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Cambodia MSME STTA – Access to Finance

December 2006 Report

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BACKGROUND

This STTA was designed to assist Cambodia MSME to better direct its activities in access to finance, and tasks assigned included the following:

- Review Assessment and Evaluation of MSME Access to Finance.

  This activity will include:

  availability of formal and informal finance, including availability and potential of value chain finance, and to design activities targeted to accessing finance particularly for the project target value chains. Activities will include:

  - Meet with value chain partners to discuss constraints to finance, best avenues for accessing additional finance
  - Meet with banks and microfinance institutions to discuss areas of mutual interest, define partnership activities
  - Review government and other donor interventions for access to finance

- Prepare for Rural and Agricultural Finance Workshop in Phnom Penh

  This task will involve the following activities:

  - Develop an invitation list of 20 – 30 participants for a Rural and Agricultural Finance Workshop, including a balance of representatives of government ministries, financial institutions, value chain firms and representatives (e.g., association representatives), project and USAID staff, other donors, and other relevant project staff.
  - Deliver a Rural and Agricultural Finance Workshop, intended to be an informational session so that participants become broadly familiar with recent work and innovations in rural and agricultural finance, and develop working relationships with each other. The Workshop will also serve as the basis of a planning session to establish next steps and a course of action for increasing access to finance broadly across rural and agricultural sectors.

- Assist the MSME Project to reevaluate existing Access to Finance indicators and targets

- Assist the MSME Project to revise its Second Year Workplan

This activity was conducted in cooperation with USAID's Washington-based BASIS project, which is responsible for developing the workshop materials, and has supported missions worldwide in expansion of rural and agricultural finance. The workshop was delivered December 4 – 7, 2006, and the Summary Evaluation Report is attached as Annex 1.

Time spent in Cambodia for this work included two weeks in October, and ten days in December, including the workshop time.

MAJOR FINDINGS

There are fundamentally two approaches that can be taken in increasing access to finance for MSMEs: working with financial institutions to develop appropriate loan products, and **working with the MSMEs themselves to strengthen their operations and make them more attractive credit clients**. While we do not recommend totally abandoning working with financial institutions, at this point we consider it more constructive to **concentrate efforts on the MSME clients**.

As noted in the report prepared following the October 2006 visit, and attached as Annex 2, the banks and microfinance institutions are particularly focused on ensuring that loans are secured with land and buildings as collateral, and it is not realistic to think that this approach will be dropped any time soon. The notion that lending must be backed by real estate is engrained in everyone – the borrowers and the lenders – and even though foreclosure is extremely rare, all parties recognize the moral suasion of a lien on real estate.

There are additional reasons for not expecting a change in financial institution approach to lending:

1) MFIs are loaned up, and are restricted from making more loans by a lack of funding. As such, they can be restrictive and require that all loans be collateralized this way. Right now the mobilization of deposits is the major focus for the MFIs, which over time should provide a wealth of funds to intermediate.

2) MSMEs, and value chains, are quite weak, and at present are not attractive candidates for financial institution leverage. The absence of substantial value chain relationships, that could form the basis of a credit extension, emerged from the workshop discussions.

The major efforts of the Access to Finance team, therefore, should be devoted to working with clients to understand the financial aspects of their businesses so that they can evaluate whether it makes sense for them to ask for credit, and will be able to present the best possible loan requests to the financial institutions. This will should be the activity that consumes the most resources and time in the coming year.

Cambodia MSME does have the satisfaction that it does have a number of financial institutions that are right-sized, and with the right attitude towards serving microbusinesses and farmers, that it can work with, on what for Cambodia is a conventional basis. Notwithstanding, there may be some opportunities in the future to take additional approaches to finance, and these should not be ignored entirely. These include:

- Development of a financing structure to finance biogas installations
- Development of financing structures to finance agromachinery
- Design of financing structures for larger businesses, e.g., processors
- Continue development of relationships with financial institutions to facilitate introductions of clients and develop sector knowledge within financial institutions
- Work with MFIs and banks on mobilization of deposits by encouraging clients to open accounts

One element that the Access to Finance team will not be working on in the future is referrals of clients to Canadia Bank for loans that would be guaranteed by Canadia's USAID guarantee facility. Per our understanding from USAID this facility will be cancelled because of lack of use. USAID has also indicated that it does not have funding available for any additional facilities.

ASSISTING CLIENTS WITH PREPARATION OF GOOD LOAN REQUESTS

Much of the workplan is already developed to work with clients, in conjunction with Components 1 and 2, on developing better financial planning. The tools that are used to do this should not be complicated or too sophisticated, as the businesses and projects are simple, and both literacy and numeracy are issues for many clients.

The workplan as drawn calls for developing linkages with universities and training facilities, as well as research on best practices of record-keeping for MSMEs and simplification of MEF's Financial Record Template for SMEs. The additions to these recommendations are as follows:

1) **Review MFI and bank loan application forms to determine the information that is requested on these forms**. Ultimately clients need to be able to complete the loan applications, and financial planning is more likely to be accomplished in the context of a loan request.

2) In absence of appropriate financial planning templates in Cambodia, some basic forms are available through DAI and can be adapted by project staff for suitable use.

The types of information that are needed should be limited to the following:

- **Project income statement** – distinguish between fixed and variable costs; include "what if" scenarios (for instance, what if the selling price per kilo is 10% lower); this could also include a series of information questions (for instance, what seller is quoting what price for inputs).

- **Household cash flow** – a summary form that shows all revenue and expenses for each activity of the household, and the net cash position at the end of each month. (A sample form is contained in the RAF Workshop CD as an exercise for Loans to Ag-Based Households.)

These forms can be adapted and standardized for each of the value chains that the project is working in, plus the "what if's" can be customized to reflect particular risks for particular sectors. Note that Credit MFI has volunteered an intern to work with Cambodia MSME on characterizing different value chains, and this could be an appropriate activity for project staff and the intern to work on together.

FINANCING OF BIOGAS INSTALLATIONS

The financing of biogas installations for farmers appears to be a possible niche market for a bank or MFI, and is worth investigating as a specialized loan product that would be based primarily on cash flow rather than on availability of collateral. Realistically, financial institutions will still expect a lien on land, but success will be measured by the financial institution not applying its usual collateral requirements, i.e., the FI would not be seeking 200% coverage of its loan. This is an attractive improvement to a farming operation to experiment with, because the installation being financed will be attached to the land, and the usual concerns about movable collateral being moved should not arise. Since the cost is in the $350 - $400 range, it would be a feasible innovation for many farmers, thus would be widely beneficial.

The best approach to getting this financing would be to do a thorough **documentation of any existing biogas installations** – what are the relevant costs, what are the cost savings as a result of substituting this technology, as well as the increased income (if any) resulting from use. The cost savings plus income, if any, should be applicable to loan payments. While this information may be obtained from the developers/sellers of the technology, the **data should be independently verified by project staff, so that they can knowledgeably educate both clients and financial institution staff** about the costs and benefits.

FINANCING OF AGROMACHINERY

Agromachinery manufacture is a new sector for Cambodia MSME, that has great potential to benefit a range of other sectors. Examples of the types of machinery being manufactured, now on a custom basis, include small trucks for farm use that have an average selling price of $2,700, and rice threshers, which sell for about $950. These are all locally built, using machinery that was originally imported as models. Typically the manufacturers started as repair shops, and are self-taught. The products are regarded as better, and less expensive, than imports. Buyers are required to make a 50% advance payment, with the balance due on delivery. The supply input companies will give the manufacturers 30 to 50% credit for purchases for up to 15 days.

These are large ticket price items for Cambodia, which means that only the best-off businesses or farmers are likely to have the capacity to purchase these items outright. A lack of this kind of equipment is a major shortcoming for Cambodian agriculture, which could widely benefit from more mechanization. The lack of finance appears to be the major constraint to greater ownership of equipment. We note that in most markets for high priced items, the product sale includes arranging for finance to facilitate the purchase. (The rise of Ford Motor Credit, GMAC, and John Deere and Caterpillar Leasing bear witness to this.) Lending for this purpose should be attractive to a financial institution because of the potential resale value, and there are several ways that this might be presented to one or more MFIs as a new product.

Cambodia is in the process of passing a secured lending law that will allow financial institutions to take liens on equipment as collateral. While this will not have an immediate benefit (the law will need a workable collateral registry to support it, and it will take time for borrowers and lenders to have confidence in taking liens on collateral that can be moved), the finance of purchase of such machinery can be a good first step. As with the other loans, the revenue and cost savings benefits need to be documented.

Additionally, the loan could be made more attractive through the development of third party participation in the financing. For instance, the manufacturers could offer a limited warranty on the equipment, that would provide for repairs or replacement under certain circumstances. Another possibility is for the manufacturer to agree, on a best-efforts basis, to re-sell the equipment at the direction of the financial institution or the buyer/borrower. The manufacturer may even agree to buy back the equipment at an amount equal to the loan balance – given that a substantial downnpayment would still be expected (although may come down from 50%) this would pose little risk, since a resale market is expected to emerge as more equipment is available.

Cambodia MSME should also investigate the availability of insurance for the equipment, to cover other types of risk.

The best approach to this type of lending would be to **identify one or more equipment manufacturers in a region with strong reputations, and develop examples of typical costs, revenues, and savings**, as described above. At that point a **brainstorming session with a financial institution – what additional assurances would they want to develop a niche lending product like this** – would be beneficial, to develop a workable product. We would encourage that such brainstorming sessions be held separately with several institutions, and appetite for risk and interest in a niche market are likely to be different, and Cambodia MSME could then focus attention on elaborating a financial product design with the one or two partners which are the most seriously interested.

DESIGN OF FINANCING STRUCTURES FOR LARGER BUSINESSES

The focus of Components 1 and 2 of the project are starting to focus more on larger businesses such as processors, and there are more opportunities to design financial packages for them, that rely on accounts receivable and ongoing contracts from substantial clients with a perceived ability to pay (such as exporters, large retailers, and large hotel operations). The **Access to Finance team can be prepared to work on these as opportunities arise**.

CONTINUED DEVELOPMENT OF RELATIONS WITH FINANCIAL INSTITUTIONS

Cambodia MSME already has established a **pattern of inviting financial institutions along on study tours and to technical presentations to clients, and this should be continued and expanded**. There are two important benefits of doing this:

1) Bankers get to know the clients in a relaxed atmosphere, without the pressure of the first meeting centering around reviewing a loan request.

2) More important, this is an opportunity for the bankers to get to know the sectors better. Bankers most commonly know a little about a lot of businesses, but rarely have in-depth knowledge of a sector. Repeated exposure of this type educates the bankers on the current thinking in the sector, as well as provides information on how to mitigate risk.

CAMBODIA MSME APPROACH TO SAVINGS MOBILIZATION

The Cambodian financial institution market is characterized by a substantial number of microfinance institutions that are an important source of credit for micro and small businesses. These have benefited from great amounts of international interest and assistance from donors and social interest lenders. Most of the MFIs are now private limited companies that are licensed financial institutions, operating under an MFI law, and one MFI has converted to commercial bank status (ACLEDA Bank). A review of the audited financial statements of the MFIs indicates that loan portfolios are growing at double digit rates from year to year, and loan quality appears to be strong.

As elsewhere, the MFIs are constrained by a lack of funds for on-lending. Historically they have relied on donor funding/capitalization, and have borrowed extensively in international markets from multilaterals such as the Asian Development Bank (ADB) and the International Fund for Agricultural Development (IFAD), often through the Rural Development Bank, a government-owned bank that was established to do on-lending. The MFIs are authorized to mobilize savings, but historically have only taken forced savings, because their IT systems have not been robust enough to manage them.

At present there is a strong interest in Cambodia in mobilizing savings and developing savings accounts, both at the MFI and at the community financial institution (CFI) level. This reflects both the need of MFIs for lendable funds and the importance of savings accounts as a coping mechanism for poor people. Unlike animals or gold, deposit accounts address the need for safety and liquidity of savings, as well as providing a return. Internationally in the microfinance field there is a strong interest in savings mobilization, primarily because the availability of safe savings accounts can benefit all poor people, not just those who can use a loan, and secondarily as a source of lendable funds for microfinance institutions.

Clearly the MFI sector in Cambodia will benefit from any help that it may receive in developing savings products, and this assistance may range from marketing advice to IT software and hardware assistance. However, **while savings mobilization is an important financial sector development, direct work in this area is outside of the scope of work of Cambodia MSME**, hence resources should not be devoted specifically to assisting MFIs or CFIs in development of deposit accounts. (If Cambodia MSME was designed to directly assist the financial sector, the development of deposit accounts would clearly be a priority. However, as the project's work in finance is intended to be only one aspect of supporting business development, and is not an end in itself.) Cambodia MSME more appropriately should take the role of being a consumer advocate for deposit accounts, for the following reasons:

- Savings accounts are safer, liquid, and offer a rate of return, thus are appropriate for income smoothing and for building resources
- Maintaining a savings account with a financial institution becomes a form of reference for the client – the length of time that an account is maintained and the average balance are strong indications of capacity to perform on loans. (Further, eventually the MFIs may develop a deposit-based loan product.)

While Cambodia MSME will not be working directly with MFIs on deposit account development, it should be promoting the benefits of deposit accounts to its clients, and should encourage the MFIs to be making presentations on deposit accounts at meetings with project clients.

ANNEX 1

DEVELOPMENT ALTERNATIVES, INC.

TRAINING EVALUATION SUMMARY REPORT

DATE: 7 December 2006

TRAINING LOCATION:	Himawari Hotel, Phnom Penh, Cambodia
DATES OF TRAINING:	4- 7 December 2006
COURSE TITLE:	Rural and Agricultural Finance Workshop
USAID STAFF PRESENT:	USAID staff present at opening and closing; no attendance during the sessions
TOTAL PARTICIPANTS:	First morning attendance plus occasional drop-ins totaled about 40; some 20 participants (3 women) were core attendees, at all or almost all sessions
TOTAL # EVALUATIONS:	20
NAMES OF INSTRUCTORS:	Mary M. Miller (writer)

(1) SUMMARY RATING:

	Excellent	**Good**	**Fair**	**Poor**
Quality of Materials	**8**	**11**	**1**	
Quality of Instructors	**7**	**12**	**1**	
Practical Application	**2**	**14**	**4**	
Overall Course	**2**	**16**	**2**	

(2) COMMENTS FROM EVALUATION FORMS:

Course Topic / Module	Most Useful	Least Useful	Request Improve-ment
Importance of RAF for Development (in Cambodia)	111	11	11
Enabling Environment / Legal Framework	11		
Market Assessment	111111111		1
Getting the Interventions Right	111	11	111
Historical Perspective and the Role of Government		1	111
Value Chain (analysis)	11111	11	11
Agricultural Finance /rural and agricultural finance	11		
Pilot Project (Participant presentation)		1	1
Financial Institutions	1		1
Demanders of Rural and Agricultural Finance		1	
Understanding Rural Markets (how to access loans for clients from MFIs and Banks)	1		
Loan Acquisition and Loan Usage	1		
Roles and Relations of Actors	1		
Simplified Financial Reporting Template (SFRT; Participant presentation)	1		
Institutional Infrastructure	1		
Role of the Donor		1	1
Understanding the Market (suppliers and demanders, enabling environment)	1111		1
Planning and sequencing next steps		1	
Trader Credit and Outgrower Schemes	1		
Leasing			1
All topics useful/none least useful	111		

Requested Improvement to Topics/Other Comments

- I would like to request other courses which are able to (build capacity of) SMEs, including courses on business plans, marketing, and SME management.

- Generally the workshop is good.
- Module 1 should be more relevant to current situation (agricultural sector) in Cambodia.
- Better to conduct (the workshop) in a series (1-2 days) to have more participants.
- Ought to have text, report, or speech of slide lessons [1]
- Need all roles raised to be carried/acted out!
- I think this training is important for Cambodian people, and I want to join the next training session.
- Please organize a TOT on SFRT.
- If possible please organize one more workshop on how to do or implement the value chain successfully.
- There should be more participants from the government sector and other microfinance institutions.
- We should study about the farmer living in the rural part of Cambodia and compare to other developing countries.
- I think the workshop is very good. If we (want to have successful projects) we need donors from outside the country to support them.
- It was very helpful to have a good cross section of sectors, i.e. government, implementers, MFIs, etc.
- I would like to have another course like this for next year if it is possible.
- (If you conduct the workshop again) all MFIs should be encouraged to present about their products so that all participants, especially the representatives of SME farmers know about these products.

TRAINER'S REMARKS:

This workshop was delivered through the collaborative effort of Cambodia MSME, a USAID/Cambodia project implemented by DAI, and USAID's BASIS project, which developed and delivered the workshop in a range of countries and circumstances. This workshop was intended to be a kickoff activity for the Access to Finance component of Cambodia MSME.

The agenda for the workshop was as follows.

Day 1

- Welcome by USAID – Reed Aeschliman, OGD Director, USAID/Cambodia
- Module 1, Importance of Rural and Agricultural Finance for Development in Cambodia
- Module 2, Session 1, Understanding the Market - Who are the Demanders of Rural and Agricultural Finance
- Module 2, Session 2, Who Supplies Rural and Agricultural Finance – Financial Institution and Value Chain Lenses. This included the Value Chain exercise, which was useful in introducing the concept of value chains, little understood in Cambodia. Leasing as a form of finance is not known or understood. The MFI was the most active financial institution in the discussion, in large part because of the strong presence of MFIs in the country.
- Module 2, Session 3, Enabling Environment; four short case studies. Groups performed particularly well on these exercises, and were easily able to hone in on the problem highlighted in the case.

[1] Note: Workbooks included all powerpoint slides, and participants were given a diskette of the powerpoints, handouts, and intervention option packets.

Day 2

- Module 3, all sessions, Market Assessment – This was followed by a group exercises to draw a diagrams of the value chains for pig raising, fish farming, agricultural machinery manufacture, vegetable farming, and handicrafts. Since there were a number of financial institution representatives in the room, this group was assigned to create a table of the types of financial institutions in Cambodia, their typical clients and products, and potential clients and products.
- Presentation of diagrams on the value chains, and table of bank services. Two of the value chains, handicrafts and agricultural machinery manufacture, were presentations on particular projects underway at present. The handicrafts presentation was about a raffia weaving project set up for poor women, returning refugees from Thailand who weave product for sale to Thai companies, apparently consolidators that then exported the product to western markets. However, it was pointed out by the presenter that the project target group did not know anything about to whom the products were on-sold, i.e., the low level of market information meant that the group currently has no way to look for more or new buyers; that raw materials substitutions are needed; as well as new designs.
- Presentation by AMRET (MFI) on its loan products. While we had requested that the presentation address a particular product/intervention to address a particular client need, the presentation was more generic.
- Module 4, Session 1, the Role of Government, included exercise on the Banco Agrario del Peru. A subsequent discussion the following morning re-covered the issue with subsidized interest rates, as more than one participant was calling for the government to provide guarantees so that MFIs could borrow more cheaply abroad, hence make lower rate loans to clients. This was steered to a discussion of the benefits of encouraging savings and the importance of mobilization of savings.

Day 3

- Presentation by Vong Sarinder of the Cambodia Community Financial Networks (CCFIN). This is a PVO that organizes village bank-type savings groups, and also allows individuals to borrow from the group savings. A major problem cited was greater loan requests than collected savings in some areas, and CCFIN has not yet worked out a way to intermediate funds between groups. (It was suggested that this might be done by bringing in an MFI as an intermediary.) This presentation also spurred a discussion of trust in financial institutions (few people have accounts; banks tend to be trusted, and MFIs are not – apparently because the institutional type is not known enough.) This presentation was done in lieu of an Intervention Option presentation on Rural Savings Mobilization.
- Module 4, Session 2, Interventions – the following interventions were covered through presentation of power point slides, without casework. Ordinarily this is the most active, interesting part of the workshop, but in this case was effectively a low point. As the workshop was being done in translation it was not appropriate to use the café society training technique or case studies (while materials were provided in English on a diskette, they had not been translated) and perhaps more important, there was no local knowledge or experience in using these mechanisms in the country.
    - Outgrower Schemes and Trader Credit – most discussion centered on the potential of outgrower schemes, although none of the participants could cite an instance of this mechanism in use in Cambodia (other than the organic vegetable growing scheme described below, and the raffia-weaving project described above).
    - Agriculture-Dependent Household Loans – this included a discussion of ag lending by the financial institutions represented in the room, which ranged from 10% of portfolio (CEB) to 20% (Credit MFI) to 30% (PRASAC) and a high of 50% (Rural Development Bank). CEB noted that it was focusing more on agricultural loan

cycles, as well as monitoring market prices for agricultural commodities. All of the financial institutions are now offering a loan product that is interest only, with a balloon payment that coincides with the harvest.
    - Credit Enhancements and Credit Guarantees
    - Movable and Immovable Collateral
    - Credit Bureaus – there is some work being done on this in Cambodia, at present only at the bank level. Joining this effort may be something that the MFI association should consider.
- Presentation by David King, DFDL, on Sample Financial Reporting Template (SFRT), a financial statement format for SMEs being adopted under the supervision of the Ministry of Economy and Finance. This will be available in an electronic spreadsheet format in the second quarter of next year, such that a set of financial statements will be generated by filling in footnote information entries. The project will be looking for training partners to have this presented around the country. The tool generated considerable interest from the participants. This presentation was done in lieu of a presentation on Business Development Services to Value Chain Actors.
- Not presented:
    - Warehouse Receipts – although the lack of silos to protect output from the weather so that sale could be delayed was noted by participants as a constraint
    - Index-based Insurance
    - Leasing – David King did advise that a leasing law is being considered.

Day 4
- Presentation by Mam Many of the Ministry of Commerce on a pilot program for growing organic vegetables by poor farmers for sale to high end hotels in Siem Reap. Some production has started, and the project is seeking donor funding for establishing a center and providing working capital to farmers. This structure is as close to an outgrower scheme as was known by the group. One MFI representative (from CEB) indicated that he would be interested in "lending into" the scheme, i.e., primarily relying on an assignment of and direct payments from the hotels to cover loan repayment.
- Module 4, Session 3, Role of the Donor
- (Special Considerations session not presented; Module 5 on Measuring Impact not presented, both by prior decision.)
- Planning Session – results are shown below

While the workshop was well-received, much of the material and interventions are geared to a market that is a bit more developed and sophisticated. For instance, while it is possible to find some sales of product up a chain, and some limited amounts of credit within a chain (e.g., between traders and farmers for inputs, and between farmers and traders or other buyers for purchase of output with payment delayed for a few days), the chains themselves are not well developed. Most farmers, for instance, are selling to local traders for resale in the local market. There are virtually no processors who would add value to the product, and only the fish market currently seems to have any export prospects. In the short run the best target seems to be to improve quality and cost management for import substitution. There also should be some prospect of growing niche products for local high end markets, i.e., high end hotels in Phnom Penh, Siem Reap, and Sihanoukville.

There was quite a bit of discussion throughout the workshop about lending against contract payments, and although there was a lot of interest by the financial institution representatives, two major issues cited were the need for scale (i.e., having enough potential transactions to warrant developing the product) and regulatory issues, specifically the lack of a secured lending law and attendant lack of a collateral registry.

During the workshop participants particularly noted the following constraints to the development of agribusiness and rural and agricultural finance:

- Low level of business skills among farmers
- Low level of technical knowledge
- Limited knowledge of financial institution lending products
- Illiteracy
- Lack of a secured lending law (only land can be pledged as collateral)
- Lack of silos, storage facilities
- Poor roads
- Lack of clarity on MFI ability to mobilize deposits – the law and regulatory pronouncements have contradicted each other. The general view is that MFIs can only take deposits in the areas where they operate.
- Inconsistency and arbitrariness of legal enforcement and jurisdiction – instances cited including having problems in getting an acknowledgement from a village chief re a pledge of land because of the borrower and the village chief being in different political camps; also the village chief allowing a property to be sold with a lien in place ("I forgot about that").

Suggestions for changes/additions to the materials:

If materials are re-presented in Cambodia it would be worthwhile to translate the relevant intervention option packets, and to develop local case studies to illustrate the application. It could be useful to develop a series of one or two hour information sessions, drawing from the materials, particularly the intervention options.

Planning Session Results

Participants were divided into three groups for planning sessions, and were asked to list the major constraints and opportunities that they saw for expanding rural and agricultural finance, and were also asked to suggest what action should be taken and who should initiate the action. The group reports were similar, thus results are grouped below. The reports were weak on implementation – it was easy to identify problems, but the problem resolution seemed to mostly be left to government (despite the universal recognition that government corruption was an overarching problem) or either the World Bank or Asian Development Bank. It did not seem that anyone in the group considered that they might take the initiative to work on addressing these problems.

Major Constraints:

- Corruption – overarching problem identified by all groups, to the point that they expect that foreign governments and donors may refuse to work in the country.
- Infrastructure, particularly the lack of irrigation – regarded as a problem that should be addressed by government and donors
- Secured lending law and collateral registry, land title registration – government, particularly relevant ministries
- Need to identify markets, improve quality, technical skills, establish quality standards, business skills – NGOs and ministries
- Sources of finance – lack of client knowledge of sources, credit staff capacity, limited outreach of MFIs, lack of technical knowledge – financial institutions and NGOs
- Need for market information – could be addressed both by government and private sector. One suggestion was that weekly market price lists might be published and circulated through networks, including MFI branches and CCFIN.

ANNEX 2

MSME Component Three, Access to Finance

Findings and Recommendations

October 2006

Mary Miller, Writer, with Pen Sovannsoksitha

This report was prepared as a part of Mary Miller's STTA to Cambodia MSME, focused on strengthening access to finance for the value chains that the project is assisting: swine raising, fisheries, tile manufacturing, and equipment manufacturing. The two basic tasks under this STTA are to assess and evaluate current access to finance and recommend project interventions to expand access to finance, and to prepare for a Rural and Agricultural Finance Workshop that will be sponsored by the project in December, 2006.

This report largely addresses findings on the current availability of finance in Cambodia, based on reviews of prior reports and studies and meetings with financial institutions and project clients, conducted in October 2006, and includes recommendations for future project activities. Industry interviews were focused on the swine-raising sector because Miller and Pen accompanied a study tour for Kratie pig farmers and others (trader, livestock agents, input supplier, local banker) to visit successful pig farms in the Kampong Cham area. MFI interviews were held in the Kampong Cham area, and bank interviews were conducted in both Kampong Cham and Phnom Penh.

Financial Sector

Overall the financial sector in Cambodia is weak, and estimates are that outstanding credit is equal to only 8-10% of GNP, suggesting that little intermediation is going on, and that business asset growth is restricted to limited equity contributions and retained earnings. With some exceptions, the commercial banks are not interested in MSMEs. There are some bright spots, however, including a **particularly strong microfinance institution sub-sector**.

Legal and Regulatory Environment Overall the enabling environment is weak. There is a microfinance **law that licenses microfinance institutions to lend and to mobilize savings** deposits. However, **collateral is limited to land**, and liens on assets other than land such as equipment, inventory, and accounts receivable, are not enforceable. Reportedly a secured lending law is being considered, but establishing a functioning movable collateral registry may take some time. It appears that **not even vehicles can effectively be pledged as collateral**, because there is no mechanism to register liens.

Land records are not good, and there are substantial disputes over ownership. Lenders indicated that one of the most useful things that donors could do would be to support better titling, so that the land titles would be clearer and could be issued more easily. The MFIs take a shortcut of sorts in taking land as collateral, which is to get the **local village head to confirm that the borrower owns the land**, but it is unlikely that this would have legal force in a court dispute and may not be suitable for larger loan sizes.

It is hard to understate the importance that all parties attach to land. All lenders insist on having land pledged on loans (although some lenders may also take other collateral and lend relatively more to long time, established clients) because ownership of the land, and the potential for it to be lost, is culturally paramount. Overall the lenders do not expect to ever foreclose (and no lender could cite an actual case of selling land to get a loan paid) but do recognize the significant moral suasion of taking a lien on land and buildings, even if not enforceable.

Microfinance Institutions A range of donors, including USAID, have been active in the past few years in supporting the development of MFIs, and the result is that there is a vibrant finance market available to smaller businesses both in Phnom Penh and in the regions, including the four provinces where Cambodia MSME operates. The **MFI sector is strong, and seems to approve loans on the basis of appropriate analysis (5 C's, etc.)** and on a timely basis, within a few days of application. As noted above, land and buildings are required as collateral for loans, but MFIs will occasionally take other collateral as well to secure larger loans for established clients.

Cambodian Microfinance Institutions

Data as of 31 December 2005

Name	Loan Portfolio Value, US Dollars	Number of Borrowers	Average Loan Size
ACLEDA*	99,900,701	140,920	709
AMK	2,444,107	36,221	67
AMRET	11,600,497	121,699	95
CEB	6,282,784	11,119	565
Credit	2,563,930	11,451	224
HKL	3,755,272	8,475	443
Prasac	11,459,411	82,545	139
TPC	4,549,733	43,194	105
VFC	3,445,767	25,347	136

*previously an MFI, now a licensed commercial bank

Source: www. Mixmarket.org

While previous surveys have indicated that the MFIs tended to offer rigid terms, recent interviews suggest that **more flexible loan products are now available**, which allow for interest only payments until cash flow is positive, as in agricultural lending. Maximum loan terms for SMEs are typically 24 months, and 12 months for agricultural loans.

There are usually two loan products available, a **group loan** (for which the group leader must have land as collateral) and an **individual loan**, which will be for as much as $10,000 or the riel equivalent. In general individual loans are preferred, and at least one MFI, the Cambodian Entrepreneur Building Limited (CEB) indicated that it had virtually no group loans. Loan repayment appears to be fairly high, and microfinance agencies such as the MixMarket give the Cambodian MFIs high ratings for transparency.

A major issue for the MFIs in the coming months and years will be the availability of funding for on-lending. As noted above, the MFIs are licensed to take savings deposits, but to date have relied on equity (from donors) and soft loans for funding. At present there is an interest in mobilizing savings, and **some of the MFIs have started to promote savings products**. It is likely that reliance on donor sources was and is an easier path, but it is also significant that only now are the MFIs getting MIS systems that are robust enough to manage deposits. One of the MFIs indicated that for the time being, savings could only be accessed from the branch where the account was located and deposits made, that institution-wide transactions would be possible once the MIS system was on line.

Access to safe places to deposit money will be a significant benefit for Cambodia MSME's clients. **Two advantages** that should eventually accrue are 1) clients get used to dealing with the financial institutions, and the **financial institutions get to know the clients**, and 2) maintaining a deposit account over a period of time becomes **an excellent reference** for a client. (There are countries in which credit offered is based on a percentage of deposits, and credit analysis consists of reviewing the activity in the deposit account.) Right now, however, there is a deep distrust of financial institutions and no experience in maintaining deposit accounts, so it is likely that the deposit business will be slow in developing. Microentrepreneurs typically do not maintain any kind of depository accounts, preferring to keep cash at home, although SMEs will have bank accounts.

There are limitations or concerns about the MFIs that should be mentioned. Maximum loan size is around $10,000 for most of the MFIs, which means that medium sized businesses, and some small businesses, do need access to bank finance. Banks are generally looking for 200% collateral on loans, which is high. Given the number of MFIs and the lack of a credit bureau system, or even a black list, the possibility of several MFIs lending to the same clients is a hazard. Since the MFIs are growing fast, the adequacy management controls as well as continued staff training are challenges. Overall, however, the MFIs are a strength of the Cambodian business system, and should be regarded as allies to Cambodia MSME.

Banks The commercial banks in the country are largely considered to have no interest in the MSME market. The four institutions which do serve the market to some extent or potentially would have an interest in doing so are listed below.

ACLEDA Bank Portfolio statistics for ACLEDA Bank are shown above. This was formerly an MFI that now has a regular commercial banking license, and is owned by a mix of international organizations such as IFC and Triodos. In many respects **ACLEDA Bank** is the leading MFI, as it does have a substantial microfinance portfolio. Since it **has the resources to do larger loans it is expected to be an important partner for Cambodia MSME** in accessing finance for larger businesses. ACLEDA Bank is also **actively pursuing the deposit account business**, and will be introducing ATMs next year.

Canadia Bank This is the largest bank in Cambodia, and is privately owned. **Canadia is a participant in a USAID MSED[2] $5,000,000 portfolio guarantee for loans to small and micro businesses, as well as loans to MFIs for on-lending**. The facility has not been used

[2] MSED was the predecessor program to DCA. The substantial difference in MSED and DCA for this deal is that the subsidy cost was not paid by the Cambodian mission, but was paid by USAID Washington. The MSED/DCA guarantee offers a pari passu guarantee of 50% of loan principal.

since it was put in place in September 2004, although the bank has recently indicated that it intends to start lending to MFIs.[3]

Canadia Bank also participates in an **SME lending scheme with KfW**, which may be a source of credit for larger project clients. While the KfW loans nominally can be used anywhere in the country, in practice borrowers must come to Phnom Penh to apply for the loans. These are 3 – 5 year loans for $10,000 - $200,000.

It also has a facility from the IFC to do mortgage lending, which it only uses for financing properties that were developed for sale by a subsidiary.

Rural Development Bank This is a government-owned bank that was established to be a wholesale source of funds to the MFIs for on-lending, but does not appear to have functioned well both because of cumbersome procedures and because of a confusion between its retail and wholesale role. While considerably more investigation is needed, this bank may be an appropriate partner for greater rural access to credit.

ANZ Royal Bank This Australian and New Zealand-owned bank is a recent entrant to the banking market in Cambodia, which is introducing ATMs to the market and is interested in developing more of a middle class consumer clientele. The bank will be **opening a branch in Kampong Cham in the second quarter of 2007**.

ANZ Royal Bank is still defining its initiative for SMEs, but expects to have a plan in place in 2007. Its long term strategy is to focus on SMEs, although it never expects to reach micro business clients. It is also reviewing what the bank department structure will be, and has not yet chosen the person who will be in charge.

In addition to ATMs, the bank is developing an internet banking capability, and **will start testing point of sale (POS) terminals** in areas where the bank has branches. It should be aggressively marketing this service next year. It is also developing a wireless ATM capacity. It is looking at developing utility bill payment through its ATMs, and the biggest problem thus far has been in dealing with the state companies that offer these services.

At present the bank has 20,000 accounts for a total of $170 million of deposits, which ranks it as the first or second largest depository in the country. More than half of the deposit clients have never had a deposit account before.

The bank's minimum loan size is currently $20,000, although it is looking at developing loan products for lower amounts. The interest rate charged is based on the risk rating. For local, stable industries it expects to charge 10 – 15% per annum. Right now the bank sees hotels and real estate as risky because of overinvestment, and subject to economic forces.

In summary, **ANZ Royal is committed to the market, including going down-market to SMEs. While cooperation with the bank may be premature** at this point, because the bank is still establishing its policies and is not yet operating in Kampong Cham, it will be important to maintain contact as the bank should become a major partner in the future.

Overall the banking market is not great, but there do seem to be some potential partners to work with on developing credit for SME clients.

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[3] Cambodia MSME has been asked to assist Canadia Bank in analyzing/selecting MFI borrowers. The project may also refer SME clients to the bank for consideration of loans that would be guaranteed by the facility.

Business Sectors – Value Chains

The comments below are based on general observations of the project's target sectors, as well as specific discussions with participants on the swine-raising study tour, but should not be regarded as exhaustive or complete. Comments below do particularly pertain to the swine sector.

Observations:

- Value chains are weak, and offer little leverage. In general, the **chains are quite short** – a farmer sells to a trader, who sells to a retailer who sells in the local market or in Phnom Penh. While some value is added at each stage and the project is working on adding value to the process, competition is tough, and seems to be largely on the basis of price. (Right now smuggled pigs from Vietnam are creating substantial havoc in the market.)
- There is **some finance available through the value chain**, if personal relationships exist. Most pig farmers, for instance, will give a pig trader 3 – 5 days to pay for a pig, if they have known the trader for a while. The input supply company will give a shipment's worth of credit, collecting for the last shipment at the time of the delivery of the current shipment. Input suppliers will wait to be paid when a pig is sold, which would amount to some weeks of credit.
- There are **few big players that can be leveraged**. In general value chain finance can be increased if there is a large player in the market who can give greater amounts of credit, or even better enhances the smaller player's operation enough that the smaller player is a more attractive credit client for a financial institution.
- The **larger players in the value chain are fairly passive**. For instance, there is a fairly large pig farmer (600 pigs at one time) who (in addition to raising and selling pigs directly) sells piglets and sows, sells feed, and sells and administers vaccines and medicines. This farmer might be a linchpin for doing more volume business, and does give some credit to the farmers that he supplies. However, he is not a middleman on pig sales – does not take pigs in payment, nor does he act as a middleman for pig sales. There could be **opportunities that could be created if larger farmers of this type could or would act as organizers as well**, e.g., doing large volume selling into the Phnom Penh market, sourcing pigs both from his own activities as well as from the farmers that he supplies.
- The value chains also need more **large player end-users**, who need high volumes and/or particularly high quality product, such that they are **motivated to assist their suppliers** (both through provision of technical assistance and facilitating access to finance) in meeting their needs. An example of this might be a sausage manufacturer in Phnom Penh who was targeting high end hotels and restaurants; an exporter is another.

Opportunities for Interventions on Access to Finance

Look for equipment finance opportunities, either for larger farmers/actors who can use such equipment themselves and also rent or provide services to their neighbors, or for association/collective purchase of equipment. Despite the lack of an appropriate collateral law, this intervention could greatly benefit the quality and quantity of output. Banks that may be interested in such finance opportunities include Canadia, ANZ Royal, and ACLEDA.

Financial leasing may be appropriate, and may be a way to create a different mindset with respect to the requirement that land must always be provided as collateral.

Support credit bureau development.

Support initiatives to enact a collateral law and create a collateral registry for movable collateral. At present it is not even possible to pledge motor vehicles as collateral, but since there is a vehicle registry, this should be relatively easy to implement.

Encourage lending based on cash flow and collateral other than land (including lowering the current 200% collateral requirements). The MSED/DCA guarantee facility at Canadia Bank is a good vehicle for this, and if Canadia will start doing some SME loans for equipment under the facility (which may include nominally also taking some lien on land) this may encourage ACLEDA and ANZ Royal to do the same, to keep up with the competition.

Start/continue inclusion of bankers in value chain activities. Right now the value chains are weak, and do not particularly warrant consideration as the basis for lending. However, the bankers need to understand the concepts of how value is being added. A year or two down the road some credit may be justified, but the banks need to grow up with the concept, not just have it presented to them at the end. Further, including bankers in value chain activities gives them an opportunity for more education about business sectors.

Develop association/collective approach through NGOs providing fingerlings, or through larger farmer/operators as buying/selling groups. There is more strength in numbers for dealing with financial institutions.

Sponsor bank/MFI presentations about the benefits of deposit accounts and other account services such as transfers. At present these are virtually unknown in the market, but offer great benefits to clients such as safety of savings. An added benefit is that a deposit relationship with a bank becomes a substantial reference for credit.

Focus on contract grower/outgrower schemes – add more value, create specialty products that are more competitive and make businesses more attractive to banks, because business operations are not based solely on price competition.