



NATIONAL BANK OF CAMBODIA

Country Paper

Cambodia Microfinance¹: Development and Challenges

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Cambodia Microfinance: Development and Challenges

I- Introduction

The Kingdom of Cambodia is a democratic monarchy with multi-political parties and a population around 14 millions, among which 85% living in rural areas. The majority Cambodians are Buddhists. The country borders Thailand to its west and northwest, Laos to its northeast and Vietnam to its east and southeast. In the south it faces the Gulf of Thailand. Cambodia with 24 provinces and capital city consists of 181,035 km² in the term of total area. The geography of Cambodia is dominated by the Mekong River and the Tonlé Sap, an important source of fresh fish. Phnom Penh is the capital city which is the hub for the industrial, political headquarter, economic and commercial centers, tourism services, and culture position for the whole country. Agriculture has long been the most important sector of the Cambodian economy. Garments, tourism, and construction are also important. The annual growth rate of around 9% from 2001-2008 contributed to a decline in overall poverty levels to 30% in 2007 compared 35% in 2004.



The Cambodia banking system started in the early 1990s when the government launched economic reform program from a centrally planned to a free market economy. Reform programs have been introduced and good progress has been achieved in regulating and supervising banks and microfinance institutions. Most rural financial operators in Cambodia have been transformed from non-government organizations (NGOs) that were involved with humanitarian work in late 1970s and have moved out of relief and rehabilitation works and redefined their roles in interventions in the development process. Among those interventions, microfinance undertakings have thrived since the early 1990s, and most of the country's 24 provinces now have microfinance services provided by MFIs and NGOs. NGOs have been involved in virtually every sector of the economy including micro credit programs and savings. Micro credit is the most active service due to banking services of commercial banks being limited in urban areas, and rural people are unable to receive such services, especially loans from the banks. Main practical rural financial services are individual loans, group loans and savings from members.

Lacking of rural financial services, the Royal Government of Cambodia (RGC) has adopted a series of policy measures, supported by international donors: (i) establishment of the Credit Committee for Rural Development (CCRD) in 1995; (ii) introduction of a framework in the Banking Law to enable eligible NGOs and other rural finance providers to become regulated microfinance institutions (MFIs); (iii) creation of a unit in the National Bank of Cambodia (NBC) to supervise and monitor MFIs; and (iv) establishment of an apex institution to provide financing for MFIs, namely the Rural Development Bank (RDB). With these measures being in effect since the late 1990s, it can be said that among Southeast and East Asian transition countries, Cambodia has put in place the most *supportive* fundamentals as to policy framework for microfinance development, though local capacities and institutions are to be yet substantially developed. Currently, commercial banks and specialized banks engaged in microfinance and NGOs microfinance operators are integrated into the regulations of the NBC.

The RGC has committed to the development of rural finance since it is a key ingredient for sustainable economic development, particularly rural development, and for alleviation of poverty. In addition, the government has announced 2006 as "*a year of microfinance of Cambodia*" and it always supports the development of this sector

through the introduction of policies and creates a favorable environment for further growth. Since the 2006 announcement, Cambodian microfinance has grown remarkably. This growth significantly contributes to economic development and poverty alleviation. With its credit and savings services, MFIs help people, especially the poor to relieve their family burdens and improve their livelihood to some extent. Currently there are 20 licensed MFIs of which 4 obtained licenses of savings mobilization, 26 registered rural credit operators and around 60 NGOs freely operating in the whole country.

II- Phases of Microfinance Development

The Law on Banking and Financial Institution was promulgated in late 1999. The NBC, the supervisory authority of the banking system, began reforming the banking system in Cambodia in early 2000. Reform programs included the reform of the Microfinance sector to allow microfinance operators to transform themselves into companies of a commercial nature, regulated under the laws and regulations of NBC. The regulation and supervision of MFIs has the primary objectives of ensuring the sustainability of their operations and services, reducing the risk of lost deposits, and preventing failure due to bad management.

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 supplies of pro-poor financial service (ACLEDA Bank, licensed MFIs, and registered NGOs) served more than 400,000 borrowers—eight times more than in 1995². 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.

1- 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 rural poor and micro-entrepreneurs. 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 Service (CRS), and

² 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.

World Vision, together with some early donors such as the United Nations Children's Fund (UNICEF), the International Labor Organization (ILO), the United Nations Development Program (UNDP), Agence Française de Développement (AFD), and the US Agency for International Development (USAID)–played a significant role in launching the 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 micro credit delivery methodologies, ranging from individual loans to solidarity groups to village banks, and self-help groups. Latter on, a few of these operators demonstrated an interest in creating sustainable financial services for poor people.

2- 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 to attain financial sustainability became the primary objective. The supporters of microfinance in Cambodia started meeting regularly during this period to share information, align objective, and define a common vision from 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 RDB, a wholesale lender to emerging MFIs.

On the policy front, the International Monetary Fund (IMF) and the Asian Development Bank (ADB) 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 businesses, with appropriate mechanisms for licensing, regulation, and supervision. Given these changes the emerging microfinance community allowed the NBC to assume responsibility for regulating and supervising microfinance businesses.

3- 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 NGOs³. 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 new MFI licensed in January 2000.) The transformation of ACLEDA Bank created an important precedent for other financial providers. During this phase, socially responsible investors and Development Financial 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).

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.

4- Business Nature of Cambodia Microfinance

a- Corporate Structure and Governance

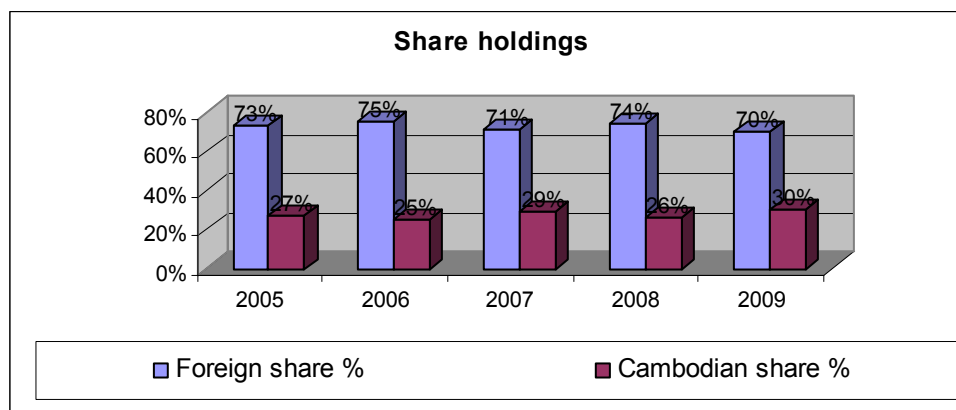
In the early stage, microfinance institutions in Cambodia have shared more or less similar mission and vision brought from their former status of NGOs to licensed and registered MFIs. The main theme of their mission and vision have been driven and dedicated to social and economic development in rural areas whereby it serves as a contributing factor

³ Prakas No. B700-06, "on the Licensing of Micro-Finance Institutions"; and Prakas B702-49Pror Kor, "on Registration and Licensing of Microfinance Institutions"(Phnom Penh: RGC,2002).

for the government's goal of poverty alleviation. During this initial period, those institutions had been established with different institutional structures under various legal forms in pursuit of performing the same objective of providing credit and saving services to un-banked residents. Such a variety of institutional structures had come into the form of credit project, NGOs, credit cooperatives and private company.

Given a continuous growth of microfinance industry and a special attention from the NBC in gathering the microfinance operators to come under supervision of the NBC, the individual institutions as well as other microfinance operators have strengthened their institutions to become more professional and proper structure. In addition, those MFIs have been concentrated on defining their share structure and actual price value of each share held by their shareholders. This requirement had been imposed by the NBC in order to ensure good governance for further enrichment of the industry.

Most of MFIs had started their operations by initial funding source supported the activities of NGOs. Then, this fund was registered with the NBC as they transformed to a licensed MFI which is the legal form granted by the NBC. Moreover, those institutions have also ensured their governing body by defining the roles and responsibilities of the board of directors in pursuit of working proficiency that is directly held by their management team. On the other hand, this important division has not yet visibly seen within all MFIs whereby some of them have not yet been licensed and registered by the NBC. Those operators mostly service credits and savings under the project or particular activities of NGOs or a specific cooperative.



b- Operational Structure

To ensure operational efficiency, the registered and licensed MFIs have strengthened their operational structure in response to the current growing pace of the microfinance

industry. Those settings are such as organizational chart, human resource development, management information system, financial management, internal audit system and other arrangements, which are aimed at enhancing transparency and good governance.

Though the microfinance operations in Cambodia have shown its short history, the objective to extend microfinance outreach, financial inclusion and follow regulatory and policy frameworks have been reflected by its commitment to enhance and establish the operational structure of each institution. This enrichment has not only ensured institutional sustainability but also provide the institutions to access funding from local and international financial institutions and DFIs with an affordable interest rate.

A proper institutional structure also allows MFIs to have a clear roles and responsibilities for their staffs, which are placed in response to individual's professional skills and experiences. Additionally, training development is also able to set out with its objective to strengthen knowledge and practical skills of their staffs. Financial policies and procedures are also significant for MFI in order to ensure their financial information and reports are reliable for shareholders, lenders and regulatory authority. Also, those financial policies and procedures have to be in line with the national and international standards, which are used globally and particularly in microfinance industry.

Furthermore, most of microfinance operators though they are registered, or licensed or credit operators under the particular projects of NGOs, have to ensure the availability of internal audit or monitoring and evaluation in order to reassess and supervise the performance of managements and employees. In short, those elements are significant for microfinance management thereby the institutions should transform their operational structure accordingly.

c- Source of Fund

Funding is very crucial for microfinance development and further outreaches of its services to farther rural areas in the country. As a matter of fact, MFIs were born from development project of NGOs which implemented its activities through funding support from foreign development agencies. Those funding was merely a seed capital; but the results of its development and transformation to licensed MFIs requires further investment with additional capital injection. The funding sources mostly come from large

foreign social investors or DFI. And, the institution is primarily focus on social mission rather than solely for profit.

There are two main funding sources of MFIs, which are firstly come into the forms of owners' equity whether its equity injection or proceedings from initial capital of rural credit operator with NGOs. And, another proportionate equity injection comes from ongoing additional investment of interested shareholders. The second funding source comes into the form of liability which is financed by commercial and concessional loans of foreign financial institutions, development agencies or governments of developed countries. Importantly, savings mobilized from the public are also acting as crucial sources to support microfinance operations.

A recent notable development of microfinance industry in Cambodia has been supported by two primary funding sources which are commercial and concessional loans. The commercial loan is normally financed by foreign financial institutions in which the borrower has to pay market interest rates. And, this is a cause of making such a high financial cost of MFI. On the other hand, the concessional loan is often financed by development partners of MFIs in which the interest rate charge is low. The latter has made an absolute advantage for some MFIs. However, this favorable condition is not able to present in all institutions, it is happened only for the institutions which are used to have closed relationship with development partner agencies. Nevertheless, the concessional loan is not an advantage for the institution that is targeted for sustainability. This is due to the concessional funding source does not exist for long term. Besides, it does not reflect a real cost of fund that is operated in the market competition.

Despite savings have been recognized as long term funding sources for microfinance operation, there are still limited to some potential MFIs because of limited knowledge about savings of rural people and their trust on the institutions. Consequently, the amount of saving mobilization does not respond to the amount of credit demand of borrowers. Recently, the NBC has established a separate legal form for licensed MFIs that want to mobilize savings from public to apply for this regulatory status as well. To obtain this separate license, the MFI has to fulfill certain regulatory requirements of the NBC. In short, the new created legal form is principally aimed at assisting MFI to mobilized local

funds for its sustainable growth rather than depending on foreign financing, which is uncertain and exposed to high risks.

d- Lending methodology

The conventional lending method has now been in practice and has also developed as a loan product of MFIs. The core principles of that product development are to respond to the needs of clients, which are defined in loan size, tenor, repayment methodology, interest rate, and credit eligibility in which all these factors have to be in line with the borrowers' situations and income streams. Moreover, an important characteristic of MFIs' loan is a group guaranty; that is, the clients are not necessary to have collateral. The choice of utilizing social solidarity, which is possessed with individual quality, is really visualized a special characteristic of microfinance that played as an efficient tool in reducing poverty of rural people.

There are three main types of credit that are being serviced by MFIs in Cambodia. These are individual loan, solidarity group loan and community bank loan. The individual loan is normally having bigger loan size and its lending term is shorter than the other two types. This particular loan type does not need a group guaranty, but it requires collateral and guarantor in order to ensure the repayment ability of the borrowers. Most of MFIs provide this loan type only to their existing clients who have good repayment records and also the one who graduated from group loan.

The second lending type is a solidarity group loan, which means the borrower is required to form a group based on their own selection of group members, who are happily and trustfully joining, and to complete a single loan application form to guaranty each others. This guaranty is meant when there is a member defaulted in loan repayment, other group members have to take the responsibility. Normally, this loan size is smaller than individual loan and each group comprised of more than two members.

The third lending methodology is community bank loan. This loan is sometimes named differently from institution to institution however the objective and lending producers are the same. The target clients of this loan are usually poor people who running small types of businesses and are also new borrowers of the MFIs. This is because loan size is very small and collateral is not required. Generally, the group member of each community bank starts from 4 members or two solidarity group that is comprised of more than two

members. Every solidarity group in the community bank forms their group members on voluntarily basis and guaranties each other. This loan is categorized in low default risk, but its disadvantage happens when a group member is in default, the other borrowers will be reluctant and hold their repayment.

To summarize, the loan product of microfinance institution is principally categorized as the three loan types. However, each institution has been trying very hard to respond to the actual demand of the clients and in particular the time of cash flow demand has been a drive of new product initiative. The basis of product development has still been on the previous establishments, which are time, period and size of credit demand and especially a matching cash flow to particular business types of the borrowers.

e- Products and Services

With a continuous growth, products and services of MFIs have been increasing to fill up the market roles of the banks in targeting its financial service to the rural people. Generally, the products and services of microfinance are focused on two main types such as loans and savings. In addition to these two conventional financial services, the MFI has provided non-financial service such as training on practical skills to rural people that allowing them to establish their own business with financial capital offered in the form of loans. The institution has also conducted training on loan utilization and saving benefits in order to clearly understand about microfinance services and make effectively use of them.

An important principle in establishing microfinance's products and services is to make them simpler, easy to use and especially responding to actual demand of the clients. This is pertaining to a recognition that rural residents are still in limited knowledge about financial services. Thus, the procedures and requirement criteria of each product and service have to be clear and easy to understand. Importantly, the institutions maintain their eager on new initiative and establishment in order to make those products and services more cost effective as for interest rate reduction.

With a strong effort of supervisory authority under the autonomy of the NBC, there have been many rules and regulations issued to allow microfinance institutions to provide their financial services with a clear and transparent manner and to avoid interest exploitation of the rural people whom the targeted clients of MFI. To date, the NBC has covered its

supervisory regulations on two conventional services of microfinance, which are credits and savings.

New establishments of mobile phone banking and micro-insurance have been illustrated a growing product diversification in microfinance industry; but, these are not yet under any particular supervisory regulations or requirements. In response to this emerging challenge, the next task of the NBC and other regulatory authorities need to further study and understand their possible application to Cambodian practical context and their implication in which all these are preserving the interest of microfinance's clients as directly involve in these services.

In conclusion, the products and services of MFIs in Cambodia have actually been the same as international practices and standard. It has also been an important and effective tool in responding to millennium development goal of poverty alleviation.

f- Clients

Having a clear understanding about targeted clients of MFI is very crucial for developing products and services that are definitely serving the benefits of the poor. Normally, microfinance's clients are poor people living in rural areas and do not have access to formal banking services. Many research findings have proofed that women is trustable borrowers who are ensuring high repayment rate and effectively utilizing their loans. This evidence has made MFI to define its indicator through number of women compared to total borrowers. This indicator is very important to signify that the MFI having high proportion of women in their total borrowers seems to have a stronger repayment rate.

In order to allow MFIs to correctly service their targeted clients, each institution has divided their kinds of clients based on credit types and business differences of the clients. This determination is to reflect the client's credit demand in term of loan size, tenor, and time demand. Moreover, it allows credit officer to analyze cash flow of individual borrower in pursuit of assessing his or her repayment capacity. Given three kinds of loan products, most of MFIs have categorized their client following these loan types, which are individual loan client, solidarity loan client, and community bank loan client. Similarly, the classification of the client following business type are agricultural loan client, trade and commercial loan client, production loan client, housing loan client, and consumption loan client.

Furthermore, other MFIs have categorized their clients based on geographical areas in which it is aimed at matching loan product to credit demand of particular resident. For instance, the area where there is a favorable condition for agriculture production; thus, the loan product needed in this area is definitely agricultural loan in which the loan size, tenor, and repayment method have to ease the repayment ability of the clients as their income generated from agricultural produces. Therefore, it is very important to provide a suitable loan product to the right client.

g- Outreach

It has been recognized that the operational structure of MFI outreaches to remote rural areas in which it is a favorable condition for the poor people to access its financial services. This is a cause of making such a high operational cost. In addition, the important factors such as physical infrastructure, human resource, and communication are the determinants of rural outreach; and also having no such supporting factors, microfinance institutions are not able to perform their functions well. However, the current rural development has been showing its ambitious pace in which it is an advantage to further development of the microfinance industry.

Additionally, the outreach of microfinance services is not only demonstrated through the presence of its operations, but also it needs to reach certain poverty level, which is known as depth of outreach, in order to reflect its role as poverty alleviation tool. In this regards, a number of clients is also an indicator to illustrate the outreach level of MFIs. Majority of MFIs have broken down their operational structures into three layers, which are head office operations, provincial branch operations, and district branch operations. Normally, district branch operation is the smallest structure, but it can father outreach its operation to remote rural areas. And, this structure has direct link with provincial branch in which it receives technical support from the head office. In short, the core operation of MFI is to farther outreach and better serve the poor people through its microfinance services.

h- Interest Rate

Interest rate is a vital aspect to the price determination of microfinance loan product. A balance must be reach between what clients can afford and what the institution needs to earn to cover all of its costs. Generally, interest rate setting is very sensitive issue that has normally been received criticism - from the outsiders who have not yet clearly understood about actual microfinance operations, on its high charges comparing to the

lending rate charged by commercial banks. However, this sensitive issue has not had any negative reactions from microfinance clients whom directly involved in the operations. The reason is that the interest rate charged by MFI is two to three times lesser than the interest paid to money lenders. However, all MFIs have virtually tried their best to reduce the price of their loan product; and principally those microfinance operators do not have any intention to pressure their borrowers through exploitative high interest rate. Moreover, all licensed MFIs have jointed a single principle under Cambodian Microfinance Association (CMA) with the aim at creating a healthy competition by not using interest rate as a mean of customer attraction.

With a clear understanding about a free market principle, which is a crucial advantage to the development of microfinance industry, the NBC has issued the regulation of no interest rate cap for all microfinance operators. This means that all institutions have to define their interest rate based on market movement and environment. From time to time, the interest rate of microfinance loan product has decreased significantly, which was from the average interest rate of 5 to 6 percent per month at its initial stage to the current average interest rate of 2.5 to 3 percent per month. Owing to the main funding source of MFIs come from large foreign financial institutions, the interest rate of those institutions have been pressured by the fluctuation international financial market. This external effect does not allow MFIs to reduce their interest rate. Instead, the institutions need to focus on reducing their operational costs to a reasonable rate.

Nevertheless, the NBC has issued a regulation on method of interest calculation of microfinance loan product in which the basis of this method is to take into calculation only the outstanding principal. This method is so-called “declining method”, which is developed with its primary objective of preventing the borrowers’ loss from using the “flat method”. The microfinance interest rate on loans is often a controversial issue among the stakeholders. It is often raised and discussed in public at large. Although such a perception exists, the interest rate trend continued to decline. As of December 2009, the monthly interest rate on loans decreased from 3.38% to 2.99% for KHR and from 2.71% to 2.26% for USD compared to 2005. Interest rates have decreased gradually because of the fair competition in the industry, physical infrastructure development, and internal management improvement, especially in term of cost control.

To summarize, the current interest rate charged by MFI is much better than before and more competitive to the rates charged by private money lenders despite of its high rate comparing to the commercial banks. Besides, an acceptable reason on such a high interest rate is given on the fact that its high operational cost incurred from remote operations. And also, a major funding source is depending on international financial market.

Average Monthly Lending Interest Rate

Currency	2005	2006	2007	2008	2009
Riel	3.38%	3.36%	3.23%	3.20%	2.99%
USD	2.71%	2.62%	2.34%	2.43%	2.26%
Others	3.16%	3.13%	3.13%	3.13%	3.07%

Average Yearly Deposit Interest Rate

Currency	2005	2006	2007	2008	2009
Riel	12.06%	8.23%	7.69%	6.84%	5.85%
USD	6.63%	6.72%	5.54%	5.17%	4.34%
Others	8.80%	8.80%	8.40%	7.70%	7.20%

III- Financial Sector Development Strategy

1- FSDP 2001-2010

The FSDP 2001-2010 identified rural finance as a critical sector requiring development and support. It was recognized that the banking system has not been able to address the demand for finance, from the poor, to smoothen consumption, build assets and develop micro-enterprises. This has been expressed by the most obvious manifestations of poverty, such as insufficient household income, lack of productive assets and inaccessibility of affordable financial services. Five key areas have been highlighted in the FSDP 2001-2010 using a phased approach:

- a- Implementing and enhancing rural credit policy;
- b- Strengthening supervision and regulation;
- c- Building financial infrastructure for microfinance;
- d- Creating institutional capacity; and
- e- Ensuring pro-poor orientation

Overall responsibilities have been divided between MEF and NBC. MEF involved with supporting policy and physical infrastructure development and funding coordination with foreign countries and international agencies. NBC is responsible for issuing the appropriate policies and regulatory frameworks and supervision.

Much have been achieved in relation to the Phase I activities. The Phase II activities are taking place, although at different paces and with highly variable achievements. Some of the phase III activities which were due in 2008 have taken place already, thus demonstrating the dynamism of the sector.

2- FSDP 2006-2015

The FSDP 2006-2015 has revised the delineation of the sector in the FSDP 2001-2010 as “Rural Finance”, to become more inclusive, and considers the sector as “Microfinance”. This encourages the diversification of risks and growth of diverse products, as well becoming more inclusive for those in urban areas. The objective is thus a viable, pro-poor and effective microfinance system to provide affordable financial services to enable the poor to enhance income and reduce poverty.

Since 2001, the microfinance sector has shown remarkable dynamism, with admirable results for a sector in its present stage of development. This has been due in no small part to the RGC’s willingness to allow the commercialization of microfinance in the country, with a private sector approach supported, where necessary, by the Government and the donor community. The continued development of a supportive network by the Government and donors, whilst allowing the private sector freedom to act within the legal and regulatory framework, should support additional rapid growth.

Inter-linkage and integration of the microfinance sector with the commercial banking sector continues as a major priority. In the long run, the commercial banking sector is the only reliable source of extensive liquidity which can meet the demands of the microfinance sector. Furthermore, there is a trade-off for the banking sector. The more successful of the microfinance sector’s clients will eventually graduate into customers for the banks.

The microfinance sector’s future development should be considered on three levels: the Macro level, the Meso level and the Micro level. Furthermore, developments should not be time-bound or time-constrained, but should be prioritized and sequenced, based upon expected impacts and absorptive capacities.

Macro level (Government and regulatory authorities):

- Support continued development of capacities at NBC for effective regulation and supervision of the microfinance sector, while at the same time making sure that all

institutions taking deposits are subject to graduated regulatory requirements and supervision based upon size and complexity of activities.

- Agreement upon common reporting standards is required to establish sound financial performance analysis and enable the support of the sector's growth, as well as to inform the public via monthly bulletins.
- Study structural risks associated with the MFIs, in terms of governance, ownership, and the small size of some MFIs and try to resolve the weaknesses.
- Identify and define microfinance markets throughout Cambodia, and this is an area in which the MEF should provide significant support. There needs to be improved statistical analysis and market definitions, geographically, sectorally, in size and in scope. There is also a requirement to define and elaborate on the scope of alternative financing sources at the local levels (moneylenders, family, friends, village banks, cooperatives, etc.). This will inform MFIs, and provide the basis for product development, for policies and, for the Government, the potential identification of incentives to promote development as well as appropriate regulation and supervision.
- Creation of capabilities to support other forms of microfinance institutions (i.e. community-based, non-registered, etc.) to broaden the types of needs being met, and introduce greater variety and flexibility into the system.

Messo level (Technical support level):

- Establish a training facility which can provide off- and on-the-job training for all levels within the microfinance sector. The training facility should include a governing council for microfinance capacity building (to include the MFIs, both licensed and registered), in order to ensure that it meets the needs of the sector. It will develop off-the-job training courses and develop increasing outreach capabilities to support the establishment of training management systems for effective on-the-job training at MFIs and beyond. This would include training of trainers; work task analysis; needs assessment; training planning, budgeting and on-the-job delivery; appraisal methodologies; management succession training; and training recording systems. The training facility would operate as an integral, responsive part of the microfinance sector, funded by sustainable pricing of services.

- Improve the provision of management information systems (MIS) for MFIs. The quality of software and systems presently varies considerably, with some MFIs unable to access integrated accounting and loan portfolio systems, whilst others have very expensive and effective systems. Minimum standards for MIS in Cambodia need to be established, particularly when improved common reporting standards are introduced. This may call for the holding of national licences by Meso or Macro level organizations on behalf of the MFIs, in order to ensure minimum quality of support to those organizations.
- Develop a wholesale market for loan financing, operated within the private sector and linking the MFIs with the commercial banking sector. At the moment, MFIs have difficulty in accessing credit in riel. A national wholesale payment system and money / interbank market should not only link the microfinance and banking sectors, but should also provide flexibility in the currency in which loans are provided. Additionally, linkages should be extended via measures enabling the banks to obtain experience of lending to, and working with, MFIs. This requires a less collateral-based approach to lending and the development of more cash flow/accounts analysis-based thinking. Potential for interim guarantee measures to enable such experience to be gained will be considered.
- The recent and welcome establishment of the Cambodian Microfinance Association (CMA) provides an opportunity for improved representation in the sector. CMA may be developed to disseminate improved policy options, to improve dialogue, advocacy, research and information exchange.
- Build a local MFI ratings capacity, based upon commercial ratings support and also linked to a credit information exchange. The information exchange should include both positive and negative information. If customers are to graduate to the commercial banking system, they will need to have established an accessible, good credit history. The CIS established for the commercial banking sector can be extended to the microfinance sector.

Micro level (Retail):

- Support to strengthen retail institutions, particularly those below the level of Licensed MFIs.

- Based upon research and statistical analysis conducted at the Macro level, a need may arise to assist other forms of microfinance institutions (non-registered, community based, etc.), and to ensure that where needs are being met by such ad hoc organizations, those needs continue to be met. The greater the variety and flexibility in the system, the stronger it will be.
- Further links should be created between NGOs dealing with the destitute and MFIs. This will allow destitute people who become non-destitute, via NGO support, to ease into the microfinance sector.

IV- Role of NBC in Promoting Microfinance

1- Regulation and supervision

The financial sector, both banking and rural finance, is a major element of the financial system of the country and sound supervision and regulation of banks and financial institution is essential. Attention must be paid not only to banks but also other components of the financial system such as rural financial institutions providing funds for small and micro enterprises and rural poor.

To implement Law on Banking and Financial Institutions and improve financial services in rural areas, NGO suppliers and operators of financial services need to be licensed as MFIs by NBC. The purpose of the regulation is not to restrict their activities but to promote them. Regulation and licensing are necessary for MFIs that collect savings from their members and the public, acquire long term borrowing from foreign and local organizations and employ these funds to provide loans in rural areas. The MFI must be registered and incorporated as a legal entity as a company, cooperative *or* have a legal status according to the law. The MFI's license shall be provided by NBC after assessing and reviewing all NBC's criteria and requirements.

With microfinance operation, supervisory authorities are confronted with conflicting targets. On the one hand, microfinance, as with all other financial activities, must be regulated to avoid the incompetence, and in some cases the dishonesty, which can undermine the system. On the other hand, if regulation is too harsh, and in particular if capital requirement is too high, micro-finance might exhibit the same behavior as banks, flee from rural areas and concentrate their activities in major cities. Therefore, the NBC has released a set of regulations according to the size of MFIs.

In particular, for the improvement of financial transparency and disclosure, the NBC is strengthening the implementation of the uniform chart of accounts for MFIs and the disclosure requirements in line with the international accounting standard. Especially, all MFIs are required to have annual audited financial statements. The NBC is strengthening the management of the MFIs as well. The NBC also has to conduct offsite supervision of reports regularly received and onsite supervision. Moreover, field visits have been conducted to verify their activities when applying for a license or registration.

For the first time in 2000, NBC issued regulations on the classification of MFIs into three categories according to the level of their operations, and created criteria for licensing and registration. The obstacles preventing NGOs from transforming into MFIs are ownerships. At the beginning, it is difficult to identify the shareholder because funds used by NGOs to operate microfinance are granted by international donors. But at the end staff association has been established as the owner of those funds, opening, the way for NGOs to transform into MFIs.

The biggest microfinance operators must be licensed by NBC. The regulation is very similar to commercial banks, except that the capital requirement is substantially lower. The medium-sized microfinance operators are only registered by NBC and are subjected to lighter regulation and in particular, reports sent to NBC are simplified. The smallest microfinance operators can operate freely with no requirement to be regulated and supervised due to high operating costs.

In addition to its supervisory activities, the NBC has encouraged MFIs to establish a professional association for microfinance called CMA which has a relationship with the bankers' association so that it can communicate with the NBC or other institutions to share views and to protect their interests.

In terms of supervision and regulation, the NBC is responsible for maintaining integrity and a sound banking and financial system in order to encourage public confidence, to protect depositors from fraud and encourage good governance. To do this, complete sets of criteria have been issued such as licensing and registration procedures; minimum capital requirement, solvency ratio, liquidity ratio, uniform chart of accounts, reporting requirement etc. Furthermore, the NBC also conducts off-site and on-site supervision on

a regular basis in order to ensure that all MFIs are operating in professional and prudential manners. Those regulations are consistent with the scope of work of MFIs and support them in expanding their activities in an appropriate manner.

a-Criteria for Licensing MFIs and Rural Credit Operators

- Criteria for licensing and registration: The identification of permanent shareholding, in particular the influential shareholders holding 20% or more of the capital.
- Requirement for being licensed: NGOs having loan outstanding of KHR 1,000 million or more on 1,000 borrowers or more.
- Minimum paid-up capital: KHR250 million
- Liquidity ratio : 50%
- Solvency ratio : 15%
- Capital guarantee : 5%
- Reserve requirement : 5%
- Calculation of interest rate shall be based on the remaining balance of credit.
- Reporting requirement: monthly for licensed MFIs and quarterly for registered NGOs.
- Reports: Asset and liability statement, profit and loss statement, statement of deposit and loan classified currency and by types, loan classification, and branch network.
- Apply uniform chart of accounts of NBC.
- Annual license fee: KHR1million for each MFI with no fee for branch, with the purpose of promoting the expansion of branch network to reach poor people in remote rural areas.
- No fee for registered NGOs.

b- Criteria for Licensing Deposit Taking MFIs

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

- 1- hold a MFI's license at least 3 years;
- 2- have a good financial condition and sound management at a safety level for at least two years before submitting the application;

- 3- have a minimum paid up capital equal to 10,000 million riels;
- 4- have an effective Management Information System (MIS);
- 5- implement NBC's uniform chart of accounts; and
- 6- have sustainable profitability of at least two consecutive years in primary operations.

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

- 1- only collect savings and fixed deposits; the amount of savings of an individual client shall not exceed 3% of Institution's net worth;
- 2- loan to an individual and group of related clients not exceeding 2% and 3% of Institution's net worth respectively;
- 3- maintain at all times a solvency ratio of not less than 15%
- 4- maintain liquidity ratio of at least 50%;
- 5- maintain capital guarantee of at least 10% of its registered capital at an account with NBC; and
- 6- maintain the reserve requirement of at least 8% of its client deposits into an account with NBC.

c- Loans Classification and Provisioning

MFIs loans have been classified into 4 types (standard, sub-standard, doubtful and loss) depending on the financial situation of the borrowers and the timeliness of principal and interest payments.

Classified	Less than 1 year	More than 1 year	Provisioning
Standard	Due payment	Due payment	0
Sub-standard	Past due payment 30 days or more	Past due payment 30 days or more	10%
Doubtful	Past due payment 60 days or more	Past due payment 180 days or more	30%
Loss	Past due payment 90 days or more	Past due payment 360 days or more	100%

d- Existing MF Regulations

There are currently several regulations that are applicable for MFIs and registered NGOs namely:

- 1- Prakas on the Licensing of Microfinance Institutions (B 700-06 Pro Kor January 11, 2000)
- 2- Prakas on the Accounting Process for Foreign Currency Transaction (B7-00-50 dated February 17, 2000)
- 3- Prakas on the Calculation of Interest Rate on Microfinance Loans (B 7.01-115 Pro Kor dated August 14, 2001)
- 4- Prakas on Loan Classification and Provision applicable to Microfinance Institutions (B 7.02-186 Pro Kor dated September 13, 2002)
- 5- Prakas on Maintenance of Reserve Requirement for Microfinance Institutions (B 7.02-45 Pro Kor dated February 25, 2002)
- 6- Prakas on Reporting Requirement for Registered NGOs and Licensed Microfinance Institutions (B 7.02-47 Pro Kor dated February 25, 2002)
- 7- Prakas on Liquidity Ratio applicable to Licensed Microfinance Institutions (B 7.02-48 Pro Kor dated February 25, 2002)
- 8- Prakas on Registration and Licensing of Microfinance Institutions (B 7.02-49 Pro Kor dated February 25, 2002)
- 9- Prakas on Adoption and Implementation of Chart of Accounts for Microfinance Institutions (B 7.02-219 Pro Kor dated December 25, 2002)
- 10- Prakas on Reporting Date for Microfinance Institutions (B7-06-212 dated September 13, 2006)
- 11- Prakas on Amendment to Prakas on licensing of Microfinance Institutions (B7-06-209 dated September 13, 2006)
- 12- Prakas on Licensing of Microfinance Deposit Taking (B7-07-163 dated December 13, 2007)
- 13- Prakas on Microfinance Institutions' Solvency Ration (B7-07-133 dated August 27, 2007)
- 14- Prakas on the Calculation of Microfinance Institutions' Net Worth (B7-07-132 dated August 27, 2007)
- 15- Prakas on Monitoring of Banks' and Financial Institutions' Net Open Position in Foreign Currency (B7-07-134 dated August 27, 2007)
- 16- Prakas on Using Language, Currency Unit, and Exchange Rate for Accounting Records and Reports (B7-07-164 dated December 13, 2007)
- 17- Prakas on Anti-Money Laundering and Combating the Financing of Terrorism (B7-08-089 dated May 30, 2008)
- 18- Prakas on Good Governance of Bank and Financial Institution (B7-08-211 dated November 25, 2008)

- 19- Prakas on Fit and Proper Regulatory Requirements for Applying Entities and Licensed Banks and Financial Institutions (B7-08-212 dated November 25,2008)
- 20- Prakas on License Fees for Microfinance Deposit Taking Institutions (B7-09-012 dated January 20,2009)
- 21- Prakas on The Liberalization of Interest Rate Setting (B7-09-213 dated September 09,2009)

2- Microfinance Supervision Division

The Microfinance Institutions Supervision Division of the Banking Supervision Department is divided into three sections: Registration and licensing; Off-Site supervision; and On-Site supervision. The division is responsible for studying applications for licensing and registration, renewal and revocation of license, and registration of microfinance operators. Similar to the Bank Off-Site division and On-Site division, the Microfinance Institutions Supervision Division is also responsible for conducting offsite and on-site inspections of MFIs to ensure transparency in implementing the laws and regulations of the NBC and to give early warnings of potential problems affecting supervised MFIs.

3- Capacity Building and Public Awareness

The microfinance sector is recognized as an important player in granting financial sources to poor people in rural areas and to micro and small enterprises. Even though lending continued to increase, the growth of lending was still not enough to meet the needs of the country's rural economy. The lack of sufficient sources of funds, the quality of human resource, weak internal control and corporate governance, and limitations in their accounting systems involved are problems that MFIs facing. Besides the high cost of operations, the exchange rate risk is also an obstacle that leads to a high interest rate and low lending growth. Therefore, NBC continues to promote and encourage all MFIs to take the appropriate policy measures to tackle those issues and challenges. Those policy measures are prudential and non prudential regulations issued by the NBC.

Beside the above measures, the NBC also conducted several national, regional conferences and seminars in order to promote the access to finance and in order to widely raise public awareness of the advantages, challenges, rural finance services, and development of microfinance sector in Cambodia. Those events are as followed:

The year 2006 had been an important year for the Cambodian rural financial system. the NBC with collaboration from UNDP organized a National Summit on Microfinance of

Cambodia which honorably presided over by *Samdech Hun Sen, Prime Minister of the Kingdom of Cambodia* and about 550 participants from senate, national assembly, government ministries, provincial and municipal authorities, diplomatic community, commercial and specialized banks, MFIs and practitioners, micro clients, small and medium sized enterprises, NGOs, and academic community gathered in the Summit. Samdech Prime Minister was highly appreciated to the development and achievement of Cambodian microfinance and officially announced the “*Year 2006 as the Year of Microfinance of Cambodia*” and also provided some recommendations in order to strengthen microfinance operations in Cambodia to be transparent, healthy, and effective in contributing to the implementation of the government's poverty alleviation program. Following the valuable and meaningful recommendations and to appreciate *the Year 2006 as the Year of Microfinance of Cambodia*, the NBC organized three consecutive regional conferences in Battambang province on May 2, 2006, in Kampot province on October 27, 2006 and in Kampong Cham province on December 8, 2006 with a total of about 1,000 participants to disseminate the benefits, challenges, rural services and the involvement of the microfinance sector to local authorities, microfinance operators and clients.

Following the Regional Program for Accelerating the Financial Empowerment of Poor Rural Communities in Asia and the Pacific through Rural Finance Innovation launched in Kunming, China on 7-9 April 2007, the NBC in collaboration with Asia Pacific Rural Agriculture Credit Association (APRACA) organized the National Forum on Creating Conducive Rural Finance Policy Environment and Regulatory Framework, which was held on July 10, 2007 at Kampong Cham Province and about 300 participants were invited from Ministry of Economy and Finance, Ministry of Women Affairs, Ministry of Rural Development, Ministry of Industry Mines and Energy, Ministry of Agriculture Forestry and Fishery, commercial banks, specialized banks, microfinance institutions, small and medium enterprises, governors and deputy governor of provinces, head and deputy head of districts and communes from 6 provinces namely Kampong Cham, Kampong Thom, Prey Veng, Svay Rieng, Stoeung Treng, and Kratie. The Forum objective is to present the result of microfinance performance, challenges and favorable environment of microfinance institutions and small and medium enterprises in order to finance the business activities. The forum is also to create awareness of the policy

environment and regulatory framework, generate commitment and undertake a plan of action to ensure public-private participation and inclusion of grass roots clients in the process.

The National Bank of Cambodia in cooperation with UNDP and ANZ Royal held a conference on *Reaching New Heights: Improved Access to Financial Services*” in November 2007 which was attended by microfinance operators, local commercial and specialized banks, international investors and other related government entities, and aimed at improving the knowledge of the local banking sector on potential of the microfinance sector in Cambodia. Microfinance institutions generally obtain funds through borrowings and other sources of funding in US Dollars and lend in local currency (Riel), which can lead the institutions into foreign exchange risks if the exchange rate highly fluctuates. Therefore, the NBC recommended that the institutions shall have strategies in finding sources of funds in Riel by obtaining loans in Riel, accepting guarantees from a third party, and operating back-to-back currencies with banking institutions. This forum expected to facilitate MFIs to dispose themselves in front of potential investors who can provide funding at reasonable price.

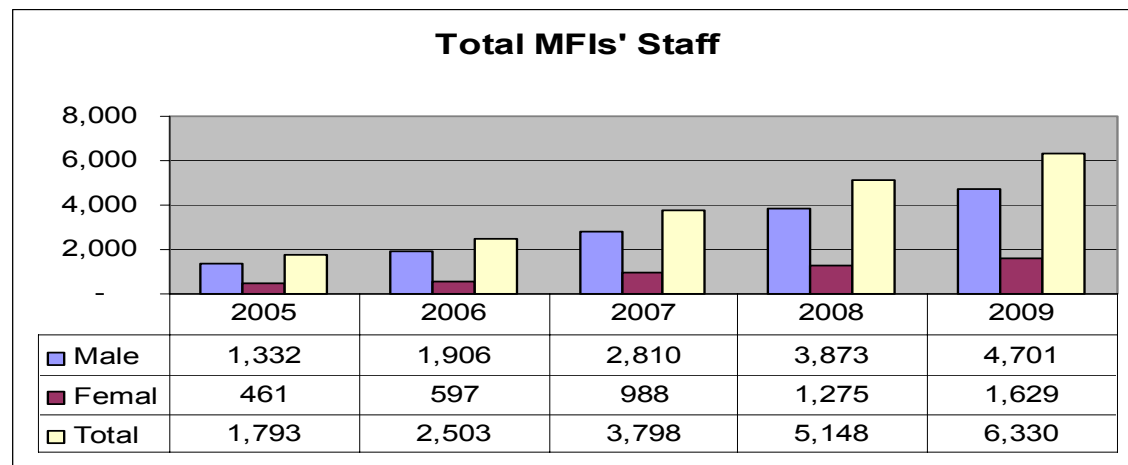
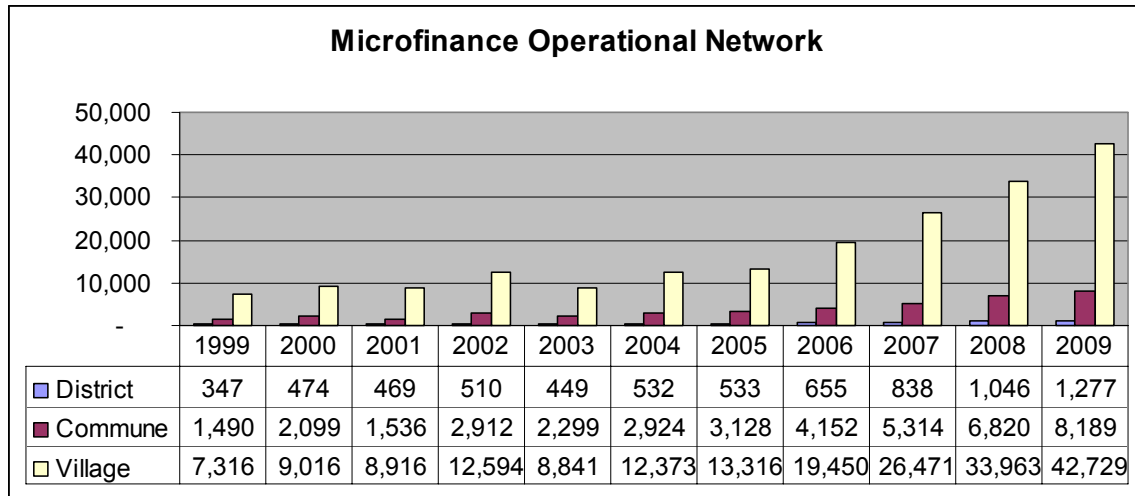
V- Microfinance Performance and Challenges

1-Microfinance Performance

a- Rural Financial Outreach and Performance

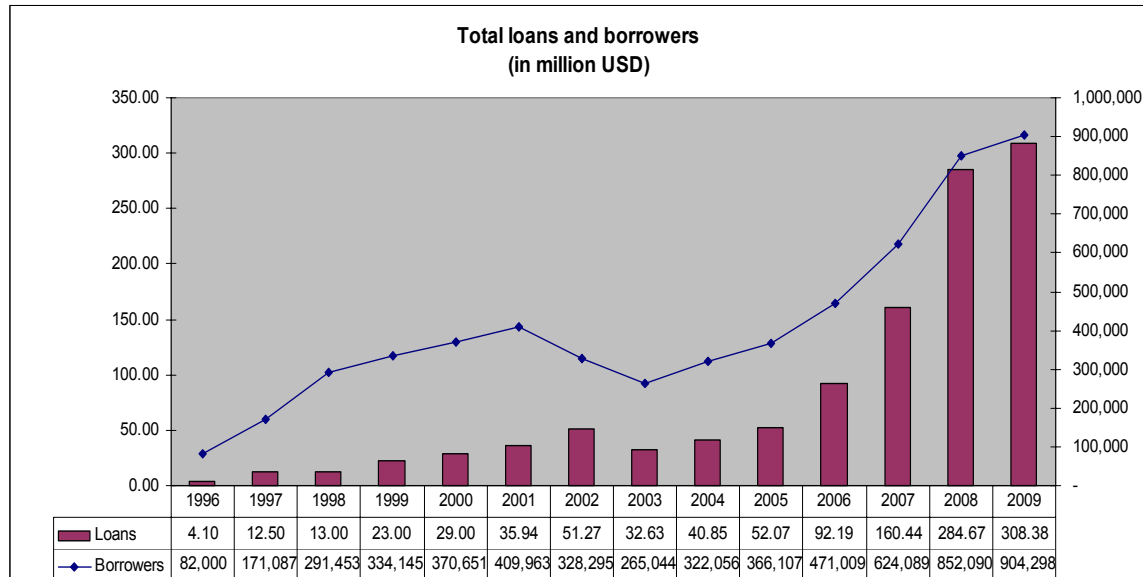
The microfinance sector in Cambodia gradually developed over the past decade. Currently, there are 20 licensed MFIs (of which 4 got saving mobilized licenses) and 26 registered rural credit operators. The network coverage and offices have been extended to almost all provinces, districts, communes, and villages. As of December 2009, there were 1,277 offices in districts, 8,189 offices in communes, and 42,729 offices in villages. In term of MFIs’ employment, the demand for employment increased gradually from 1,793 staff in 2005 to 6,330 staff in 2009.

	2002	2003	2004	2005	2006	2007	2008	2009
Licensed MFIs	3	5	10	15	16	17	18	20
Registered NGOs	27	29	28	23	24	25	27	26

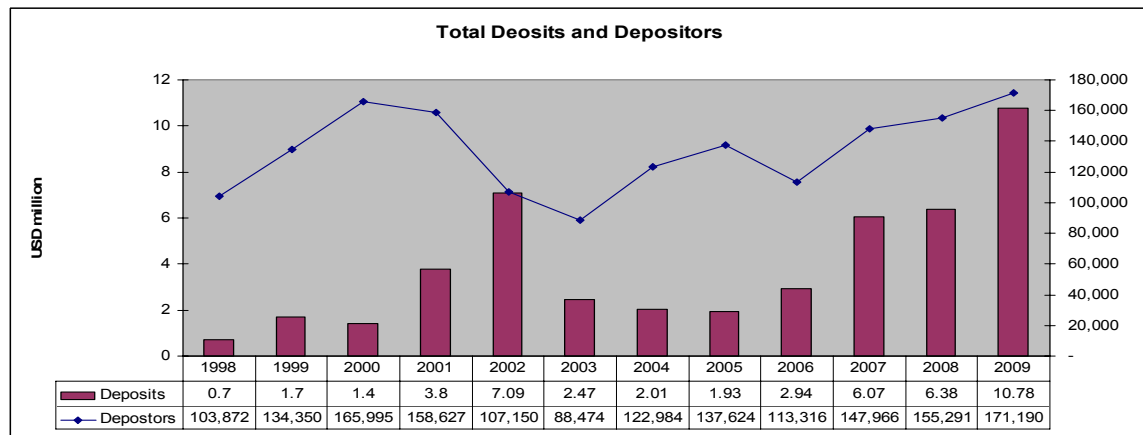


As of 2009 MFIs and registered NGOs provided a total loan outstanding of USD 308.38 million to 904,298 borrowers. Compared to 2006, 2007, and 2008 total loan outstanding increased by 74%, 77% and 8% respectively. The growth rate in 2007 and 2008 demonstrated the significant credit expansion as a result of increase in the institutions' capital as well as borrowings both locally and internationally. However, it dramatically declined in 2009 as a result of an impact of world financial crisis, overlapped lending and lack of demand for credits. More rural people have gained more knowledge regarding microfinance services and thus had more trust in microfinance loans which is illustrated through the increases in borrowers compared to 2006, 2007 and 2008 (33%, 37% and 6% respectively). For deposits collection, in 2009 MFIs and rural credit operators mobilized total deposits of USD10.78 million from 171,190 depositors. Compared to 2007 and 2008 total deposits increased by 5% and 69% respectively. While the depositors increased by 5% and 10% respectively. The growth rate

was a result of allowing MFIs to collect deposits from the public according to the NBC's Prakas on the Licensing of Microfinance Deposit Taking Institutions (MDI).



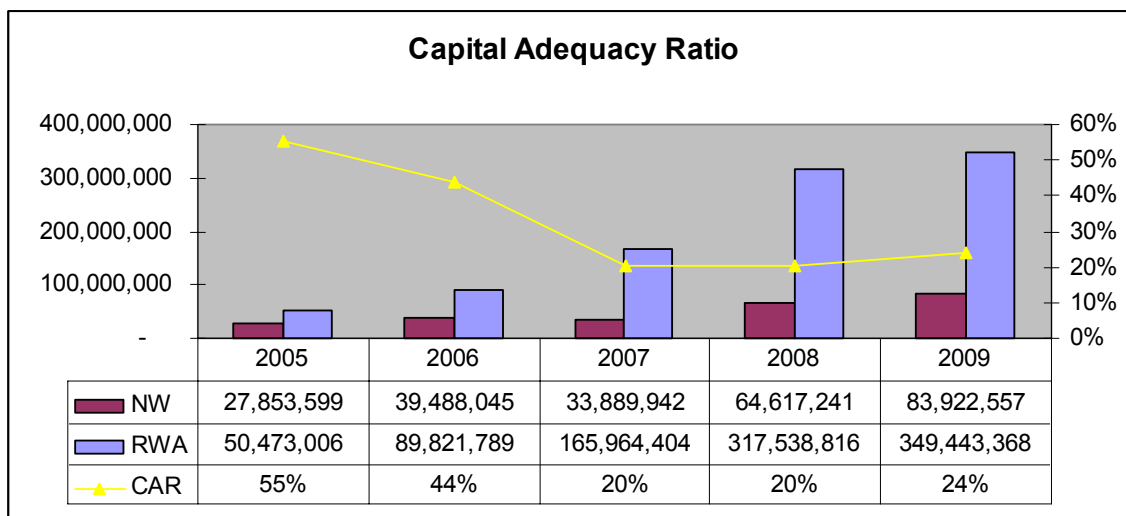
Note: data are excluding ACLEDA Bank from 2003



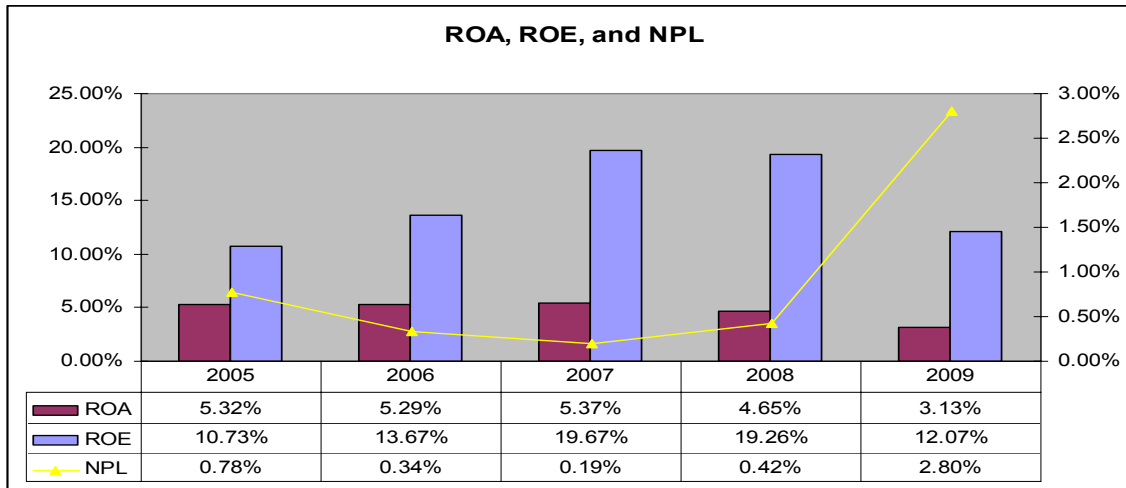
Note: data are excluding ACLEDA Bank from 2003

b- Prudential Ratios and Profitability

According to NBC's *Prskas* on Licensing of Microfinance Institutions, MFIs shall maintain at all time the solvency ratios of at least 15%. The solvency ratio declined gradually from 55% in 2005 to 24% in 2009 but it still above the regulatory requirement. For the past few years, the repayment rate of MFIs was very high reflected by the low non performing loan ratio (NPL) which was less than 1%. However, the NPL ratio increased dramatically from 0.19% in 2007 to 2.8% in 2009 as a result of a slow down of demand for credits, overlapped lending issues, and impact of global financial crisis.



Return on asset (ROA) and return on equity (ROE) grew gradually from 5.32% and 10.73% in 2005 to 5.37% and 19.67% in 2007 respectively. However, from mid-year 2008, the profitability of MFIs slowed down, which was partly affected by the slowdown of micro and small business activities and overlapped lending issues, especially in rural areas, which in turn likely affected the clients' repayment capacity. As of 2009, ROA and ROE declined to 3.13% and 12.07% respectively compared to 4.65% and 19.26% in 2008.



c- Financial Transparency and Accountability Awards

In 2005 Microfinance in Cambodia was given international recognition when the 2005 CGAP Financial Transparency Award was given to three Cambodian Microfinance Institutions: ACLEDA, AMK, and PRASAC. These winners were chosen among 175 competitors from 57 countries. AMRET, TPC, CREDIT and VFC received 2005 CGAP Merit Recognition in East Asia and Pacific

In 2006, history repeated itself as Cambodian excellence becomes a tradition: Four members were honored with the 2006 CGAP Financial Transparency Awards: AMK, Amret, CEB and VFC. Cambodia, honored four times in the category, is the only Southeast Asian country so recognized. These winners were chosen among 231 competitors from 63 countries. In addition three MFI's received 2006 CGAP Merit Recognition in East Asia and Pacific: CREDIT, TPC, and PRASAC. Cambodia received three out of the five awards given in this category in Southeast Asia.

AMK, Maxima, CHC and VisionFund received certificate award on Social Performance Indicator by Mix-Market in 2009.

AMK, HKL, VisionFund and Sathapana received certificate award on Microfinance Transparent Pricing by Microfinance Transparency Org in 2009.

2- Challenges

Our vision for microfinance is to establish a viable and sustainable private microfinance market, with the government providing a supportive and appropriate institutional framework to that market. The ways forward in the short to medium term towards achieving this vision should be a set of interconnected strategies that require the attention of various stakeholders. In this respect, some of the following issues need to be improved and take into consideration of the sustainable development of microfinance.

A- New Product Development

Electronic banking is a means by which banking business is transacted through automated processes (ATM) and electronic devices such as computers, internet, telephones and plastic card payment. As a number of banks and financial institutions and their branch networks increased, banking business becomes more competitive. Banks and financial institutions seek to design and develop new financial products to satisfy their clients in terms of quicker services, speedier access to financial services and cheap costs. In view of the introduction of electronic banking in banks and financial institutions in Cambodia and use of IT in the banking sector, it is important to establish a regulatory framework for electronic banking to protect depositors' money. The risks associated with electronic banking include all the inherent banking risks. New establishments of mobile phone banking and micro-insurance have been illustrated a growing product diversification in microfinance industry. But, these are not yet under particular

supervisory regulations or requirements. In response to this emerging challenge, the next task of the NBC as the regulatory and supervisory authority needs to further study and understand their possible application to Cambodian practical context and their implication in which all these are preserving the interest of microfinance's clients as directly involve in these services. The NBC is in the process of discussing with banks and financial institutions to the establishment of a regulatory framework on mobile and e-banking to ensure the safety of payment system and depositors' money.

WING which is a mobile phone payment provider established by the ANZ had launched its operation in Cambodia since early of 2009. Customers can use WING's services to transfer and withdraw money from mobile phone. WING's targeted customers are garment workers and rural people moving to urban areas for works. So far, WING has built and extended its operation network of 567 WING Cash X-Press outlets across 19 of 24 provinces. WING's customers have been increased gradually to 71,067. Currently, the Vision Fund and PRASAC MFIs have conducted a pilot project with WING in using mobile payment services such as cash transfer and withdrawal.

B- Enhanced commercial microfinance

Though financial services to the poor began with NGOs focused on relief and rehabilitation type work, micro-finance activities have now steadily and increasingly turned into an important industry in Cambodia. More and more NGOs have acquired licenses and transformed themselves into licensed MFIs. Some have even achieved financial stability and have effective self-regulation mechanisms in place. And experience has shown that effective self-regulation mechanisms associated with a motive of attaining self-sustainability through commercialization of services are compatible.

Regulators see that micro financial service providers need to develop themselves in order to meet the dynamic, changing operating conditions. They have to consider various elements when moving to commercialization, which include, among others, management information structure, institutional values, operating systems, and professional staff. Bilateral and multilateral agencies can play an active role in promoting the commercialization of micro-finance, in particular through equity participation. Just like the advantages of traditional forms of foreign direct investment in the manufacturing or formal banking sector for the host economy, such participation on the part of those

agencies in the rural finance institution framework brings both financial benefits and technical expertise to the local service providers. The NBC also promotes participations from private investors involved in microfinance activity. Some of them have been transformed from informal moneylenders into formal micro-finance.

C- Improved financial sustainability of microfinance operators

Despite the success reported here, constraints on micro-finance remain high, especially with regard to financial resources. Most rural credit operators have utilized external funds such as foreign aid and borrowing. This excessive reliance on external financing in the form of grants or projects financing is mainly attributable to a lack of savings and good savings services. A microfinance institution should try to mobilize savings, and the authorities need to be proactive and have the right system in place to protect depositors while allowing licensed MFIs that meet the criteria to collect deposits. This means that sound MFI supervision has to be emphasized in order to maintain the trust and confidence of the people and to assure them that their money is secure and properly managed.

In this respect, it is necessary to highlight the role of public awareness campaigns for the people to understand the benefits of using MFIs saving services instead of traditional forms of savings (or in kind) such as gold, paddy rice, livestock or the informal Cambodian savings form called “Tongtines”. This is an important issue, given that knowledge about the financial sector in Cambodia is limited. On the other hand, microfinance operators have to acquire professional management skills and the technical capacity to develop savings products that are more flexible and responsive to the needs of the prospective clients. MFIs need to properly manage mobilized savings funds. This line of thinking, if successfully implemented, would provide licensed MFIs the opportunity to better financially intermediate funds, and would provide a more stable domestic resource base to support the growth and sustainability of their lending operations.

D- Corporate governance

It has been observed that corporate governance in many microfinance institutions is poor. A non-existent code of ethics, lending to related parties, and ineffective boards are major concerns. Management failure is usually a result of the poor corporate governance. To strengthen governance and prevent risk of the banks and financial institutions, the NBC

already issued regulation on corporate governance and considers issuing several regulations covering internal control systems and external auditors in line with international standard, especially Basel Core Principles for Effective Banking Supervision. To ensure that MFIs are in compliance with these regulations, MFIs shall establish policies and procedures that effectively delegate the operations of MFIs and also strengthen the Board of Directors, managers and staff capacity.

E- Credit Information System (CIS)

The Credit Information System is an important tool in the loan approval process and thus in the rural credit growth, especially when there is a lot of competition between microfinance institutions in one operating area. Thus, the absence of the CIS for microfinance institutions is considered a setback for the sector that causes the MFIs hardly assess the credit worthiness of borrowers and hence contributed to overlapped lending issues and debt burden to the borrowers. With the assistance of ADB, the CIS has been introduced in 2006 for only banks. But, this CIS does not function well because of systematic problems. According to the Financial Sector Development Strategy 2006-2015, the CIS established for the commercial bank sector can be extended to the microfinance sector. Thus, to accommodate the microfinance development in line with the National strategy, the board of the CIS has agreed to allow MFIs to be members of CIS. Hopefully, this CIS system will function well and widely used by members as is expected to be fixed and upgraded this year.

F- Supervisory Capacity

As new product development and a number and size of MFIs grow continuously, there is a need to have sufficient supervisory resources in term of budget, human resources, and regulatory framework to catch up with these growth and changes. The fast development of financial services, the technology and modern electronic equipment use require supervision officers to upgrade their knowledge at every opportunity since these new services have created new risks. Thus, the training of supervision officers drives effective supervision to catch up with the overall development of financial sector. Besides the in-house training program, the Banking Supervision Department also receives training offered by institutions such as the International Monetary Fund, the Asian Development Bank, SEACEN and other central banks and associations. In addition, capacity building at the NBC in order to acquire adequate expertise and manpower to supervise MFIs remains a challenge. Such a challenge could only be overcome with TA support. The NBC continues to host more

conferences on public awareness of microfinance in Cambodia, enhance the capacity of supervision officers so as to catch up with recent developments and contribute to the strengthening of the sound banking and financial system in Cambodia, and to gaining confidence from local and foreign investors.

G- Regulation and supervision

NBC's regulation and supervision of microfinance activities in Cambodia has so far achieved good results which reflect the strengthening of law enforcement and cooperation with MFIs and private sector. The NBC's approach to rural finance is one of the support and flexibility so that supervision will not impose any burdens on licensed MFIs. The challenge for the supervisory authority will be to accompany the development of this sector by adopting regulations when needed. For example, previously, the regulation for MFI collecting deposits had been restrictive; now, this regulation has been relaxed as some MFIs have strengthened their capacity and soundness. Collecting more deposits will give more resources to MFIs to extend their loans to rural poor with lower cost and the rural population will increase their savings and get familiar with using the banking system. But, these changes would have to be cautiously implemented and only the strongest MFIs could be authorized to collect deposits as indicated in the Prakas on Microfinance Deposit Taking Institutions. Besides the above-mentioned, there are many tasks to be implemented in the future, such as strengthening the implementation of the Law on Banking and Financial Institutions, issuing corrective actions to banks and MFIs that are not yet in full compliance with laws and regulations, reviewing and issuing new regulations involved and continuing to publish supervision reports publicly.

VI- Conclusion

So far, microfinance activities have contributed benefits and good experience for the development, which is the most important sector in the poverty reduction policy of the government. The microfinance sector in Cambodia has been internationally recognized and highly rated since it commenced its path towards a sound regulatory, supervisory, and managerial environment. For borrowers, the main benefits received from microfinance is the upgrading of their living standard because having access to credit services creates a credit culture with the spirit of being responsible for the borrowed money to be repaid on the maturity date including interest. On the other hand, borrowed

funds should be utilized for production so that the borrower can have enough income to support his living, meaning that he should not spend borrowing funds on non-business activity.

A good credit culture is observable in the high repayment rate (from 95% to 99%) of the poor who borrowed money from MFIs. Borrowing from MFIs is a good resource for the poor because this type of loan fund charges a lower interest rate than others especially informal money lenders. Regulated MFIs have the advantages of sound management and compliance of all regulations, which in turn contributes to its operations and builds more confidence in the microfinance sector and easy access to funding sources. Adherence to all guidelines and regulations issued by the NBC would lead MFIs to effectively conduct sustainable rural financial services. Even with such satisfactory progress, this remains an initial stage. However, there are outstanding objectives to achieve, such as encouraging MFIs to extend their branches in the remote areas and to mobilize savings. These achievements cannot be separated from the support of international donors that encourage the microfinance sector through both technical assistance and funds for sector improvement. In addition, the government's well-directed policy in the Rectangular Strategy has proven crucial in leading to the successful development of the financial sector, especially in the role of microfinance for poverty reduction.

