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Reforming Microfinance in Cambodia: Towards Sustainable Poverty Alleviation in the Post-COVID Era

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Abstract

Cambodia experienced robust economic growth in the 2010s, but the COVID-19 pandemic caused a significant economic contraction in 2020. Despite a strong vaccination campaign and subsequent economic recovery, poverty remains a critical issue, with a significant portion of the population living in or vulnerable to poverty. Microfinance has been promoted as a key tool for poverty alleviation; however, Cambodia's microfinance sector faces challenges such as high interest rates, collateral requirements, and over-indebtedness among borrowers. This paper explores the history and current state of microfinance in Cambodia, highlighting the discrepancies between its implementation and the original principles of microfinance as envisioned by Muhammad Yunus. It calls for reforms to lower interest rates, adopt more humane debt collection practices, and integrate microfinance with social security systems to better support those in need. These measures are essential to ensure that microfinance can effectively contribute to poverty reduction and sustainable economic growth in Cambodia.

Keywords: Cambodia, COVID-19, Microfinance Institutions (MFIs), Financial Inclusion, Poverty Alleviation.

1. Introduction

In the 2010s, Cambodia experienced strong economic growth. However, the outbreak of the COVID-19 pandemic at the end of 2019 led to an economic growth rate of -3.14% in 2020, marking the first instance of negative growth since the early 1990s. Fortunately, with over 98% of adults vaccinated with two doses, Cambodia ranked second globally, just behind Taiwan, in the COVID-19 recovery index published by Nikkei Asia in early 2022 (Li, 2022). The government's policy of coexisting with COVID-19 is expected to lead to economic growth of 5.5% in 2023 and 6.0% in 2024, returning to near pre-pandemic levels (ADB, 2023).

However, the benefits of Cambodia's economic growth over the past 20 years have not been evenly distributed among all its citizens. According to estimates from the United Nations Development Program (UNDP), although the poverty rate has been declining since 2014, 16.6% of the population still lived below the national poverty line in 2022 (Khmer Times, 2023). Cambodia's official definition of the poverty line in 2020 was an income of less than 10,951 riel per person per day, which equates to less than 2.7 USD per day (World Bank, 2022: 27). Nevertheless, according to the Global Multidimensional Poverty Index (MPI) published by the Oxford Poverty and Human Development Initiative (OPHI), which assesses poverty based on health, education, and living standards, 4.1% of the Cambodian population was living in severe poverty, and 20.5% were vulnerable to poverty in 2023 (OPHI, 2023). The latter group hovers around the poverty line and can easily fall into deeper poverty due to factors such as illness, accidents, unemployment, or crop failures caused by natural disasters. In other words, it is estimated that over 2.4 million Cambodians are at risk of falling into a poverty trap.

2. Historical Context and Microfinance Initiatives

Since the 1990s, international development institutions like the World Bank have identified poverty reduction or eradication as one of the primary goals of official development assistance (ODA). This goal was later incorporated into the United Nations Millennium Development Goals (MDGs) and Sustainable Development Goals (SDGs). The World Bank and its affiliate, the International Finance Corporation (IFC), regard microfinance as an effective tool for poverty alleviation and have actively promoted it.

Why is this the case? Poor people often do not qualify for commercial bank loans due to a lack of stable assets and income. Microfinance institutions (MFIs) specifically target these individuals, providing small loans that enable them to engage in business and agricultural activities, thereby promoting employment and increasing income, ultimately helping them escape poverty. The Bangladeshi economist Muhammad Yunus exemplified this concept by founding Grameen Bank, which improved the economic conditions of rural women in Bangladesh and earned him the Nobel Peace Prize in 2006. Yunus firmly believed that "the poor always repay their debts" and that

"given the opportunity, they will seize the chance to improve their circumstances" (Dowla and Barua, 2006). Grameen Bank provides poor people with access to financial markets, breaking the cycle of extreme poverty. This expansion of financial services to previously neglected individuals and small enterprises has recently been referred to as financial inclusion.

3. The Evolution of Microfinance in Cambodia

Microfinance (credit) as a tool for poverty eradication began to receive support from international organizations such as UNICEF, the ILO, USAID, the French Development Agency (AFD), and other large international NGOs in Cambodia in 1989. These organizations provided microloans to rural residents. Following Cambodia's transition to peace in the early 1990s, even more international organizations and NGOs began implementing rural credit programs.

In 2000, the National Bank of Cambodia (NBC), the country's central bank, issued an administrative order requiring non-profit organizations with a capital of more than 250 million riels (approximately \$62,500 today) involved in microcredit to apply for a microfinance institution license. Many microfinance programs originally executed by NGOs became independent financial institutions. For example, ACLEDA Bank, currently the largest bank in Cambodia by assets and branches, originated from an NGO funded by the ILO and UNDP. It transformed into a commercial bank in 2003. Other significant MFIs, such as SATHAPANA Bank, followed similar paths, transitioning from NGOs to microfinance institutions and eventually to commercial banks while continuing to offer small loans.

According to NBC statistics, by the end of 2020, Cambodia had 79 microfinance institutions (MFIs) with a total of 749 branches and service points. This figure excludes three now commercial banks—ACLEDA, SATHAPANA, and HATTHA—that were former MFIs and were still permitted to offer small loans after transformation. The number of MFIs rose to 87 at the end of 2023, though two major MFIs transitioned into commercial banks within three years, suggesting that ten new MFIs entered the market driven by expectations of substantial profits.

Despite the absence of formal diplomatic relations between Cambodia and Taiwan, Taiwan-based banks and financial companies have entered Cambodia's MFI sector. For example, the Taiwan Business Bank kicked off its TBB MFI Plc. in 2015, and the Shanghai Commercial and Savings Bank acquired an 80.1% stake in AMK in 2018, one of the top three MFIs in Cambodia before the pandemic (AMK, 2018). Additionally, in May 2024, SinoPac Financial Holding Company announced its plan to acquire Amret, Cambodia's largest MFI by branch count, for an estimated USD 543 million (Kawase, 2024).

Cambodia's microfinance system from the outset differed significantly from Yunus's model. Grameen Bank offers loans at a uniform 10% interest rate regardless of amount or term, with the expectation that loans are used for self-employment, fostering entrepreneurial spirit and poverty alleviation. In contrast, Cambodia's microfinance system operates differently:

(1) Interest rates were initially very high

Heather A. Clark (2020), an Australian journalist documenting ACLEDA's transformation, estimated that before 2000, Cambodian microloan interest rates exceeded 60% annually. Following the enactment of the Real Lending Act in 2000, rates fell to 48%. After 2005, with more MFIs entering the market, rates continued to decline but still exceeded 20% in 2015. American scholar Maryann Bylander (2016) estimated that in 2011, the median microloan amount was \$300, with a median monthly interest rate of 2.7%, equating to an annual rate of 32.4%. Yet, Cambodia's per capita income in 2011 was only \$882.28.

(2) Diverse financial products

Cambodian MFIs do not restrict loan purposes and offer an increasingly diverse range of financial products, including consumer loans for purchasing motorbikes, phones, and appliances. This approach makes Cambodian MFIs resemble traditional financial institutions or financing companies.

(3) Aggressive marketing triggered by intense competition

High demand and interest rates in Cambodia's microfinance market have attracted many institutions. Despite market competition driving down interest rates, they remain high. Intense competition has led to aggressive marketing tactics, such as encouraging borrowers to take new loans to repay old ones or to borrow money for travel expenses to work in Thailand.

(4) Unaffordable loan

Cambodian MFIs often require collateral or guarantors, leading to situations where borrowers, unable to repay due to illness, natural disasters, or other factors, face the threat of losing their livelihoods. This drives rural farmers to extreme measures, such as cutting expenses, sending children to work, or seeking employment in Thailand to avoid land seizures (LICHADHO and Shkmakum-Teang-Tnaut, 2019).

4. Challenges and Criticisms

The high interest rates of microfinance loans have caused unrest in rural areas. Many rural residents mistakenly believe that MFIs or banks are state-owned or government-funded, possibly due to misleading sales tactics by MFI staff. This perception has prompted official responses. Ahead of the June 2017 local elections, Prime Minister Hun Sen demanded that ACLEDA and Prasac change their logos, as they resembled those of the

Ministry of Economy and Finance and the National Bank of Cambodia (NBC). ACLEDA spent \$3.5 million to rebrand, while Prasac promptly removed its logo from ATMs, leaving them blank (Chan, 2017). Hun Sen also ordered telecom companies to send text messages clarifying that MFIs are privately owned. In mid-March 2017, the NBC issued a directive capping microloan interest rates at 18% annually to quell public discontent (Heng et al. 2021). However, the Cambodia Microfinance Association (CMA) complained about the lack of prior consultation and suggested raising fees to maintain profitability.

According to the CMA, around 2.2 million out of Cambodia's 10 million adults had unpaid microcredit loans in 2019. The average debt amounted to \$3,320, roughly twice the country's annual GDP per capita. The credit sector was experiencing a 40% annual growth rate (Economist, 2020), making Cambodia one of the countries with the highest microfinance penetration rates, with many customers falling into over-indebtedness. In early June 2017, The Phnom Penh Post reported on a woman in Kandal province who complained about a microloan with a monthly interest rate of 3.5%, equivalent to an annual rate of 42% (Willemyns and Dara, 2017). In the June 2017 local elections, the opposition party, although not winning a majority, secured nearly 30% of commune chief seats and 43% of commune council seats, possibly reflecting public discontent with microfinance.

After several COVID-19 outbreaks in February 2021, the Cambodian government imposed strict lockdowns and curfews, severely impacting livelihoods. Many media reports highlighted the dire situation of rural borrowers. An AFP report from Trapeang Veng village in Siem Reap province described how three-quarters of the village's 113 households were indebted, owing a total of \$300,000 (Reap, 2020). By the end of 2020, the NBC reported that 18% of all outstanding loans were microloans, totaling \$6.7 billion (Amarthalingam, 2021). Human rights groups, including Equitable Cambodia and the Cambodian League for the Promotion and Defense of Human Rights (EC and LICADHO, 2021), estimated the total debt, including banks and MFIs, at \$11.8 billion. The pandemic exacerbated the plight of many already over-indebted microloan borrowers, pushing some who could previously repay into deeper financial trouble, creating a vicious cycle of debt.

In May 2020, opposition figure Sam Rainsy, who had been in exile for many years, called for a debt repayment strike on Facebook, urging borrowers to refuse repayment. Human rights groups also issued open letters requesting MFIs to offer leniency on repayments, but these were rejected. Although Prime Minister Hun Sen publicly acknowledged the borrowers' struggles and called on financial institutions to show understanding, he simultaneously warned that non-repayment due to opposition incitement would result in land seizures (Turton, 2020).

If borrowers fail to repay, MFI profits suffer, and non-performing loan rates rise. An IFC (International Finance Corporation) spokesperson noted that in 2020, there were 66,500 restructured loans totaling over \$1 billion (McLellan, 2020). Fearing the collapse of Cambodia's microfinance system, international development institutions

provided funding. In June 2020, the IFC announced \$25 million each for HATTHA Bank (formerly Hattha Kaksekar Ltd.) and AMRET for women-owned small and medium enterprises (IFC, 2020a, 2020b). Additionally, Japan's International Cooperation Agency (JICA) provided a loan to RHB Bank to help borrowers, particularly garment workers, affected by the pandemic.

5. Conclusion

Despite regulatory efforts, the high-interest rates and collateral requirements of Cambodian MFIs have led to significant debt burdens for borrowers, particularly in rural areas. During the COVID-19 pandemic, strict lockdowns and economic disruptions exacerbated these challenges, pushing many borrowers into severe financial distress. Reports indicated widespread over-indebtedness, with debtors struggling to repay loans and facing the threat of land seizures.

Government interventions, including a 2017 directive capping microloan interest rates at 18%, aimed to address public discontent and curb exploitative practices. However, MFIs responded by increasing fees to maintain profitability, highlighting the ongoing tension between financial sustainability and social responsibility.

The Cambodian microfinance sector represents a complex interplay of economic development, poverty alleviation, and financial inclusion. While microfinance has the potential to uplift the poor, its implementation in Cambodia has often deviated from the ethical principles championed by pioneers like Muhammad Yunus. The high-interest rates and aggressive lending practices have, in many cases, deepened poverty rather than alleviating it.

Future efforts must focus on balancing the financial sustainability of MFIs with the socio-economic needs of vulnerable populations. Enhanced regulatory oversight, ethical lending practices, and comprehensive support for borrowers are crucial to ensuring that microfinance fulfills its promise as a tool for poverty eradication in Cambodia.

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