives and individual agency actions, and at the headquarters level to reinforce changes suggested by the peer reviews.

This report presents a brief overview of the evolution of the Cambodian microfinance industry (Section II), an analysis of gaps in the microfinance industry (Section III), an analysis of the strengths and weaknesses of donor effectiveness (Section IV), and concrete recommendations on how donors can best respond to existing gaps in the pro-poor financial system of Cambodia and improve their overall effectiveness (Section V).

<sup>1</sup> See annexes 4 and 6 for further details.

## II. OVERVIEW OF MICROFINANCE IN CAMBODIA

Cambodia still suffers from the legacy of 20 years of civil unrest (1970–90). During that period, a significant number of educated Cambodians fled the country, and government structures were not fully operational, if they existed at all. The social and economic infrastructure of the country was virtually destroyed by the Khmer Rouge. Today, Cambodia is one of the poorest countries in the region: 36 percent of its 13.4 million citizens live below the national poverty line, and 20 percent of households are headed by a female.<sup>2</sup>

Following the Paris Peace Accords of 1991, donor funds for reconstruction began flooding into the country. In the challenging post-conflict context of Cambodia, microfinance was one area where donors achieved remarkable success in close partnership with private-sector actors, civil society, and the government. In fact, the accomplishments of microfinance in the country serve as an emerging model for institutional governance, transparency, and public-sector regulation of a privately operated industry. Cambodian microfinance institutions have now attracted foreign investors, which are playing an important role in shaping international perceptions of the investment climate in the country.

The financial and banking sector were destroyed by the Khmer Rouge regime, which abolished money for a number of years. In the 1990s, Cambodia's banking sector went from a system limited to a single public bank to a two-tiered banking system that separated the functions of the central bank from commercial banks. The Royal Government of Cambodia (RGC) introduced banking regulations in 1999 and a bank restructuring program in 2000. As a result, many banks were liquidated. (Thirty-two institutions were consolidated into 19). Today, 17 banks remain in operation, including one state-owned commercial bank, three foreign bank branches, 10 local banks, and three specialized banks (one of which is state owned).<sup>3</sup> With one notable exception—ACLEDA Bank—these banks

are highly liquid, conservative, and serve a narrow, elite clientele.

### Evolution of Cambodian Microfinance

Initiatives that began as unsustainable, donor-financed credit projects in the 1990s were collectively transformed by donors, international implementing partners, and local stakeholders into a sector led by profitable, regulated financial institutions. In just one decade, microfinance evolved from a series of small, isolated initiatives into what is arguably the most sophisticated part of the national financial sector. In 2004, the main suppliers of pro-poor financial services (ACLEDA Bank, licensed MFIs, and registered NGOs) served close to 400,000 borrowers—eight times more than in 1995.<sup>4</sup> This evolution was marked by three phases that reflected changes in the approach and behavior of financial service providers, the government, and the donor community.

**1990–1995: Start-up phase.** The start-up phase began in the early 1990s, when multilateral and bilateral donors, and international NGOs began financing projects to deliver credit to poor micro-entrepreneurs.<sup>5</sup> At that time, there was a vacuum of functioning institutions, as well as government oversight, in the financial sector. International NGOs—such as the Groupe de Recherche et d'Échanges Technologiques (GRET), Catholic Relief Services (CRS), and World Vision, together with some early donors such as the United Nations Children's Fund (UNICEF), the International Labour Organization (ILO), the United Nations Development Programme (UNDP), Agence Française de Développement (AFD), and the US Agency for International Development (USAID)—played a significant role in launching the first microfinance programs in Cambodia.

Most of these early initiatives were financed as credit components within integrated rural development programs. They utilized a wide range of microcredit delivery methodologies, ranging from

<sup>2</sup> For national poverty data, see UNDP, *Human Development Report 2004* (New York: UNDP, 2004). For data on female-headed households, see Mark Pickens, "Savings-Led and Self-Help Microfinance in Cambodia: Lessons Learned and Best Practices" (Phnom Penh: PACT, 2004).

<sup>3</sup> See Royal Government of Cambodia (RGC) and Asian Development Bank, (AsDB), "The Financial Sector Blueprint for 2001–2010" (Phnom Penh: RGC and AsDB, 2001); and IMF, "Selected Issues" (Washington, DC: IMF, March 2003).

<sup>4</sup> Cambodian Committee for Rural Development (CCRD) and Rural Development Bank (RDB) of Cambodia, 1995–2002 (Phnom Penh, Cambodia). The figures cited by these sources do not include an estimated 50,000 additional clients served by non-registered NGOs in Cambodia.

<sup>5</sup> The term "non-governmental organization," or NGO, is commonly used in Cambodia to refer to private, non for profit associations.

individual loans to solidarity groups to village banks, and self-help groups. Early on, a few of these actors demonstrated an interest in creating sustainable financial services for poor people.

**1995-1999: Institutionalization.** This phase was characterized by the separation of credit components from integrated program structures and the institutionalization of NGO microfinance activities. Helping microfinance providers attain financial sustainability became the primary objective. The supporters of microfinance in Cambodia started meeting regularly during this period to share information, align objectives, and define a common vision for the sector. NGOs formed their own forum, while the Cambodian Committee for Rural Development (CCRD), a government body funded by donors, provided a platform for broader discussions. Also at this time, the government created the Rural Development Bank (RDB), a wholesale lender to emerging MFIs.

On the policy front, the International Monetary Fund (IMF) and the Asian Development Bank (AsDB) supported the RGC to formulate a comprehensive macroeconomic and structural reform program, including financial system modernization and corresponding legislation. The Central Bank Law of 1996 established a legal foundation for a modern central bank. The Law on Banking and Financial Institutions of 1999 created a legal framework for a broad range of financial service companies, with appropriate mechanisms for licensing, regulation, and supervision. Given these changes, the emerging microfinance community encouraged the CCRD to allow the National Bank of Cambodia (NBC) to assume responsibility for regulating and supervising microfinance.

**1999-Present: Commercialization.** The success of NGOs in providing credit to the poor and largely rural population encouraged the NBC to issue regulations establishing a special license for MFIs and a registry for NGOs.<sup>6</sup> The issuance of new *Prakas* (regulations) in 2000 and 2002 marked a move toward the commercialization of microfinance and its integration into the formal financial system of Cambodia.

The vision of integrating microfinance into the regulated financial system arose out of a consultative process among the RGC, the NBC, and

leading MFIs. In October 2000, the industry leader, ACLEDA, transformed from an NGO into a specialized microfinance bank with the support of its founding donors and new institutional investors. (Its change in status followed the creation of a new MFI license in January 2000.) The transformation of ACLEDA Bank created an important precedent for other financial providers. During this phase, socially-responsible investors and development finance institutions (DFIs) replaced the donors that had financed the start-up and institutionalization of NGOs, which until this stage had served as their primary funding and advisory partners. Nine of the leading NGOs subsequently transformed into licensed institutions with the assistance of their original donors and new investors (which contributed capital and governance).

As of June 2004, the pro-poor financial sector in Cambodia was led by ACLEDA Bank, followed by nine licensed MFIs (10 since December 2004), and 28 NGOs registered with the NBC. (For portfolio and outreach figures, see table 1.) The registered NGOs vary in terms of outreach, capacity, and commitment to sustainability; and only a few currently possess the resources to become licensed MFIs. In addition, a plethora of smaller NGOs and other community-based organizations currently provide microfinance services, including an estimated 60 NGOs that are not registered, and a few incipient mutual and savings associations.

Canadia Bank recently entered the market to provide wholesale financing to MFIs and, with donor support, is also lending to small enterprises. With the exceptions of ACLEDA Bank, the RDB, and to some extent, Canadia Bank, formal banks do not yet serve the poor. Several foreign private investors (e.g., SIDI, Triodos, and Horus), however, actively participate in the country's pro-poor financial sector.

**Beyond 2004: Financial systems integration.** Microfinance stakeholders have made remarkable strides in advancing a commercial approach to expand pro-poor financial services in Cambodia. Today, ongoing commitment and decisiveness from all stakeholders is needed to ensure that poor people continue to be the focus of Cambodia's financial system as it matures. In particular, donors will have to determine their role in a private-sector, commercial model for providing financial services to the poor.

<sup>6</sup> Royal Government of Cambodia, *Prakas* No. B700-06, "On the Licensing of Micro-Finance Institutions"; and *Prakas* B702-49 *Pror Kor*, "On Registration and Licensing of Microfinance Institutions" (Phnom Penh: RGC, 2002).

**Table 1. Microfinance Portfolio and Outreach in Cambodia for Selected Years** (in US dollars)

Item	1995	1997	2002	2003	2004 (June)
<b>Lending Portfolio</b>					
ACLEDA	1,157,093	5,860,578	27,461,933	40,572,670	49,711,076
Licensed MFIs	n/a	n/a	5,637,792	12,552,666	19,019,744
Registered NGOs	n/a	n/a	12,791,441	10,633,628	8,144,821
<b>Total Loan Portfolio</b>	<b>3,000,000</b>	<b>15,000,000</b>	<b>45,891,166</b>	<b>63,758,964</b>	<b>76,875,64</b>
<b>Total Borrowers</b>	<b>50,000</b>	<b>225,030</b>	<b>327,935</b>	<b>374,056</b>	<b>392,892</b>
<b>Savings Portfolio</b>					
ACLEDA	n/a	n/a	5,678,728	13,160,685	21,603,048
Licensed MFIs	n/a	n/a	143,433	795,065	1,124,129
Registered NGOs	n/a	n/a	730,076	811,475	138,074
<b>Total Savings Portfolio</b>	<b>n/a</b>	<b>n/a</b>	<b>6,552,238</b>	<b>14,767,225</b>	<b>22,865,251</b>
<b>Total Depositors</b>	<b>n/a</b>	<b>n/a</b>	<b>107,120</b>	<b>133,628</b>	<b>155,137</b>

*Note:* The 1995–1997 data was compiled by consultant Heather Clark on the basis of data provided by the CCRD and RDB, and includes estimates of all known microfinance programs. Data from 2002–2004 was derived from the NBC “2003 Network Information Report” and includes only licensed MFIs and registered NGOs. Insufficient information was available for 1999. Prior to 2000, savings accounts were negligible, consisting only of mandatory savings. As of 2002, savings numbers reflect both mandatory and voluntary savings. ACLEDA figures include all loans (microloans, small loans, and medium-sized loans).

### III. GAP ANALYSIS OF THE CAMBODIAN MICROFINANCE INDUSTRY

Integrating microfinance fully into the formal financial system requires working at all three levels of the financial system: micro, meso, and macro. While retail institutions (the micro-level) are the backbone of the financial system, microfinance providers also require support services (the meso-level) to train their staff, improve their systems, and become more transparent. Institutions evolve well in a conducive environment (the macro level) when policies, regulations, and supervision set appropriate rules of the game and create incentives.

A financial systems approach takes all three levels into consideration. This approach has special implications for donors who aspire to assist the ongoing development of microfinance in Cambodia. Historically, donors have concentrated their support at the micro- and macro-levels. The meso-level, however, will assume an increasingly important role as the financial system matures. Looking forward, donors are encouraged to reflect on their role in an increasingly sophisticated commercial, regulated financial industry.

#### Box 1. Three Levels of the Financial System

**Micro:** Retail financial service institutions (e.g., NGOs, banks, MFIs, cooperatives), and other suppliers (e.g., money lenders, agricultural traders, etc.)

**Meso:** Service providers and industry infrastructure (e.g., networks, trainers, auditors, information technology providers, wholesale financing facilities, credit bureaus)

**Macro:** Policy, laws, and the regulation and supervision framework (e.g., banking regulations, interest-rate policy)

The following sections identify the main gaps at each level of the financial system that require further donor support.

#### Micro-level Gap Analysis

The lack of strong retail, pro-poor financial institutions is a significant challenge in most countries. Cambodia is an exception: it already has a critical mass of promising institutions. These financial service providers have considerable differences in capital and funding, management capacity, governance structure, and supervision. In the future, it is possible that Cambodian finance could experience institutional failure and the consolidation common

to rapidly-growing industries. Retail institutions indifferent to financial sustainability could potentially create unhealthy competition and market distortion by undercutting sustainable retailers. However, well-managed growth and improved management capacity of emerging institutions will strengthen competition and provide clients with better choices.

The donors that have played a key role at the micro-level in Cambodia are AFD, the Australian Agency for International Development (AusAID), the European Commission (EC), Gesellschaft für Technische Zusammenarbeit (GTZ), ILO, International Finance Corporation (IFC), Kreditanstalt für Wiederaufbau (KfW), UNDP, and USAID. Strengthening the retail level will now, in part, depend on the ability of donors to help microfinance stakeholders address the six challenges listed below.

**Lack of savings services.** The development of savings services has lagged behind credit services. As of June 2004, the combined deposits of MFIs and registered NGOs represented less than 5 percent of their lending portfolios. There were two major exceptions to this rule: Cambodia Community Savings Fund (CCSF), Cambodia's largest savings-led microfinance program (supported by AusAID), and ACLEDA Bank.<sup>7</sup>

ACLEDA Bank offers attractive deposit services and uses savings to fund 43 percent of its lending portfolio. CCSF is a promising model, but the NBC has not yet developed regulations for savings-based institutions that protect depositors. The weak level of voluntary savings mobilization has two major negative consequences. Poor people do not have access to formal deposit services, a service equally as important—if not more so—than credit for poor households, especially in rural areas. Savings mobilization is also an undeveloped source of local funding that could both finance the expansion of financial institutions and instill institutional discipline.

The lag in savings services is partly explained by the fact that microfinance organizations could accept voluntary savings from their members only

<sup>7</sup> CCSF is an apex institution for 39 member-owned and member-operated savings banks with 14,673 participants in the Battambang and Banteay Meanchey provinces. These savings banks have from 350 to 1,400 members. See Mark Pickens, "Savings-Led and Self-Help Microfinance in Cambodia."

after they became licensed MFIs, an institutional status that was established in 2000. To date, formal banks have not offered significant deposit services to poor clients. The formal banking sector, however, has only recently come into existence and targets up-market clients. Informal self-help groups, such as those developed by Church World Service (CWS), do not yet play a predominant role in the financial sector.

**Box 2. Cambodian Institutions Offering Microfinance in 2005**

**Banks:** 3, ACLEDA Bank, Rural Development Bank, Canadia Bank

**Licensed MFIs:** 10, AMK (Concern), AMRET, CEB, Hattha Kaksekar, CREDIT, PRASAC, Seilanithih, TPC, Tongsang, Vision Fund

**Registered NGOs:** 28, including CCSF, MAXIMA, and CREDO

**Other NGOs:** 60

**Insufficient technical capacity for growth.** Most microfinance providers lack the full range of skills required to meet the increasingly sophisticated challenges of a growing market. These challenges apply even to market leaders, such as ACLEDA Bank and several licensed MFIs, which have visionary and talented leaders. The principal areas in which institutions need ongoing support are human resource development, information technology (IT), management information systems (MIS), internal control systems, board development, product innovation, and organizational structure.

**Undeveloped funding sources.** Microfinance providers are highly dependent on funding from foreign donors and social investors, despite the high liquidity of the Cambodian banking sector. Moreover, most commercial bank loans are made in US dollars, whereas poor clients demand local-currency loans. The typical domestic funding markets for financial institutions are undeveloped in Cambodia. Domestic savings is an emerging market, and markets for issuing commercial paper, bonds, and equity do not yet exist. Finally, attempts to create private instruments that would provide wholesale loans to MFIs and NGOs are still evolving. The RDB has been able to meet the demand of MFIs, and a private model is still in the embryonic stage. Lastly, with the exception of Canadia Bank, most commercial banks have not yet shown an interest in funding MFIs and are not lending much in general.

**Untested governance and ownership structure.** As the industry expands, the model of institutional ownership and governance created for the first privately owned MFIs in the country will face a number of challenges. Strong governance is crucial to attract equity and capital, which are key to sustainability of Cambodian microfinance. A number of issues still need to be addressed:

- Registered and unregistered NGOs do not have owners with commercial incentives or responsibility; in fact, it is unclear who the owners of these organizations are.
- To dispose of accumulated assets in NGOs that became licensed MFIs, donors transferred ownership of their original grants either to the government or to the NGOs that remained in existence after transformation. Transfer of ownership to the government, however, introduced public-sector influence into a private-sector industry without a clear exit strategy.
- Cambodian owners have a critical role to play in ensuring good governance, yet, with few exceptions, they have little experience in this role.
- The composition of shareholders in most Cambodian MFIs means that owners have different orientations, priorities, and knowledge regarding private financial institutions. It is unknown how these interests will converge, especially in times of crisis.

**Uneven playing field.** Competition among financial institutions is not yet mature for several reasons. First, there is a large gap between the market leader, ACLEDA Bank, and the rest of the pro-poor financial institutions. The true forces of competition—which promote product innovation, decrease prices, and improve services—are not yet fully in play in most regions of Cambodia.

Second, banks, licensed MFIs, registered and unregistered NGOs, and mutual savings and credit associations are not held to the same set of regulations, incentives, and expectations by their owners. For example, banks and licensed MFIs are compelled to make good loans, set interest rates that maintain profitability, and invest in good management systems. Other types of institutions are not held accountable to the same performance standards. Finally, some institutions are unconcerned with sustainability and may charge unsustainable interest rates, allow their portfolios to deteriorate, and thus pollute the market.

**Poor service delivery in remote areas.** Few microfinance providers have extended their services to remote areas. Little is known about potential demand for financial services there, especially for savings and other non-credit services.<sup>8</sup> Many people who were interviewed by the review team questioned whether the rural economy was sufficiently vigorous to make credit viable, that is, whether remote households could generate sufficient surpluses to repay principal and interest. Moreover, it is important to distinguish between *remote* areas (i.e., areas with sparse populations and poor access to financial services) and *rural* areas (i.e., areas outside urban centers). Contrary to broad local perceptions, the review team believes that microfinance providers have achieved remarkable coverage outside Phnom Penh. At the end of 2003, for example, ACLEDA Bank had 97 branches in 15 provinces, with plans to expand to all provinces, while MFIs and registered NGOs provided services in 16 of 21 provinces.<sup>9</sup>

### Meso-level Gap Analysis

Meso-infrastructure is critical to support the consolidation and expansion of retail providers and to promote transparency in the microfinance industry. In Cambodia, the International Finance Corporation/Mekong Private Sector Development Facility (IFC/MPDF) and AFD have been the most active at this level, with the AsDB, IFAD, ILO, and GTZ also involved on a more limited basis. For example, the IFC/MPDF supported a banker's training institute; GTZ, ILO, and AFD jointly developed a multi-currency "Micro Banker" accounting and portfolio software package; and AsDB, AFD, and IFAD funded the RDB. The private sector is also supplying important services via business schools and audit firms. Despite these initiatives, the meso-level is the most undeveloped part of the financial system, a pattern common in financial system development. Four specific challenges of this level are discussed below.

**Lack of debtor information exchange between financial institutions.** No formal mechanism exists for MFIs to exchange information on borrowers. The prevailing interpretation of the bank secrecy law is that it prohibits the creation of a credit bureau. Such information would be particularly

useful in Cambodia because client borrowing from multiple institutions has become widespread, especially in urban areas—behavior that can lead to over-indebtedness and default. MFIs are thus deprived of valuable information that could help them identify bad clients and compensate for the difficulties and cost of non-collateral-based lending.

Promising credit bureau initiatives do exist. Certain banks, for example, are planning to share information on borrowers through the Association of Banks of Cambodia (ABC). Certain MFIs also share information informally at the regional level through branch office networks.

**Lack of industry-wide technical service providers.** The supply of private-sector, fee-based support services for the financial system, especially for microfinance, is limited. Financial institutions are forced to use expensive services from abroad on an individual basis, or depend on donors to furnish needed services. Subsidized technical assistance provided by donors to individual financial institutions can, however, under-mine fair competition in a commercial market.

No local Cambodian firm specializes in management information services (MIS) for MFIs. Nor is it likely that the market will become large enough to support one, leaving most institutions to struggle individually to find information management solutions. In addition, very few firms in Cambodia are able to deliver quality accounting and auditing services, limiting the ability of MFIs to improve their transparency and control systems. The absence of audit and accounting capacity also deprives the national banking supervisor, as well as institutional owners and stakeholders, of a necessary tool to maintain the transparency and discipline of all financial institutions, be they MFIs or banks. Without transparency, it is difficult to protect clients, attract investors, or improve performance.

**Young industry association.** Microfinance practitioners do not yet have a recognized, formal forum to present their interests. Licensed MFIs, which are considered part of the financial system, are legally represented by the ABC. However, these MFIs have created a separate Cambodian Microfinance Association (CMA) to meet their specific needs. CMA member and advocacy services are undeveloped, depriving MFIs of a means to formally exchange information, access cheaper services, and advocate with donors and the public sector as a unified voice.

**Inadequate wholesale financing mechanism.** The initial experience with wholesale financing

<sup>8</sup> A forthcoming study on rural savings by the Canadian Cooperative Association will provide important data on this topic.

<sup>9</sup>ACLEDA Bank, *2003 Annual Report* (Phnom Penh: ACLEDA Bank, 2004); and National Bank of Cambodia, "Network Information by Province" (Phnom Penh: NBC, September 2003).



mechanisms in Cambodia was with the Rural Development Bank (RDB). Created as a public vehicle for providing credit to the rural sector, the suitability of the RDB to engage in the commercial microfinance market is highly questionable. Many individuals interviewed for this review argued that RDB was hampered by cumbersome administrative procedures and con-fusion between its wholesale and retail role. The poor track record of state-owned banks globally in providing credit to the poor suggests that retail lending should be left to the private sector. A very recent and promising initiative is the entrance of Canadia Bank into the wholesale market,<sup>10</sup> with guarantees and technical support provided by the IFC and the USAID Development Credit Authority (USAID/DCA). Other banks have also expressed interest in this facility.

### Macro-level Gap Analysis

The “Financial Sector Blue Print,” developed by the Cambodian government with AsDB, encapsulates a comprehensive vision for the Cambodian financial sector. Getting regulation and supervision right will protect the financial soundness of institutions and client deposits, and ensure the integrity of the financial system. The regulatory and supervisory framework for micro-finance in Cambodia is one of the most conducive in the region and offers a viable structure for the emerging microfinance industry. In addition to AsDB, AFD and the IMF have also played a positive role in creating this environment.

**Inherent structural risks.** Cambodian microfinance faces some specific risks that derive from its organizational structures:

- Unlimited liability exposure of any “influential shareholder” (owning more than 20 percent of an institution’s capital) promotes fragmentation of ownership and dilutes the owners’ incentive to play an active governance role.
- The low minimum capital requirement for MFIs promotes the creation of small, weak institutions that could potentially overwhelm the NBC’s supervisory capacity. (Conversely, banks, face very high capital requirements.<sup>11</sup>)
- The lack of systematic public dissemination of market information, such as a monthly bulletin with financial statements and performance

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<sup>10</sup> As of October 2004, the bank had not yet processed any transactions.

<sup>11</sup> The minimum capital requirement for a licensed MFI is 250 million Cambodian riel, approximately equivalent to US\$ 62,500, compared to the US\$ 13 million minimum capital requirement for a commercial bank.

indicators, reduces transparency in the industry. Although transparency is largely a meso-level issue, it can be enhanced by the dissemination of information by supervisory authorities.

**Thin regulation and supervision capacity.** NBC-staff experience in regulating and supervising microfinance is still quite recent. At present, the regulator does not have sufficient capacity and resources to manage an expanding microfinance Industry. The banking regulator’s primary mandate is to protect public deposits and the payment system. The tiny percentage of savings mobilized by MFIs (1 percent of the commercial banking sector savings) necessarily limits the resources that can be dedicated to microfinance. Yet industry expansion will require NBC involvement to guide the sector and maintain standards of soundness. For example, the NBC faces the challenges and cost of integrating mutual savings and credit associations into the regulated system, once these institutions begin to reach greater numbers of clients.

**Lack of legal framework for NGOs.** No comprehensive law in Cambodia governs the legal organization of NGOs, which raises serious issues of governance, especially for NGOs that are active in microfinance or other income-generating activities. (NGOs that function as charities and rely exclusively on grants and donations may have different issues.) The question of who owns the NGOs that generate and re-invest profits is particularly relevant, as these owners can become shareholders in licensed MFIs.

**Lack of a payment system.** The absence of infrastructure for cash transfers, clearances, and settlements increases the risks and costs associated with market expansion, especially in remote areas. For the moment, ACLEDA Bank provides these services in those areas where it has a presence.

**Weak framework for secured transactions.** Cambodia lacks a legal and institutional framework for the use of land and moveable assets to guarantee loans. Nor is its judiciary trained in the execution of collateral-based lending contracts.

**Tax burden on financial intermediaries.** The obligation of financial institutions to withhold taxes on interest paid on deposits raises the administrative costs associated with small savings accounts. The review team learned of at least one licensed MFI that postponed its savings program because of the high costs imposed by this obligation.

## IV. DONOR EFFECTIVENESS: STRENGTHS AND WEAKNESSES

This section highlights the main strengths and weaknesses of the donor community which supports pro-poor financial services in Cambodia (although not all individual donors exhibit them in equal measure). Understanding these strengths and weaknesses sheds light on some of the gaps that remain in the financial system and indicate areas that donors can help move forward.

The CLEAR used eight elements of donor effectiveness to analyze donor actions and decisions that fostered or hindered the development of microfinance in Cambodia. These elements were strategic clarity, strong staff capacity, accountability for results, relevant knowledge management, appropriate instruments, influence and clout in the country, commitment to collaboration, and responsiveness to local stakeholders.

Over time, most key donors involved in supporting microfinance in Cambodia (AFD, AsDB, IFC/MPDF, GTZ, KfW, USAID, and UNDP) developed a unified vision of how the industry should evolve. At its most successful, this shared vision allowed donors to help entrepreneurial institutions grow and terminate ineffective programs. Yet donors also exhibited several weaknesses—notably, uncertainty about how best to work with the national government, foster diversity and depth of financial services, and exchange knowledge.

To complement the overall donor community assessment, the review team completed brief individual assessments of the major donors currently active in the sector. These assessments will be submitted confidentially to AsDB, AFD, EC, IFC/MPDF, and KfW. Public disclosure of these assessments will be left to the discretion of the individual agencies. It should be noted that the amount of time that the review team spent in Cambodia was insufficient to conduct individual assessments of all donors working in the country.

### Strengths

***Strategic commitment to commercial microfinance, integrated into the financial system.*** Leading donors changed their initial strategy of supporting credit components in integrated projects to building formal, sustainable institutions. The supporters of ACLEDA Bank—KfW, UNDP, ILO, and USAID—provided a visionary precedent early in the development of the industry that facilitated the transformation of the NGO into a commercial

institution, by offering the right mix of technical and financial assistance.

Other donors, such as AFD, GTZ, and IFC/MPDF, also financed projects with the explicit objective of creating financially sustainable institutions (e.g., Hattha Kasekar, AMRET—formerly EMT—CEB, and Selanithih). This strategic commitment to commercial microfinance was also integrated into the “Financial Sector Blueprint” funded by AsDB. In this document, AsDB worked with the Cambodian government to lay out a vision for the financial sector in 2010 emphasizing the importance of developing a sound, market-oriented financial system that offers services to Cambodians of all economic strata.

***Timely and participatory support for the regulation and supervision framework.*** Cambodia is a case where coordinated donor work on the regulatory regime facilitated the expansion of microfinance. The success of donor interventions is noteworthy because work at this level requires a delicate mix of skills, influence, and vision. Donors helped build consensus among technical advisors, international NGOs, microfinance practitioners, and government representatives on an innovative and inclusive regulation and supervision framework.

The CCRD, supported by UNDP and AFD, served as the platform for stakeholders’ early engagement with the NBC. Two donors—AsDB and AFD—provided technical leadership in this area. AsDB provided technical and policy support to create multi-tiered institutional options within the regulatory framework and bolstered the supervisory capacity of the NBC. AFD’s experience at the retail level enabled it to help the NBC develop techniques to monitor some of the first licensed MFIs.

***Sustained deployment of specialized technical expertise.*** Donor-funded technical expertise played a crucial role in fostering the emergence and rapid growth of leading MFIs in Cambodia. Donors made this expertise available in numerous ways. Some offered specialized expertise in-house, such as the UNDP/ILO, which gave key technical advice to ACLEDA Bank in its early years. Others contracted international service providers with the appropriate microfinance skills. AFD, for example, hired GRET to set up microfinance projects that eventually became autonomous MFIs. Still other donors enhanced the microfinance experience of Cambo-

dian staff by sending them to training events such as the Microfinance Training Program (in Boulder, Colo., USA) and other donor-sponsored trainings.

***Insistence on performance-based management.***

Early proponents of creating a sustainable industry (AFD, GTZ, KfW, and USAID) set initial performance standards that contributed to the professionalization of the industry. Most donors involved at the retail level used performance-based contracts, both with financial institutions and their implementing partners (e.g., GRET, Horus, CRS) and implemented monitoring and reporting systems to track performance against good-practice standards. Moreover, several donors took corrective, and often painful, actions to address substandard performance and fraud when they encountered such problems.

***Willingness to adapt.*** Key microfinance donors in Cambodia understood their changing role in a maturing market. Accordingly, they helped broker relationships between international investors and the institutions that they supported. USAID, KfW, and UNDP, for example, combined resources to simplify the transformation of ACLEDA from a project into a licensed bank. Donors such as KfW helped identify development finance institutions and social investors to replace donors as investors in new, commercially-oriented MFIs. To cite another example, IFC/MPDF helped CEB attract Shorecap and Triodos Bank as equity investors. With private capital now entering the market, donors are no longer lending to strong MFIs.

## **Weaknesses**

***Mixed messages on the role of the public sector.***

Some donor practices have undermined the division of roles between the public sector (as regulator) and the private sector (as owner and implementer). These practices contravene the principles of the Cambodian government's "Financial Sector Blueprint," and undermine the commercial vision of the sector. Donors that transferred ownership of donated funds to the RGC (to be invested in licensed MFIs in the form of subordinated debt) gave the public sector *de facto* ownership of significant MFI shares.

It is unclear what will happen to this money when the original donor projects end. If an MFI closes, the legislation specifies that the government owns whatever money is available after all settlements have been made. Donors also helped create the RDB, a public wholesale facility, without fully assessing whether it was the most efficient mechanism to fund emerging MFIs. Its three main

donors, AsDB, AFD, and IFAD, did not coordinate their views of whether the RDB's optimal role was as a wholesaler or retailer. AsDB supported the wholesale role of the RDB, with conditions consistent with the regulation framework. The purpose and use of the AFD and IFAD financing is worrisome, however, because it seems to leave room for the RDB to provide retail services.

***Neglect of non-credit financial services.***

Donors in Cambodia, as elsewhere, have focused overwhelmingly on a credit-oriented model of microfinance. AusAID's support of the Cambodia Credit and Savings Federation (CCSF) and USAID's funding of ACLEDA Bank are notable exceptions. Also, MFIs have received virtually no donor support to develop other much-needed financial services, such as transfer payments and microinsurance.

***Lack of harmonized performance monitoring.***

Different donor reporting formats and cycles impose undue burden and high costs on microfinance providers. Almost all NGOs and MFIs struggle to comply with competing reporting demands, and brought this up as a critical issue as during a focus group convened by the review team. Fulfilling the specific requirements of different donors also distracts boards of directors from instituting performance reporting and internal control systems that match an institution's own needs.

***Inadequate knowledge management.***

In general, donors in Cambodia have poor institutional memories and lack the culture and systems to exchange information regularly. Weak knowledge management undermines their ability to design new programs based on past successes and failures. The frequent rotation of international staff also destabilizes the continuity of long-term programs, a problem exacerbated by the lack of permanent, professional Cambodian staff. Donors are also not very good at disseminating information to one another and to the microfinance industry at large. They admitted during the review that they do not systematically document their experiences in microfinance and classify much of the available information as confidential.

***Unsuitability of most donors to play an effective governance role.***

Few donors have the requirements necessary for good governance of private financial institutions: equity instruments, staff with board development skills and experience, and proper incentives. Donor staff rotate frequently and rarely have private-sector experience. Their incentives may be skewed toward disbursement and political

considerations. Development priorities, such as narrowly-focused targeting of specific populations or geographic zones, may also encourage or tolerate sub-standard performance. Some of these challenges also apply to DFIs.

***Lingering support for credit components in integrated development projects.*** While credit components in integrated programs have decreased significantly in Cambodia, certain donors, such as IFAD and the EC, still finance them. Credit components almost always distort the market, which creates adverse consequences for sustainable institutions and the industry as a whole. Many stakeholders interviewed raised the case of PRASAC as an example of a credit component that did not follow good practice.

While often designed with the best intentions, credit components rarely perform well because they do not benefit from specialist input, and because global program objectives generally overshadow micro-finance objectives, diluting the commitment to institutional sustainability. Given the general trend in donor programming toward sector-wide approaches, the risk of credit components reappearing in donor projects is increasing. This programming trend is also causing the profile of country-office staff to become increasingly generalist, with an overall decline in microfinance and other specific technical expertise.

## V. RECOMMENDATIONS

The dedication of enlightened Cambodians to a shared vision, combined with appropriate donor support, has resulted in a microfinance success story. As the story continues to unfold, private investors are prompting donors to reassess their role in the maturing microfinance market. In the future, the role of public donors needs to be more strategic and will require more technical expertise and fewer capital injections. Donors will have to identify their strengths vis-à-vis private-sector actors and assess their comparative advantages beyond the retail level. As the line between microfinance and the formal financial system blurs, successful donors are likely to offer both financial system development skills *and* a commitment to serve the poor.

This report includes two sets of recommendations that build on donor strengths, address their weaknesses, and respond to the gaps in the pro-poor financial system of Cambodia. The first set of recommendations offers donors guidance on how to address the most important industry gaps at the micro-, meso-, and macro-levels. (Text boxes identify the main characteristics needed for donors to engage effectively at each level.) The second set of recommendations identifies specific actions that donors can take to improve their internal and collective capacity to be effective partners to Cambodian practitioners and the national government.

### Donor Responses to Industry Gaps: Recommendations

The review team believes that donor support is still needed at all three levels of the Cambodian financial system. The meso-level, which remains underdeveloped, requires particular attention. A few, specialized donors have contributions to make at the macro-level, but the micro-level should be largely left to private and commercial actors, with the exception of technical assistance.

#### Micro-level

**Strengthen promising existing institutions.** Cambodia already has a plethora of organizations (about 100) that offer some kind of financial service to poor people, i.e., banks, licensed MFIs, registered and non-registered NGOs, savings-led institutions, and others. Donor support of such institutions should be limited in scope, as these institutions should be preparing to operate on a fully-sustainable, private basis. For each category,

donors who wish to remain in the sector (KfW, AFD, and USAID have an advantage here) should adopt clear funding criteria. Institution building requires discipline; it means selecting sustainable partners that will deepen the market through sound competition, as opposed to funding target groups or encouraging weak entrants.

Before providing direct funding to any institution, donors should ask themselves the following questions: Can private investors or private banks lend directly to the institution? Can an efficient wholesaler do so? What type of distortion could result from the planned donor funding?

**Licensed MFIs** The bulk of outreach will likely come from the existing ten licensed MFIs in Cambodia. Donors should thus prioritize institution building for these practitioners.

- Facilitate access, on a highly selective basis, to top-quality technical support in areas such as governance, internal controls, and product development—all critical for managing the growth of market leaders (see also the meso-level recommendations).
- Donors can help MFIs to link with domestic and international private capital, but they should leave capitalization to DFIs and social investors, which are better equipped to invest equity and play a governance role in licensed institutions. To facilitate such links, donors will need appropriate contacts and staff to engage with financial-sector actors.

**Registered NGOs.** Some registered NGOs might have the potential to become licensed institutions and reach scale. Others may merge, and a small number may deserve support due to their ability to offer innovative products in underserved areas.<sup>12</sup>

- Based on a competitive process, fund only registered NGOs that can become commercial, either by transforming into licensed MFIs or by linking to sustainable MFIs. Selection criteria could include: the potential to become sustainable, including charging market interest rates; ability to reach scale quickly; commitment and

<sup>12</sup> It should be noted that the review team based its analysis on a small sample of registered NGOs that may not be representative of this category of microfinance providers as a whole.

capacity of management; and innovative delivery systems and product mix to reach unserved clients.

- Link support for their transformation to performance benchmarks. Transformation plans should include guidelines for integrating the NGO into an existing MFI or bank if the organization is unable to become an independent, licensed institution.
- Help NGOs that transform into licensed entities to identify and structure the first round of private investment. Agencies wishing to play this role will need to contract specialists with investment banking experience. The IFC, for example, has good networks in this area.
- Explore ways to transfer ownership of donor grants to transforming NGOs in a market-based, private-sector manner.

**Savings-led institutions.** These institutions should typically not require large amounts of external funding. Donor support should be focused on technical assistance, not capitalization or credit lines.

- Provide assistance to promising savings-led institutions (i.e., institutions with a minimum level of outreach, vision, and basic systems), such as mutual savings and credit associations. AusAID’s work with the CCSF in providing limited technical assistance through the Credit Union Federation of Australia and the Canadian Cooperative Association appears to be a model worth exploring. Other donors with deep savings-led traditions, such as France and Canada, may also have useful contributions to make.

**Other suppliers of microfinance services (non-registered NGOs, community-based organizations, and credit components).** In general, this category of suppliers will not achieve mass outreach, making donor subsidies difficult to justify.

- The Cambodian market does not need, nor can it sustainably support, hundreds of credit-led financial institutions. Given the stage of development of the microfinance market, donors should not support weak organizations that provide financial services.
- Avoid funding credit components in integrated development programs or any other unsustainable institutional structure. Depending on the final objective of a program, using grants or linking with existing financial institutions will be less damaging for the poor in the long run.

### Box 3. Characteristics of Effective Donors at the Micro-level

- Strategic commitment to financial systems development
- Staff with microfinance experience
- Capacity to work with specialized consultants and implementing partners
- Instruments that can be used to directly support the private sector (e.g., grants, loans, equity)
- Commitment to financing initiatives that take risks
- Performance-based project management

**Fund innovations jointly, using time-bound performance thresholds.** Donors have an important role to play in supporting innovations by retail institutions. They should be willing to take risks and be patient in support of innovations that allow institutions to better meet client needs. Possible areas of support include:

- Funding action research, pilot projects, and technical assistance for product and delivery mechanism innovations. Such funding is particularly needed for the development of reliable deposit services and for service delivery systems that reach remote areas.
- Whenever possible, putting mechanisms in place that allow all industry members to compete for donor resources. At the very least, donors should coordinate planned activities and consider joint funding wherever feasible. For example, a locally managed innovation fund could provide resources on a cost-sharing basis to institutions that have a clear capacity to deepen the market.
- Establishing performance thresholds and incorporating them into funding agreements with practitioners and institutions.
- Developing explicit exit strategies to fund innovations. Although donor funding should allow institutions to run through the full product development cycle, new products or delivery systems should not require ongoing subsidies.

### Meso-level

**Support a commercially based wholesale market.** In compliance with the RGC “Financial Sector Blueprint,” donors should support private-sector wholesalers, rather than public-sector wholesale facilities, via options such as these:

- Learn from and build on the pilot guarantee project with Canada Bank, initiated by USAID/DCA, IFC/MPDF, and KfW. Other donors interested in developing the wholesale market should consult and coordinate with these three agencies before launching new initiatives. As commercial banks develop the interest and capacity to provide wholesale funds to MFIs, similar models could be replicated by the private sector.
- Donors that have supported the RDB (IFAD, AFD, and AsDB) and donors that have been working on a private-sector model (IFC, KfW, and USAID/DCA) should meet to agree on a collective vision for the wholesale financial market. This vision should be widely shared with all donors working in microfinance in Cambodia.

***Facilitate development of local services for MFIs.***

Donors should consider creating a multi-donor project to fund and strengthen the supply of commercial support services to the microfinance industry, such as in these areas:

- Organize training of trainers courses to build the capacity of Cambodian trainers. Coordinate with the IFC/MPDF to strengthen the Cambodian Institute of Banking’s training curricula.
- Provide financial and technical support to the accounting and auditing industry association. The World Bank and the AsDB are well suited for this activity.

***Support the development of the Cambodian Microfinance Association (CMA).***

- Advise the NBC to find an institutional arrangement for CMA that is consistent with the banking law. A good relationship and collaboration with the Association of Banks of Cambodia (ABC) will be important for the CMA’s effectiveness. The current work of the IFC/MPDF with the ABC makes it a natural partner for the CMA.
- Provide technical assistance to strengthen the association in three key areas: member services, advocacy dialogue with the banking regulator and the RGC, and strategic planning (for the institutional viability of the CMA). A strong CMA can be a useful vehicle for ensuring that practitioners’ concerns are integrated into future work on regulation and supervision.

**Box 4. Characteristics of Effective Donors at the Meso-level**

- Strategic commitment to financial systems development
- Sufficient staff expertise to manage technically sophisticated projects
- Grants that directly support the private sector
- Flexibility to co-fund and invest in multi-donor programs
- Credibility to work with the private sector and develop markets

***Fund an initiative to facilitate exchange of debtor information among MFIs.***

- Provide advisory support to the NBC to review the banking secrecy law and allow debtor information to be shared between financial institutions. Such an initiative could become a natural part of AsDB’s work with the NBC.
- Develop a technical assistance program to support operating systems for information exchange among institutions and create a central clearinghouse for information. This initiative could be coordinated with the CMA and the ABC, as it would require the commitment of all MFIs and banks to be effective.
- Informal mechanisms may be appropriate in the short and medium term, but in the longer term, donors could help establish a national credit bureau that would include information from microfinance providers.

***Promote the acquisition of management information systems (MIS) by MFIs.***

- Help develop local advisory support services that can assist microfinance providers in making MIS decisions. One option would be for the IFC/MPDF to seek co-financing to build this analytical capacity within the CMA (or to find another suitable “home” if the nascent CMA is overburdened). The strategy might include training IT specialists in microfinance (including young graduates) to provide this service. Donors can also help link institutions to international MIS specialists through facilities, such as the CGAP Information Systems Fund. The CMA could potentially pool the purchasing requirements of its members for increased bargaining power with MIS providers.
- Establish an Information Systems Matching Fund to assist microfinance institutions with MIS implementation.

## Macro-level

**Offer sustained technical assistance to the Bank Supervision Department of the NBC.** Donors should help the NBC address the challenges and risks of the growing microfinance industry, such as managing the proliferation of licensed institutions, integrating mutual savings and credit associations into the formal financial system, and protecting the growing depositor base.

- Ensure ongoing technical support to the banking supervision department. Based on its previous work, AsDB is particularly well positioned to continue this task. Some attention might be given to reviewing minimum capital requirements for licensed MFIs, the unlimited liability exposure of influential shareholders, and the creation of a monthly bulletin to increase transparency. Donors could also help the NBC create a website with yearly statistics on all retailers in the financial system, including banks.
- Provide training to supervision staff and ensure that manuals are adequate, updated, and applied in daily work.
- Integrate mutual savings and credit associations into the regulated financial system. Donors could provide financial and technical resources to the NBC so that it develops a regulatory and supervisory framework adapted to this model.

**Coordinate work on the regulation and supervision framework.**

- Work in concert to avoid sending conflicting messages. Avoid overburdening the NBC with tasks that could undermine its capacity to manage its core responsibilities. AsDB should play the leading role, together with the IMF (the principle advisor to the NBC). Other donors should consult with these two agencies.
- Involve the CMA and CCSF in dialogue on regulation and supervision.

**Support development of a payment system infrastructure.** Broader support of the entire financial system should include developing a national payment system infrastructure. Strengthening secure transfer services (i.e., the infra-structure required for clearances and settlements) is crucial to extending financial services to remote, rural areas. The World Bank has specialized expertise in this area that could be harnessed for Cambodia.

**Strengthen legal and judiciary capacity regarding collateralized loans.** The review team recognizes

that this task will take many years to implement. Donors could initially provide funding and technical assistance to create a registry and a unit of judges specifically trained in secured transactions law. Donors could also work in parallel to identify extra-judicial solutions, such as relying on local authorities or respected elders to offer practical options over the short term.

**Review taxes on financial intermediation.** Donors should examine the disincentives to provide small savings accounts resulting from the current tax structure and propose appropriate modifications. Donors involved in Cambodia's previous fiscal reforms, i.e., the World Bank and IMF, should conduct this reassessment.

**Explore the possibility of developing a trust/NGO law that establishes a legal status for profit-making NGOs.** Donors could initiate a dialogue with the RGC on the timing and priority of tackling the legal status of NGOs. The conversation could be limited in the first instance to NGOs involved in income-generating activities, such as microfinance. If appropriate, donors could later provide funding for legal support on the issue, working through one of the Technical Working Groups in Cambodia or a subgroup of the Private Sector Forum. Donors that have experience working directly with a large number of NGOs, such as USAID, would be best suited to ensure a participatory process for discussing the issues and, eventually, draft legislation.

### Box 5. Characteristics of Effective Donors at the Macro-level

- Strategic commitment to financial systems development
- Influence and clout with the RGC and NBC
- In-country staff with financial-sector expertise and strong communication and negotiation skills
- Grants for technical assistance
- Experience supporting policy reforms in financial, economic, and legal sectors
- Willingness to cooperate with other donors on sectoral initiatives

## Donor Effectiveness Recommendations

Not every donor can or should work at all three levels of the financial system, as they do not all possess the eight elements of effectiveness (strategic clarity, strong staff capacity, accountability for results, relevant knowledge management, appropriate instruments, influence and clout in the country, commitment to collaboration, and responsiveness to local stakeholders). Various com-



binations of these elements are needed to respond to existing gaps in the financial system and meet its evolving requirements. Five of the eight elements of donor effectiveness are highlighted in this section, and presented with specific actions that donors are encouraged to take to improve their overall effectiveness in Cambodia.

### **Strategic Clarity**

Stick to the vision of microfinance as part of the commercial financial system. Moving forward, donors should proactively ensure that their current operations and new programming reflect this common vision.

- Put on paper the key principles for donor support of microfinance in Cambodia. These principles should briefly codify the operational implications of the vision. At its most basic, the document should encourage all donors to adhere to a “do no harm” principle. To develop the principles, the donor community can refer to the “Financial Sector Blueprint,” recommendations in this report, new donor guidelines for microfinance,<sup>13</sup> and similar donor principles from other countries (e.g., Uganda).
- Induct new donor staff into the Cambodian microfinance community by explaining the vision and principles in informal orientations. Special effort should be made to introduce implementing partners and consultants to the vision as well.
- Build on the donor successes in Cambodia. Certain leading donors that have specific technical expertise and a good track record in the country still have contributions to make, although their new role will differ from their previous role. These leaders—AFD, AsDB, IFC/MPDF, and KfW—can make targeted interventions based on their respective comparative advantage to consolidate successes achieved thus far. In parallel, donors should plan a progressive phasing out of current activities, leaving space for private Cambodian and international actors to provide ongoing services required by the sector.
- Let private investors (DFIs and social investors) take on the equity investment role in licensed intermediaries.

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<sup>13</sup> See the new donor principles for supporting microfinance, *Building Inclusive Financial Systems: Donor Guidelines on Good Practice in Microfinance* (Washington, DC: CGAP, 2004), at [www.cgap.org/docs/donorguidelines.pdf](http://www.cgap.org/docs/donorguidelines.pdf).

- Promote this vision with government partners. This could prevent damaging non-market influences, such as public officials questioning interest rates or loan collection practices that can inhibit the provision of financial services to the poor.

### **Strong Staff Capacity**

- Continue to invest appropriate technical expertise in program design, implementation, and monitoring. At its current stage of development, microfinance in Cambodia requires specialized technical expertise, not large donor subsidies. Donors should train Cambodian and international donor staff, using internal resources and tapping into existing donor training courses, such as the Microfinance Training Program in Turin, Italy, and the one-week UNCDF/CGAP donor training course.<sup>14</sup>

Investing in permanent Cambodian staff is especially relevant for donors that frequently rotate their staff, as this investment will provide a reservoir of strong human resources. Donors should also have international staff in Cambodia or the region that possess sufficient knowledge of microfinance and the formal financial system to manage specialized consultants and discuss technical and policy issues with local stakeholders.

### **Accountability for Results**

Maintain commercially oriented, performance-based management of programs. Donors should continue to use performance-based contracts with implementing agencies, consulting firms, and financial institutions, and should be willing to take corrective action if necessary. AFD and GTZ have developed particularly good practices in this area.

### **Relevant Knowledge Management**

- Document and disseminate microfinance experience internally and to the industry at large. Donors, for example, could set up a library hosted by an agency with the space and capacity to manage it. The library could also be made available on the web. UNDP, the World Bank, or IFC/MPDF might be able to provide this service.
- Translate and disseminate publications on good-practice into the Khmer language. Given the high cost of translation, the CMA could identify the most useful documents to translate. Every donor agency could then contribute to disseminating such materials. (A selection of succinct materials

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<sup>14</sup> For more details on these two programs, see [www.cgap.org/direct/special/training.html](http://www.cgap.org/direct/special/training.html).

on microfinance written specifically for donor staff is available on the CGAP Donor Information Resource Centre at [www.cgap.org/direct](http://www.cgap.org/direct).)

- Create low-cost mechanisms for internal learning. Donors should institute financial and non-financial incentives to encourage staff to participate in knowledge networks, consult with technical specialists at headquarters and in the field, and generally participate in knowledge exchange with colleagues and partners. Both GTZ and KfW have developed impressive mechanisms and incentives for knowledge management, such as regional staff sector networks.

### ***Commitment to Collaboration***

Donors in Cambodia have exhibited strong willingness to collaborate, as evidenced by the working groups that have been established in several sectors. Although some donors express fatigue with the large number of meetings, there is a strong commitment to working groups that tackle issues best handled jointly, rather than through individual action. Donor support to microfinance could benefit from greater collaboration, through such specific means as these:

- Consult with key industry players during project design, implementation, and evaluation. Before launching new initiatives, donors should consult widely to ensure they are filling a gap and are not duplicating or undermining the work of others. There are also key moments in a project's cycle where consultation with others would be particularly beneficial, for example, during mid-term reviews. Consultation on specific technical issues can be crucial. For example, donors should coordinate their financial and technical support to the NBC and RDB.
- Involve donor staff with some technical knowledge and decision-making authority in the consultations. To ensure that they know each other, key staff will have to invest time in attending private-sector or financial-sector group meetings. Informal lunches can also be effective.
- Co-fund, especially when individual agency capacity is inadequate. Donors without the in-country experience or staff required to fund and manage successful programs should consider co-funding with donors that have complementary strengths.
- Agree on common reporting standards. Donors should task a small technical group of donor staff with developing a common reporting format that incorporates indicators that are useful to MFI management, satisfy donor headquarter requirements, and adhere to international standards. Lessons can be learned from the common reporting tool agreed upon by KfW, USAID, and the UNDP for ACLEDA Bank. Donors should then commit to accepting the exact same report from all microfinance providers supported by them.
- Regularly update a contact list of microfinance stakeholders. (Annex 4 provides a recent, extensive contact list of industry stakeholders; one donor will need to take the responsibility for regularly updating this list.)

## Annex 1. Summary of Donor Recommendations

LEVEL	RECOMMENDATIONS	REQUIRED ELEMENTS OF EFFECTIVENESS
<b>MICRO</b>	<ul style="list-style-type: none"> <li>• Strengthen promising existing institutions</li> <li>• Fund innovations jointly, using time-bound performance thresholds</li> </ul>	<ul style="list-style-type: none"> <li>• Strategic commitment to financial systems development</li> <li>• Staff with microfinance experience</li> <li>• Capacity to work with specialized consultants and implementing partners</li> <li>• Instruments that can be used to directly support the private sector (e.g., grants, loans, equity)</li> <li>• Commitment to financing initiatives that take risks</li> <li>• Performance-based project management</li> <li>• Responsiveness to local practitioners</li> </ul>
<b>MESO</b>	<ul style="list-style-type: none"> <li>• Support a commercially-based wholesale market</li> <li>• Facilitate development of local services for MFIs</li> <li>• Support the development of the Cambodian Microfinance Association (CMA)</li> <li>• Fund an initiative to facilitate the exchange of debtor information among MFIs</li> <li>• Promote the acquisition of management information system (MIS) by MFIs</li> </ul>	<ul style="list-style-type: none"> <li>• Strategic commitment to financial systems development</li> <li>• Sufficient staff expertise to manage technically sophisticated projects</li> <li>• Grants that directly support the private sector</li> <li>• Flexibility to co-fund and invest in multi-donor programs</li> <li>• Credibility to work with the private sector and develop markets</li> <li>• Patient, long-term perspective</li> </ul>
<b>MACRO</b>	<ul style="list-style-type: none"> <li>• Offer sustained technical assistance to the Bank Supervision Department of the NBC</li> <li>• Coordinate work on the regulation and supervision framework</li> <li>• Support development of a payment system infrastructure</li> <li>• Strengthen legal and judiciary capacity regarding collateralized loans</li> <li>• Review taxes on financial intermediation</li> <li>• Explore possibility of developing a trust/NGO law that establishes a legal status for profit-making NGOs</li> </ul>	<ul style="list-style-type: none"> <li>• Strategic commitment to financial systems development</li> <li>• Influence and clout with the RGC and NBC</li> <li>• In-country staff with financial-sector expertise and strong communication and negotiation skills</li> <li>• Grants for technical assistance</li> <li>• Experience in supporting policy reforms in the financial, economic, and legal sectors</li> <li>• Willingness to cooperate with other donors on sectoral initiatives</li> </ul>

## Annex 2. Consolidated Profiles of Donor Activities (self-reported by agencies)

### Bilateral and Multilateral Development Agencies - Areas of Activity and Instruments

AREAS OF ACTIVITY	ADB	EC	IFC/ MPDF	UNDP	USAID	AFD	AUSAID	KfW
<b>MACRO</b>	✓			✓		✓		
<b>MESO</b>			✓	✓				
<b>MICRO</b>	✓	✓	✓	✓	✓	✓	✓	✓
Institution building	✓		✓	✓			✓	✓
Loan funding	✓					✓		✓
MFIs	✓	✓	✓			✓	✓	✓
Commercial banks	✓		✓		✓			✓
State-owned banks	✓					✓		
Credit unions/ cooperatives							✓	
Credit lines/multi- sector projects								
<b>Instruments available to support MF</b>	✓	✓	✓	✓		✓		✓
Grants for capital		✓				✓		✓
Grants for technical assistance	✓	✓	✓	✓		✓		✓
Equity						✓		✓
Guarantees						✓		✓

## Other Funders - Areas of Activity and Instruments

AREAS OF ACTIVITY	Concern Worldwide	Shore Cap	SIDI	Triodos	World Relief
<b>MACRO</b>					
<b>MESO</b>					✓
<b>MICRO</b>	✓	✓	✓	✓	✓
Institution building	✓		✓		✓
Loan funding		✓	✓	✓	
<b>MFIs</b>	✓	✓	✓	✓	✓
Commercial banks	✓	✓	✓	✓	
State-owned banks					
Credit unions/ cooperatives					
Credit lines/multi- sector projects					
<b>Instruments available to support MF</b>	✓	✓	✓	✓	✓
Grants for capital		✓	✓	✓	
Grants for technical assistance	✓	✓	✓		✓
Equity	✓	✓	✓	✓	✓
Guarantees			✓		

### Bilateral and Multilateral Development Agencies – Microfinance Portfolio (in US dollars)

AREAS OF ACTIVITY	ADB	EC	IFC/ MPDF	UNDP	USAID
<b>Microfinance disbursement 2001–2003</b>	1,869,000	2,500,000			
<b>Microfinance credit components disbursement 2001–2003</b>					
<b>Commitment – Microfinance 2004 (stand-alone projects and credit components)</b>	1,257,000	200,000			

AREAS OF ACTIVITY	AFD	AUSAID	KfW	TOTAL
<b>Microfinance disbursement 2001–2003</b>	2,311,000		2,000,000	8,680,000
<b>Microfinance credit components disbursement 2001–2003</b>	1,300,000	1,300,000	2,000,000	4,600,000
<b>Commitment—Microfinance 2004 (stand-alone projects and credit components)</b>	1,935,700	560,000	4,500,000	8,452,700

### Other Funders – Microfinance Portfolio (in US dollars)

AREAS OF ACTIVITY	Concern Worldwide	Shore Cap	SIDI	Triodos	World Relief	TOTAL
<b>Microfinance disbursement 2001-2003</b>	505,945				100,000	605,945
<b>Microfinance credit components disbursement 2001–2003</b>	889,000			4,592,500		5,481,500
<b>Commitment –Microfinance 2004 (stand-alone projects and credit components)</b>	1,100,000	500,000		1,500,000		3,100,000

### **Annex 3. Summary of Donor and Investor Support to the Cambodian Microfinance Industry (as of January 2005)**

#### **Micro-level**

##### **Support to NGO credit programs (completed)**

- AFD grant to ACLEDA NGO
- AFD grants for credit program expansion to GRET/EMT project, HK project, CARE/Seilanitih project, and ANS (Battembong)
- AFD grant for transformation of EMT (grant provided through GRET, as the technical assistance provider, both in-country and in-house)
- AFD grant to HK NGO and Seilanitih NGO (financed an individual, in-house technical advisor)
- EC grant in support of PRASAC project credit component
- EC grant to PCA for its transformation from project to RFI
- GTZ grant to ACLEDA NGO for branch start-up in Kompong Thom
- GTZ grant to HK NGO for pilot savings project
- GTZ grant to CEB to support its transformation from NGO to LLC
- GTZ grant to ACLEDA Bank for BAAC exposure visit (Thailand)
- IFC/MPDF technical assistance to CEB for its transformation from NGO to LLC to RFI (completed)
- IFC/MPDF grant to finance credit rating of CEB
- IFC/MPDF ongoing support of CEB (corporate advisory assistance)
- KfW support of ACLEDA NGO through government of Cambodia
- USAID grants to NGO MFI programs through international NGOs, including World Relief and CRS
- USAID grant to ACLDEA for BRI exposure visit

##### **Support to credit components in integrated programs (completed)**

- AusAID grant of US\$ 200,000 to Ministry of Rural Development integrated health project
- EC grant of US\$ 4 million to PRASAC credit program

##### **Support to regulated financial institutions by bilateral donors (ongoing)**

- AFD support to AMRET for in-house technical assistance by GRET
- AFD support to AMRET for improvements of MIS (Micro Banker Windows) with GRET and HORUS
- CGAP grant to AMRET for IT/MIS development
- CGAP grant to GRET for developing an insurance product
- KfW represents ACLEDA NGO on board of ACLEDA Bank

##### **Support to commercial banks**

- AFD support to RDB for refinancing NGO MFIs
- IFAD loan to RDB for refinancing NGOs and project partners of IFAD (e.g., project in Battembong)
- IFC loan to Canadia Bank for SME lending and refinancing MFIs with USAID loan guarantee (pilot)
- KfW loan to ACLEDA Bank for SME lending (pilot)
- USAID loan guarantee of IFC loans to small and medium enterprises and MFIs: US\$ 500,000, with up to US\$ 5 million over 5 years (pilot)

##### **Support to credit mutuel/credit unions/cooperatives (ongoing)**

- AusAID support to CCSF (Battembong)

**Investors/shareholders supporting banks** (ongoing)

- DEG investment in ACLEDA Bank

**Investors/shareholders supporting MFIs** (ongoing)

- ACLEDA Bank shareholders: DEG, IFC, Triodos-Doen, Triodos Bank
- AMRET shareholders: SIDI, La Fayette
- HK shareholder: SIDI
- CEB shareholder: Shore Cap, plus loans from Blue Orchard, Novib, and Triodos Bank

**Meso-level****Capacity building: Training** (*ongoing unless otherwise noted*)

- ADB technical assistance grant to Cambodian Institute of Bankers (pending)
- AFD grant to MFI partners (EMT, HK, Seilanitih) for management and staff training (completed)
- AFD grant for MFI manager training on a cost-sharing basis (grant funded HK manager in Swedish International Development Cooperation Agency program, facilitated by IFC/MPDF and Sida)
- IFC grant to Canadia Bank for MFI appraisal training to be provided by EDA India
- IFC/MPDF collaboration with Cambodian Institute of Bankers (Association of Bankers of Cambodia)
- IFC/MPDF collaboration with EDA (India), which has proposed to offer training for banks and MFIs

**Advocacy**

- CMA registered in 2004 with 11 members (no funding as of yet)
- IFC/MPDF and ABC: Business Enabling Environment – Working Group on Banking and Finance, Technical Working Group on Financial Sector Development
- Collaboration between WB, GTZ, Asia Foundation, and others on Conference on Land Law Reform
- Collaboration between WB, IMF, ADB, and others on Cambodian Rural Finance Strategy

**Second-tier lending through RDB** (*ongoing unless otherwise noted*)

- ADB grant to RDB for TA (completed)
- AFD grant to RDB for MFI onlending
- ADB loan to RDB for MFI onlending
- ADB grant to RDB for TA
- IFAD grant to RDB for MFI onlending
- USAID guarantee to Canadia Bank (up to US\$ 5 million)
- IFC technical assistance to Canadia Bank (US\$ 500,000)

**Reforms in accounting and auditing** (completed)

- Uniform chart of accounts (2003)

**MIS** (*ongoing unless otherwise noted*)

- EC funded DOS-based Micro Banker program for PCA (completed)
- AFD support to AMRET for improvements to Micro Banker Windows
- CMA plan for providing collective MIS training and support to a small group of RFIs, including CEB, HK, Seilanitih, AMRET

**Credit rating and institutional assessments**

- M-CRIL rating of EMT (2001)
- CGAP assessment of EMT (2002)
- CGAP assessment of HK (2002)
- M-CRIL rating of CEB (2003), partially funded by IFC/MPDF
- Moodys rating of ACLEDA Bank (2004)



## **Macro-level**

### **Regulation and supervision** *(ongoing unless otherwise noted)*

- AFD and ADB worked to forge the legal and regulatory framework for Cambodian microfinance sector (AFD completed)
- ADB supported technical assistance to the NBC on regulation and supervision of licensed MFIs
- AFD grants to NBC to monitor four MFI NGO partners transforming (EMT, HK, Seilanitih, and ANS) into licensed MFIs—used as a learning opportunity for NBC (completed)

### **Influencing government policy** *(ongoing unless otherwise noted)*

- ADB: Financial Sector Blue Print
- WB: Cambodian Rural Sector Strategy
- UNDP and AFD: CCRD (completed)
- IFC/MPDF: Private Sector Forum, Working Group on Banking and Finance; also looked at ASEAN experience on withholding tax and taxation laws in the region to advise NBC and government
- WB, GTZ, ADB, others: Annual Forum on Land Law (2005)
- Proposed Technical Working Group on Microfinance

## Annex 4. List of Participants

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**Annex 5. MFI Recommendations to Donors**

*These recommendations were collected during a meeting with all licensed Cambodian MFIs in October 2004.*

- Work directly with financial institutions (save time and reduce costs)
- Be responsive and flexible: Do not impose conditions (e.g., interest rates, targeting, loan sizes)
- Conduct due diligence and support MFI business plans
- Focus on sustainability and exit strategy
- Hire donor staff with the right technical skills
- Agree on common reporting requirements and accept standard reports, audits, etc.
- Strengthen capacity of the Cambodian Microfinance Association (CMA)
- Identify gaps in the microfinance market and align donor operations to comparative advantage



## **ANNEX 6. LIST OF DOCUMENTS**

Please note that these documents are available at IFC/MPDF

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- Prakas on banks' capital guarantee
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- Prakas related to banks' solvency ratio
- Prakas on the calculation of banks' net worth
- Prakas on the accounting process for foreign currency transactions
- Prakas on the classification of and provision for bad and doubtful debts, including interest in suspense
- Prakas on controlling banks' large exposure
- Prakas on loans to related parties
- Prakas on the establishment of the Interbank Market Working Group
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- Prakas on reporting requirement for registered NGOs and licensed MFI
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