Microfinance in Cambodia: Development, Challenges, and Prospects

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I- Introduction

Microfinance is widely regarded as an effective tool in reducing poverty, thus aiding countries in achieving millennium development goals. It is defined as a financial service for the small and micro-entrepreneurs, and individuals without access to traditional banking systems. Commercial banks do not want to extend credit to the poor because they lack collateral, do not have stable streams of income, and are not creditworthy. Therefore, it is very risky to lend to the poor. In addition, the small loan size normally demanded by poor borrowers requires higher transaction costs, and thus it is not profitable. Until the concept of microfinance and its practice was widespread, the poor had been deemed un-bankable. Proponents of microfinance believe that the poor possess feasible business ideas and entrepreneurial talents, but without access to finance, they are unable to unleash their talents, and so are trapped in poverty. Because it is unlikely or difficult to access formal finance, these entrepreneurs often turn to informal sources such as village moneylenders or loan sharks, who charge exorbitant interest.[1] The high interest rates reduce their profit margins significantly, and often render financing their micro-business project unviable.

Lacking access to finance causes difficulty to the poor, regardless of their income generating activities. Farmers do not have working capital to invest in seeds, fertilizers, or wages for farm laborers. Those who are working in informal sectors such as petty traders or street food vendors may not be able to replenish their stock for the upcoming days. Also, the poor are not likely to have sufficient sums to cope with emergencies such as drought, flood, or sickness of family members. Thus, access to formal finance plays an important role in improving the livelihoods of the poor, as well as coping with emergency. And microfinance provides an alternative to the traditional commercial bank loan. Using methods such as social collateral, where the borrowers are required to form a group to borrow from the microfinance institution, reduces the cost and provides the means to extend finance to the poor. Although there is concern about the practice of social collateral, in many cases it is working well, as the repayment rate is high, normally over 90 percent, indicating that the poor do repay the loans, and so are bankable.

Seeing the potential of microfinance, donors as well as private investors have mobilized funds to finance the establishment of the microfinance institutions in many developing countries. Like other developing countries, after the end of the war, lasted from the early 1970s to 1990s, Cambodia also received substantial capital inflow, and its microfinance industry has grown rapidly. This hasty

[1] As there are many informal moneylenders operating in Cambodian villages; interest rates vary widely. According to a report by the Phnom Penh Post, informal interest rates can be as high as 10 percent per month, which is 120 percent per annum, much higher than the interest rates charged by microfinance institutions. Those are between 20 to 30 percent, or above 30 percent per year in the case of a microloan. For information on informal interest rates, please see Renzenbrink (2013), Hutt (2017), and Carmichael (2017).

development has brought both opportunities and challenges. This paper describes the development of the Cambodian microfinance industry from its inception, its transformation from the NGO-type poverty lending approach to the financial approach, the opportunities the industry has provided and the challenges it faces, the responses from the government, and the future prospects of the industry.

II- Development of Cambodian Microfinance

Cambodia went through more than two decades of tragic history including war and genocide from the early 1970s to the late 1990s. Although all warring factions decided to end the conflict by signing the Paris Peace Accord on October 23, 1991, peace and stability were fully restored in 1998 when the last remnants of the Khmer Rouge armed forces were defeated and reintegrated into the society. During the war, social, physical, and human capital was destroyed, including the banking infrastructure and system. After the peace accord was signed, refugees, militants, and their families returned to their homelands. The effort to support demobilized soldiers and refugees gave impetus to the spread of microfinance through donor assistance to NGOs, although there is a longer history of informal microcredit, which the Cambodian people have been practicing for generations.

The Association of Cambodian Local Economic and Development Agencies, generally known by its acronym ACLEDA, was among the pioneers in the microfinance industry. It was established in January 1993 as an International Labor Organization (ILO) and United Nations Development Program (UNDP) microfinance program, and was transformed into a specialized bank in October 2000, and a full-fledged commercial bank in December 2003.[2] Now it is one of the largest commercial banks operating in all 24 provinces of Cambodia and Phnom Penh municipality, and has international branches in Myanmar and Lao PDR. The transformation of ACLEDA cast doubt on the development community and its social mission of providing financial services to the poor. Nonetheless, Ito's (2008) study shows that, although it has been transformed and become a commercial bank, ACLEDA still continues to provide microcredit and retains its former client base, the poor. Therefore, the study finds that ACLEDA's mission has not drifted.

The transformation of ACLEDA is not the only case of this happening. Since then, several other microfinance institutions have also transformed. In 2016, for instance, AEON microfinance has become a specialized bank, and SATHAPANA became a commercial bank. Thus, this is something of a trend in the industry; once the institutions grow large enough they seek transformation, because by gaining the status of a commercial bank, the institution is able to provide broader services, and also to collect deposits from the public. However, all of these institutions keep providing micro-credit, as it is very profitable.

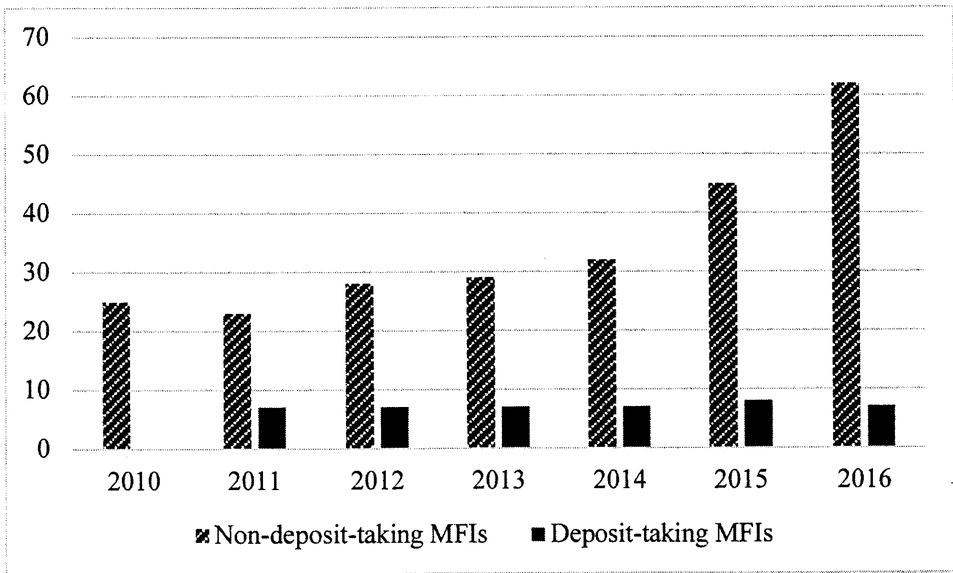
In Cambodia, the country's central bank, the National Bank of Cambodia (NBC), supervises the banking and microfinance industry. It is compulsory to register at NBC to operate a microfinance institution (NBC 2008, 410). According to the regulations, there are two types of microfinance

[2] The ACLEDA web page (https://www.acledabank.com.kh/kh/eng/ff_history) provides a brief history of ACLEDA and an important chronology of the transformation. For more details, please see Clark (2006).

institutions (MFIs), namely non-deposit-taking MFIs and deposit-taking MFIs.[3] The different types of institution imply different legal and capital requirements. For example, while non-deposit-taking MFIs are required to hold a minimum registered capital of 250 million Khmer Riels (KHR) or about USD 62,500 (NBC 2008, 401), deposit-taking MFIs are first required to operate as a non-deposit-taking MFI for at least three years, have a sustainable profitability of at least two consecutive years in primary operations, and have a minimum paid-up capital of at least KHR 10,000 million (about USD 2.5 million), which is 40 times the sum required to register as a non-deposit-taking MFI, plus other requirements (NBC 2008, 413). In 2016, the central bank raised the capital requirement of non-deposit-taking MFIs to KHR 6 billion or USD 1.5 million, and deposit-taking MFIs to KHR 120 billion or USD 30 million, which is 20 times that of non-deposit-taking MFIs (NBC 2016). Deposit-taking MFIs are required to fulfill more stringent requirements, as they are permitted to collect deposits from the public, so they must be financially healthy enough to assure the safety of the saving and to have enough liquidity to response for large withdrawal. This is important for the health of the financial market.

Figure 1 shows the increasing number of non-deposit-taking MFIs and deposit-taking MFIs from 2010 to 2016. The total number of microfinance institutions increased from 25 in 2010 to 69 in 2016. In the NBC report, before 2011, there was no separation between non-deposit-taking and deposit-taking MFIs. Since 2011, the number of deposit-taking MFIs has been fluctuating around seven; the number of deposit-taking MFIs increased to eight in 2015, when there was an acquisition of one local non-deposit-taking MFI by a foreign investor, to create a deposit-taking one. However, in 2016, because SATHAPANA, one of the largest deposit-taking MFIs, was transformed to become a commercial bank, the number of deposit-taking MFIs was reduced to seven once again. So, the increased number of microfinance institutions is attributed to the increase in the number of non-deposit-taking MFIs

Figure 1. Number of MFIs and Deposit-taking MFIs

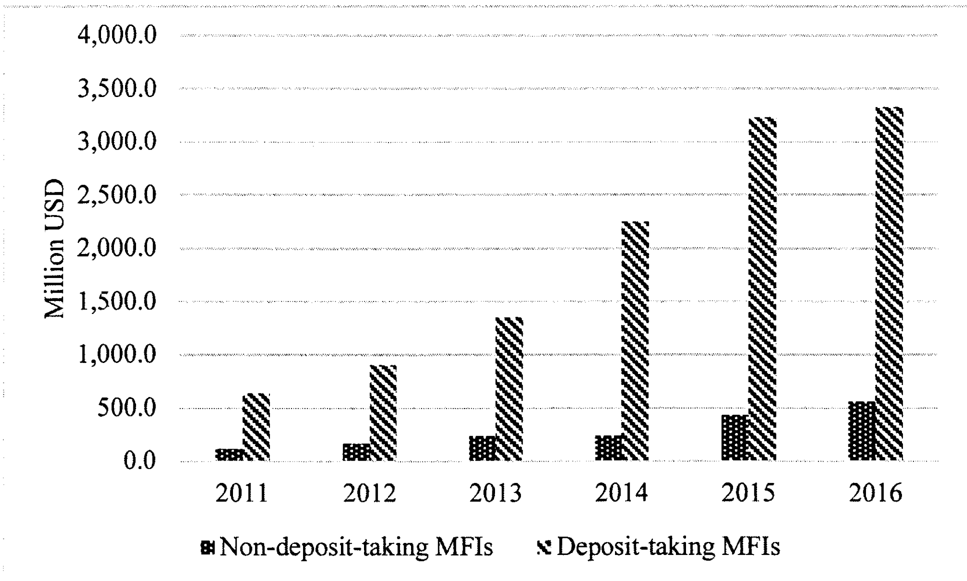


Source: NBC 2010-2016

[3] In NBC reports and statistics, the short forms, MFI and MDI are used to refer to non-deposit-taking and deposit-taking MFIs respectively. To be consistent with the literature, the use of MDI will be avoided; instead, the term non-deposit-taking and deposit-taking MFIs will be used.

Along with the increase in number of microfinance institutions, their assets also increased substantially from about USD 756.3 million in 2011 to USD 3,888.5 million in 2016, a growth of more than fivefold in five years (Figure 2). Although there are larger numbers of non-deposit-taking MFIs than deposit-taking MFIs, the former's assets are much smaller. In this period (2011-2016), the average share of assets of non-deposit-taking MFIs is a mere 13.6 percent, while that of deposit-taking MFIs is 86.4 percent. In 2016, the division in share of assets is 14.4 percent to 85.6 percent.

Figure 2. Total Assets of Microfinance Institutions



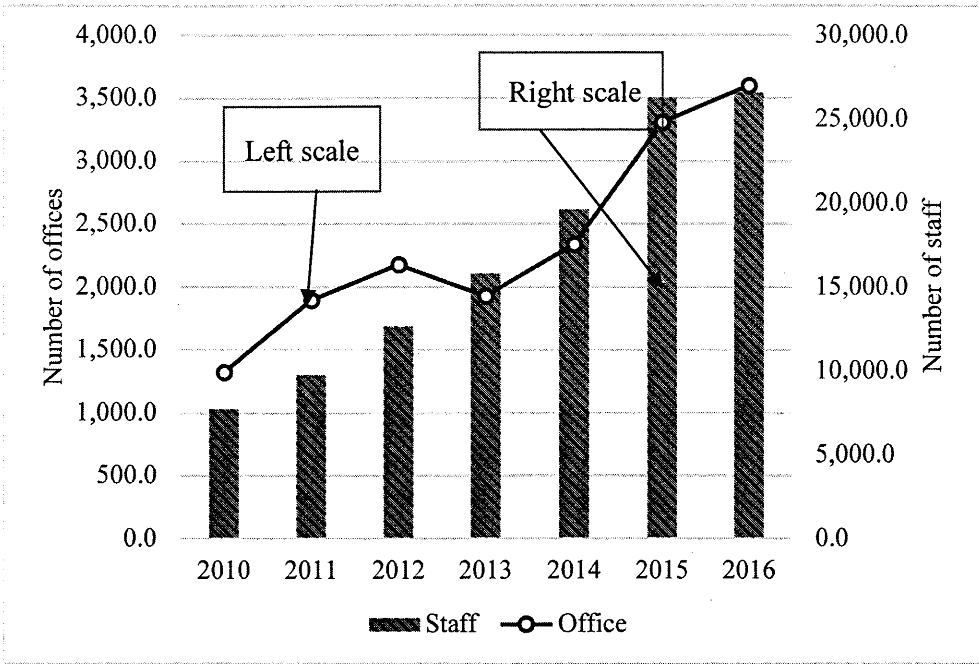
Source: NBC 2011-2016

Microfinance Outreach

The growth of the assets of microfinance institutions enables easy access to credit, which means there must be tough competition among microfinance institutions to attract and reach their clients. Evidently, the number of microfinance staff and offices keeps increasing steadily. In 2010, the total number of offices of microfinance institutions at the district level was 1,320, and increased almost threefold in next years, to 3,599 offices in 2016. Number of staff has increased from 7,715 to 26,268 in the same period, which implies that, on average, there are seven staff members per office. In terms of the number of offices, there are roughly 20 microfinance institutions on average operating in one district (Figure 3).[4] The abundance of offices that are at the district level implies that there are fewer obstacles for the client to access the institution. In fact, as a conventional practice, credit officers regularly travel to the villages to collect payment and disburse loans, and also to chase around potential borrowers; thus, it is very convenient for the customers to borrow, and sometimes they are even tempted to borrow due to multiple visits of the credit officers, although they do not really need credit and do not need to fund or expand a business.

[4] In the Cambodian state administration, the country is divided into 24 provinces plus the capital, Phnom Penh. Each province is subdivided into districts, and districts into communes. Most microfinance institutions have their offices at the district level. All deposit-taking MFIs operate in most of the districts in the 24 provinces and Phnom Penh.

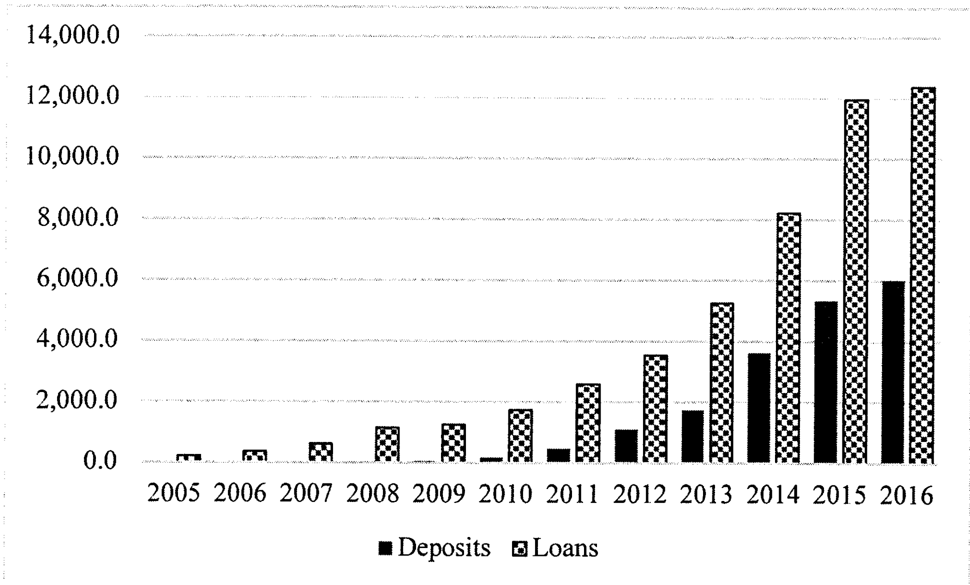
Figure 3. Number of Staff and Offices of the Microfinance Institutions



Source: NBC 2010-2016

As a consequence, the number of loans and depositors has been increasing very fast. Figure 4 shows the increasing number of both loans and deposits. Both have increased rapidly, but the growth of deposits is faster. In 2005, the amount of deposit was only KHR 9 billion, compared to the total loan size of KHR 205 billion, which is a more than twentyfold difference. Nonetheless, the deposit has grown steadily, averaging 96.6 percent from 2006 to 2016, while the growth of loans was only 47.2 percent. This growth significantly reduces the gap between deposit and loan. In 2016, the amount of deposit was KHR 6,016 billion, which was about half of the total loan of KHR 12,375 billion. The increased deposit indicates that Cambodian microfinance institutions, largely deposit-taking MFIs, are able to mobilize domestic funds to provide loans to their customers, and thus become less dependent on external financing. Deposit products provide a means for the poor to save, because they not only need credit services, but they also save some portion of their meager income for future and emergency use. In Cambodia, depositing at microfinance institutions earns higher interest than depositing at the commercial banks. Thus, it benefits the poor, who are able to manage to save in small chunks. The fact that the growth of deposit has been faster than that of loans suggests that more people are able to exploit the benefits of saving services provided by microfinance institutions, and more and more people trust the institution. In other countries such as India, the poor even pay the commission fee for their savings, let alone earning interest from it. This is because unless the money is kept with others, they may never be able to accumulate savings, as the temptation to spend is much stronger, and in many cases intra-family relationships make it difficult for the poor to save. When the wife keeps the savings at home, her husband may take the savings from her to buy alcohol, or spend on gambling or other unproductive purposes. Sometimes if a relative knows that there is money at home, they will try to borrow it (Karlan and Apple 2011, 143-166).

Figure 4. Number of Loans and Deposits



Source: Lam 2017

Table 1 shows more details of the growth of loans and deposits. The striking fact is the growing amount of the average loan. In 2016, the average loan had increased to about KHR 6.4 million, which is about USD 1,600. Considering the Cambodian per capita gross national income of only USD 1,140 (World Bank n.d.), it is worried that Cambodia may face the problem of over-indebtedness[5], which may pose a threat to the whole microfinance industry. Nonetheless, the high average loan size signals that borrowers are able to access to large enough capital to invest in productive activities or purchasing capital goods. It is extremely difficult to them to expand business if they are able to access microloan or only several hundred American dollars.

Table 1. The Increasing Microfinance Outreach and the Growth of Loans and Deposits

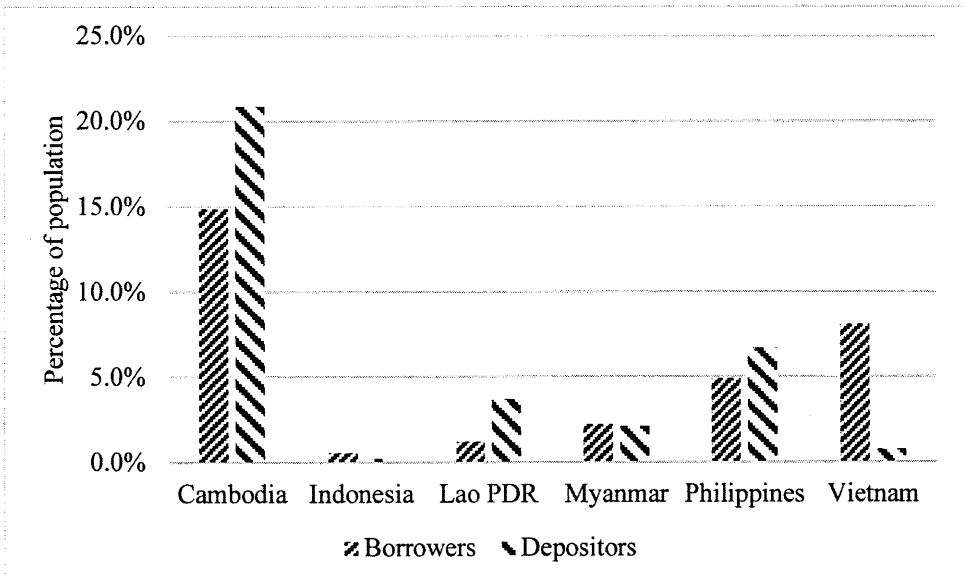
Year	Borrower (Thousand)	Depositors (Thousand)	Deposits (Billion KHR)	Loans (Billion KHR)	Average Loan (KHR)	Average Deposit (KHR)
2005	366.0	138.0	9.0	205.0	560,109.3	65,217.4
2006	471.0	113.0	10.0	357.0	757,961.8	88,495.6
2007	624.0	148.0	21.0	618.0	990,384.6	141,891.9
2008	826.0	109.0	22.0	1,131.0	1,369,249.4	201,834.9
2009	871.0	103.0	40.0	1,245.0	1,429,391.5	388,349.5
2010	978.0	164.0	164.0	1,725.0	1,763,803.7	1,000,000.0
2011	1,142.0	242.0	459.0	2,591.0	2,268,826.6	1,896,694.2
2012	1,297.0	687.0	1,094.0	3,539.0	2,728,604.5	1,592,430.9
2013	1,566.0	900.0	1,745.0	5,262.0	3,360,153.3	1,938,888.9
2014	1,775.0	1,047.0	3,621.0	8,219.0	4,630,422.5	3,458,452.7
2015	2,022.0	1,419.0	5,337.0	11,954.0	5,911,968.3	3,761,099.4
2016	1,921.0	1,596.0	6,016.0	12,375.0	6,441,957.3	3,769,423.6

Source: Lam 2017

[5] A borrower is over-indebted if his/her total debt service is larger than his/her income in a specific time period (Live 2013).

The growth of the Cambodian microfinance industry has been very fast relative to other countries. Data shows that about 15 percent of the Cambodian population are active microfinance borrowers, while more than 20 percent are depositors. This percentage is much higher than those of other Southeast Asian countries (Figure 5). However, this number does not reveal the fact that people in other countries may have better access to commercial banks or other forms of formal finance. In fact, the Cambodian microfinance industry is one of the most profitable in the world, and the industry attracts 9.7 percent of the global microfinance investment. This is second only to India, where the investment is 10.7 percent, while India has a population about 90 times larger (Symbiotics 2016, 23). Why the huge amount of microfinance investment flowing into Cambodia? One explanation is that, in general, microfinance is one of the most profitable businesses, and as the Cambodian government is eager to accept all kinds of foreign investment, MFI funds from many sources are attracted into the country.

Figure 5. Microfinance Borrowers and Depositors in Southeast Asian Countries



Source: Author's Calculations Based on Data from Microfinance Information Exchange and World Development Indicators

Loan Use Patterns

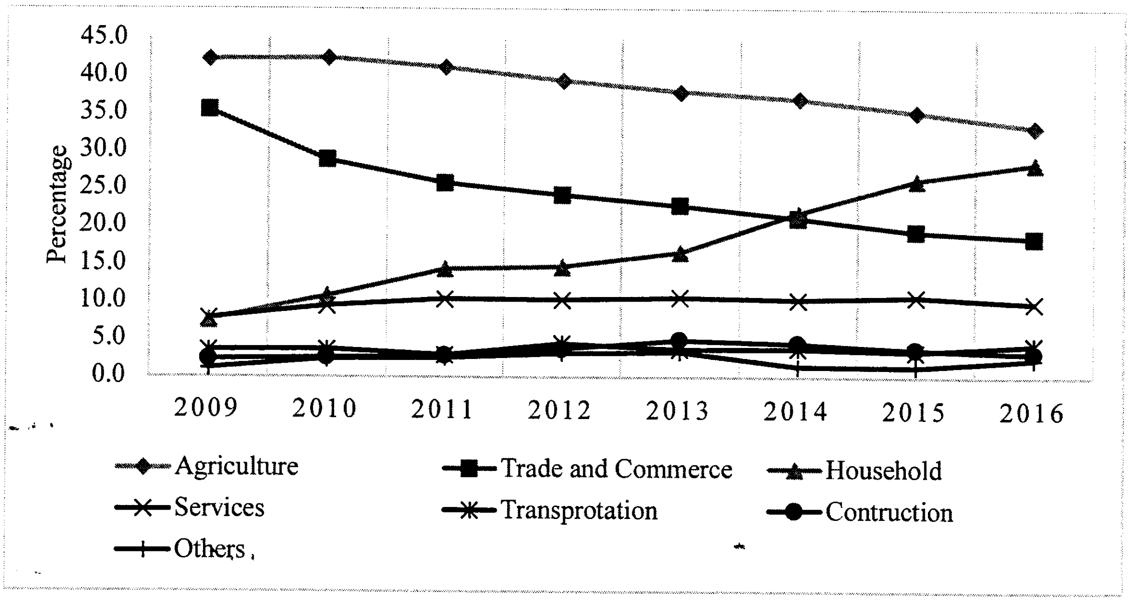
The overarching objective of microfinance is to help the poor climb out of poverty through self-employed income generating activities, that is, microfinance aims to finance micro-entrepreneurial activity. Even though microfinance loans are implicitly aimed at financing business activity, it is difficult to monitor the loan use and avoid the problem of loan fungibility. The Cambodian central bank, NBC, defines microfinance as "the delivery of financial service such as loan and deposit to the poor and low income households, and micro-enterprises." Like other definitions, such as those given by Kiva, one of the global leading microfinance investors, and Robinson (2001, 9), there is no clause explicitly prohibiting using microloans for other purposes including consumption.[6] In reality, not everyone is an

[6] On the web page of Prasac, one of the largest deposit-taking MFIs in Cambodia, there are a variety of credit services, including loans such as car and motorbike loans, and personal loan, which is comprised

entrepreneur with a workable business idea. Thus, the need for microfinance goes beyond the funds to operate a business. The poor lack sufficient funds in the case of an emergency, so if they have access to microfinance, they are unlikely to borrow from a loan shark for emergency expenses, hence reducing the risk of asset loss due to the need to pay exorbitant interest to loan sharks. In addition, in order to buy an item that requires a large sum, it may take time to save, and the temptation to spend is much stronger. Thus, borrowing from microfinance institutions allows the poor to purchase the item they need now, and pay back the large sum later, usually gradually. This is in line with the objective of microfinance that Professor Yunus created in the early 1980s in Bangladesh, i.e. helping the poor get rid of loan sharks, or to use microfinance to eliminate loan sharks.

Figure 6 shows that besides financing business, borrowers use loans for other purposes such as household use, and construction or house renovations. As can be seen in the figure, loans for agricultural purposes account for the largest share among microfinance loans, more than 40 percent in 2009, but have gradually declined to less than 35 percent by 2016. This indicates the typical path of development: as an economy grows, the share of agriculture shrinks. This does not mean reduction in agricultural loans. In general, in terms of loan volume, all types of loan have grown in this period, and agricultural loans in particular have grown about eight times from just KHR 525,314 million (about USD 131.3 million) in 2009 to KHR 4,210,614 million (about USD 1,052.7 million) in 2016. What should be noticed is the declining share of the loans for trade and commerce, and the rapid increase in the share of loans for household use. This is the cause of concern for over-indebtedness, as households may not be able to service the debt on time, thus risking defaulting.

Figure 6. Loan Use by Types of Business



Source: NBC 2011-2016

of marriage loan and loan for buying household appliances. For Prasac credit service, please see: https://www.prasac.com.kh/services/credits/. For Kiva's definition of microfinance, please visit: https://www.kiva.org/microfinance.

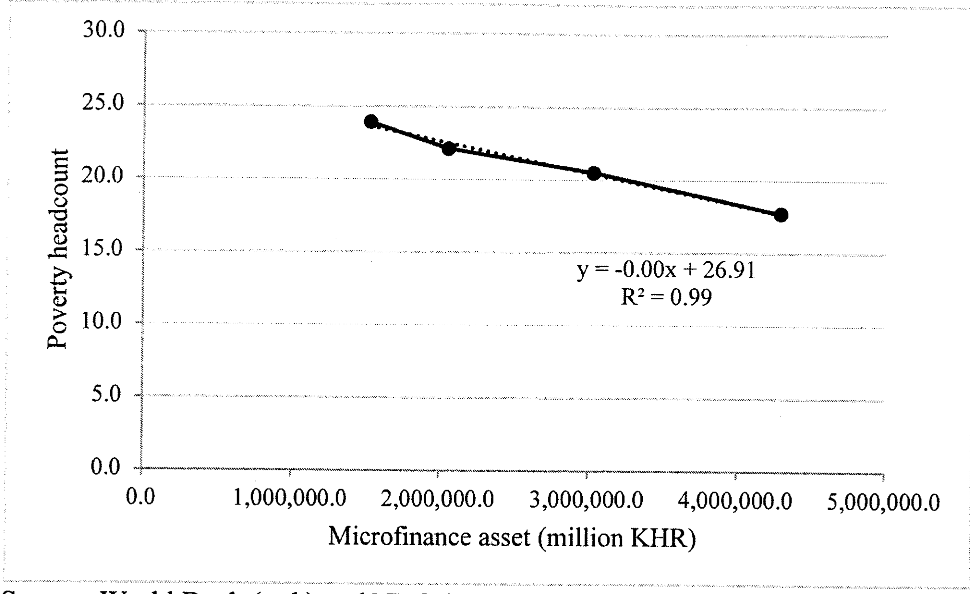
III. Microfinance and Poverty Reduction

Microfinance is widely regarded as an effective tool for reducing poverty in many developing countries including Cambodia.[7] Nonetheless, empirical evidence from various countries is mixed. Microfinance was found to be effective in reducing the poverty of those close to the income poverty line, but ineffective at reducing extreme poverty in Bolivia, one of the world's largest microfinance markets (Mosley 2001, 102). On the other hand, in Bangladesh, home to the world's largest microfinance institutions such as the Grameen Bank and the Bangladesh Rural Advancement Committee (BRAC), micro-loans were found to reduce poverty, especially among the female borrowers (Pitt and Khandker 1998, Khandker 2005). In addition, a more recent study by Katsushi S. Imai and Md Shafiul Azam (2012, 651) finds that microfinance increases the income of the poor and their food consumption, and it does not matter whether the loan is productive or non-productive. At the regional level, although the poverty reducing effect of microfinance is evident, the magnitude is limited (Weiss and Montgomery 2005, 391).

In Cambodia, empirical study indicates that the poverty impact of microfinance is also inconclusive. If we look at the correlation of microfinance assets, which shows the growth of the microfinance industry, and the poverty headcount ratio, it is clear that the relationship is negative, which means that as microfinance assets grow, fewer people are in poverty (Figure 7). However, we should be careful to avoid misinterpreting correlation as causation, as this correlation analysis did not control for other impacts on poverty reduction, such as the growth in agricultural sectors, tourism, and the garment industry. In the case of a commune in Battambang Province, Teng et al. (2011) find that having access to microfinance increased the asset and income of borrowers. The possession of important assets such as motorbikes, bicycles, mobile phones, and VCD players increased after villagers had access to microcredit. The increased income among borrowers was attributable to the increased number of jobs. Borrowers in the study area, like other rural areas, generally subsist on more than one informal job, mainly agriculture-related jobs, petty trades, and selling labor. Due to the access to microcredit, the study found, a larger portion of the people had more than one job. Also, microfinance improved education and family welfare, and reduced inequality. It was found that women who got access to microfinance had the right to make family decisions, and used the loan to pay for the schooling of their children and provide nutritious food for the family. For the results regarding inequality, the authors estimated the Lorenz curve found more equal income distribution after having access to microfinance. In another study, using difference-in-difference method, Phim (2014) finds that households with access to microfinance moved out of poverty quicker, and his regression analysis shows that microfinance allowed households to increase consumption and food expenditure, and improve investment in human capital, health, and education.

[7] Stephens and Bou (1999) portray the case of the impact of microfinance on poverty reduction in Cambodia.

Figure 7. Correlation between Microfinance Asset and Poverty Headcount



Source: World Bank (n.d.) and NBC (2009-2012)

However, not all studies found positive impacts of microfinance on poverty reduction in Cambodia. Both formal and informal microfinance was also found to reduce household consumption. The unproductive use of loans, such as for consumption, coupled with the high interest rate, pushed borrowers to become over-indebted (Seng 2017, 15).

IV- Challenges of the Microfinance Industry

Over-indebtedness

Loan repayment plays an important role in the sustainability of microfinance institutions, although many institutions take advantage of concessional loans from donors to finance their operations. In order to insure a satisfactory repayment rate, the institution must carefully scrutinize the creditworthiness of the borrowers, and disburse loans only to those who have sufficient capacity to repay. Otherwise, in the case of default, the microfinance institutions, as general practice, cooperate with authorities to seize the assets of the defaulting borrowers.[8]

Although this phenomenon is not pervasive, it creates fear among the borrowers (Kohlbacher and Down, 2016) and led the prime minister to issue an order to all public officials not to involve themselves with the microfinance institutions in the move to repossess the property of the defaulting borrower (Chan, 2017).[9] There is no concrete data available on the loss of houses or land due to microfinance loans, but anecdotal evidence suggests it is about 10 or 15 percent of land loss (Steptoe

[8] In India, moneylenders were believed to intentionally lend money to the poor with high interest rates, so that they could confiscate the poor's asset or force the poor to become their bondage laborers (Robinson 2001, 170-222).

[9] This move is perceived as politically motivated, as the prime minister does not want people to think that officials are helping the microfinance institutions in repossessing borrowers' property, thus affecting his popularity. It was the same when the central bank announced the interest cap; it was widely believed to be politically motivated, as the local election was approaching (Hor 2017b).

2013). In Kampot Province, ACLEDA bank has become one of the primary land-owners (Dell'Asin 2011). The confiscation of the property of the defaulting borrowers is inhumane and contradictory to the mission of poverty reduction, since if the poor are deprived of their property, such as houses and agricultural land, they will be pushed deeper into the grasp of poverty.

Microfinance is supposed to reduce the indebtedness of the Cambodian people from loan sharks, but in reality many people are indebted because of microfinance. In a study on the drivers of over-indebtedness, it was found that 34 percent of microfinance borrowers were either at risk or insolvent (Liv 2013, 35). The strongest factors leading to over-indebtedness include multiple borrowing, limited financial literacy, and education level (Liv 2013, 68). If the over-indebtedness issues become more serious, rising to the level that borrowers lose assets such as agricultural land or houses, or become poorer, microfinance will not only fail to achieve its overarching objective, but will be functioning just like a loan shark or informal moneylender.[10]

The Interest Cap

Although the interest rate charged by microfinance institutions in Cambodia is lower than those reported by Hugh Sinclair (2012) for Mexico and Nigeria, it is considered still high,[11] and is believed to be one of the main causes of default and loss of assets, and over-indebtedness, which exacerbates poverty among borrowers. Microfinance institutions were accused of reaping enormous benefits from the high interest rate, in similar fashion to that of loan sharks. Theoretically, if the interest rate is high, only high-risk investors will borrow the funds to finance their business, as a high-risk business will be able to provide high return, so that the investor can pay back the borrowed funds. But a risky business is also more likely to fail, thus increasing the risk to lender. Businesses that will generate low return tend to be more predictable and more secure, and the chance of failure is minimal, but because the interest rate is high, the entrepreneurs are not able to receive loans to finance their business. Therefore, the high interest favors high-risk business, and crowds out the risk-averse investors, which is not good for the lender or the economy. This means that it is also not in the interest of the lenders to charge high interest on loans, theoretically.

In a bid to ameliorate this risk, the government, through the central bank, issued a directive to set the interest cap for loans from registered microfinance institutions. In a directive dated May 13, 2017,

[10] For informal moneylenders, it is difficult to cooperate with the authorities in the case that borrowers fail to repay the loan. Sometimes, it causes conflict as shown in Sen's (2016) work. Therefore, as a general practice, informal borrowers extend loans only to those borrowers they know relatively well.

[11] Before the interest cap, the interest rate charged by Cambodian microfinance institutions was higher than that charged by Indonesia's leading microfinance bank, Bank Rakyas Indonesia's Unit Desa, which charged an average interest of 19 percent (Bland 2014). In Vietnam, interest charged by formal institutions ranges from 8 percent to 13.5 percent (Haughton and Khandker 2016, 4). Thailand set an interest cap in 2013, and the interest rate of microfinance is a maximum of 3 percent per month, or 36 percent per year; the cap was set to help borrowers be less dependent on loan sharks that used to charge about 10 or 20 percent per month (Pootpisut 2013). Other countries that have set interest caps including Bangladesh (27 percent effective rate), Myanmar (2.5 percent per month), and China (24 percent) (Asian Development Bank 2016, 5).

the central bank required all registered MFIs to charge interest rates of maximum 18 percent per annum for all loan types (NBC 2017). This caught many microfinance institutions off guard.[12]

The interest cap draws both negative and positive response. Opponents argue that the interest cap would reduce the availability of small loans, as the institution would not be able to supply them, thus making the poor borrower unable to access formal microfinance. Although the interest cap is intentionally set to help the poor, opponents say it backfires and hurts them (Alshebami and Khandare 2015, 10). In the case of Bangladesh, Md Aslam Mia (2017) finds that after the cap, microfinance institutions reduced outreach, and clients would need to pay a higher price in the long run. Newly established and high-cost institutions would be difficult to operate. After the cap was announced in Cambodia, Daniel Rozas of the MIMOSA (Microfinance Index of Market Outreach and Saturation) project told the Nikkei Asia Review that the cap is a not good, and is a misguided policy (Hutt 2017). It is expected that once the poor cannot access loans from microfinance, which now become unavailable due to the interest cap, they will turn to unregistered moneylenders or loan sharks that charge usurious interest; thus the micro-borrowers will again need to pay more expensive interest rates, and will not be protected (Consultative Group to Assist the Poor 2004). This effectively revitalizes the traditional moneylender. In South Africa, to protect the borrower from usurious charges from microfinance institutions, the government formulated a regulation to limit the interest ceiling, but Mohane, Coetzee, and Grant (2000) argue that the cap would force borrowers to seek funds from loan sharks, meaning it would induce illegal lending and not induce the institutions to innovate low cost operations. They suggest that to induce the institutions to charge appropriate interest, the government should promote competition among microfinance institutions, rather than impose an interest cap.

On the other hand, the positive impact of the interest cap may be through technological innovation. As microfinance institutions are asked to charge lower interest rates, they have to reduce costs by innovating new management and operation technology, or need to merge to benefit from the economies of scale. Several local microfinance institutions and their overseas partners are considering consolidation, and exploring ways to benefit from financial technology (Black 2017).

Loans from Multiple Sources

The interest cap may do little to help solve the problem of over-indebtedness among borrowers. As they are able to borrow from multiple sources, their debt will accumulate and the principal will grow. Large principal means that borrowers need to repay large sums to the microfinance institution even if the interest is low, which may be over their capacity. The fact that borrowers are able to access loans from multiple sources indicates the weakness of the microfinance institutions' capacity to track the credit of the borrowers. Having loans from multiple sources is a serious problem of the microfinance industry. Nevertheless, with the recent operations of the Credit Bureau Cambodia, the risk may be better under control. This is because one of the roles of the credit bureau is to assess the creditworthiness of

[12] It is difficult to find interest rate data. Microfinance loans differ in accordance with loan size, duration of loan, loan modality (group or individual loan), and borrowers "creditworthiness." But it was widely reported that before the cap, interest was well above 18% per annum. Reported in the Nikke Asia, interest rates before the cap were between 20 percent and 30 percent, or maybe over 30 percent (Hutt 2017, Carmichael 2017). This rate is still not as high as in Mexico and Nigeria, where microfinance institutions charge an interest rate of over 100 percent (Sinclair 2012, 15-27, 83-105).

the borrowers and report to its members, financial institutions including banks and microfinance institutions, although the consent of the borrower is needed (Credit Bureau Cambodia n.d.).

In a study of eight microfinance institutions, which covers 44 villages, among 1,326 borrowers 56 percent had more than one loan, 28 percent had more than two loans, and 15 percent had more than three loans (Liv 2013, 13).[13]

Financial Literacy

It is no surprise that financial literacy is low among the Cambodian population, as the main determinants of financial literacy are education level and income (Morgan and Trinh 2017). Cambodia is a poor country, where many people still struggle to read and write, although the country graduated from being a low-income country to a lower-middle-income country in 2016, according to the World Bank classification (World Bank 2016). In addition, the Cambodian education level is among the lowest in the region. This low level of education is aggravated by the disparity between different social groups, such as the rich and the poor, and the urban and rural groups. Literacy is much higher among the urban and wealthier groups (World Inequality Database on Education n.d.)

Financial literacy is one of the most important factors for appropriate saving, borrowing, and investing behaviors. In 2015, the Global Finlit Survey places Cambodia at 135 out of the 144 countries in the survey on financial literacy (Baliga 2015).[14] A more recent study by Morgan and Trinh (2017) also shows that Cambodia was placed at the lower end of the 30 countries included in the study.

For many Cambodian rural borrowers, the identity of a microfinance institution per se is vague. Many microfinance institutions began as donor-funded institutions or NGO programs. Although some are now recently commercialized and operate as commercial banks, many borrowers still implicitly regard them as NGOs or governmental institutions, by referring to microfinance institutions as "*angkar,*" which literally means NGO. Additionally, when they borrow from microfinance institutions they unwittingly state that they borrowed from an NGO or from the state *(kchey luy angkar or kchey luy roth,* literally meaning borrowing from an NGO or from the state*)*. This prompts the fear that borrowers may think the loan is charity, or that they may not need to return it as it is from the government. The problem was exacerbated when it was politicized, as a political party promised constituents that their microfinance debt would be cancelled if the party was voted in (Kann 2017, Kuch 2017). Recognizing the risk, the government, via the central bank, issued a directive to all commercial banks and microfinance institutions to print a poster, posted in front of their office, indicating clearly that they are private institutions. In addition, there is a mass media broadcast, including TV, radio, and text message from the mobile phone company, informing the public of this message (that microfinance is a private institution) for a period of one year after the announcement is in effect.

In a bid to improve financial literacy, the central bank in cooperation with an Australian NGO started distributing booklets explaining the concepts of saving, interest rates, and managing daily

[13] In an interview with the Phnom Penh Post, the CEO of the Credit Bureau Cambodia downplayed the multiple loan problem. For more information, please refer to McGrath's (2016) interview.

[14] Hor (2017) provides more details of the survey; according to the results, only 18 percent of the respondents could answer three of the four questions on basic financial literacy, 40 percent could answer the questions on interest rate calculation, and 21 percent could answer the questions on diversification of investment.

expenditure to all primary schools in early March 2017, and are discussing with the ministry of education the idea of incorporating financial literacy into the school curriculum from the next academic year (Hor 2017a). It is too early to determine whether or not this financial literacy program is successful, as we need a longer period of time to see the impact of such an intervention. Nonetheless, it is worth noting that traditional numeracy skills may have limited impact on the over-indebtedness of households. Rather, money management skills are more important (French and McKillop 2016). Also, introducing financial literacy into the school curriculum may help these potential borrowers to effectively manage money when they enter their working life, but for the current borrowers, the government should also initiate policy to improve their financial literacy.

Trade Off between Micro-Loans and Loans for Small and Medium Enterprises (SMEs)

Most scholars and development experts praise the role played by microfinance. However, there are also notable critics of microfinance, such as Miltford Batement, who argue that in Cambodia, microfinances disrupted development rather than promoting it (Bateman 2010; 2017). Because capital is scarce, it should be allocated in the most efficient manner. Allocating too much for micro-enterprise reduces the funds available to invest in SME expansion and growth. As SMEs grow, they will be able to access the international market and rely less on domestic demand. But micro-business is different; they depend too much on domestic demand, and when there are too many micro-businesses created, they compete for customers. As a result, demand for each micro-business's products and services decreases, along with the decreased profit. Thus, they may be unable to service the loan.

V- Conclusion

There are two approaches to microfinance, the poverty lending approach, in which the institution extends subsidized credit to the poorest of the poor, as the institutions are able to access subsidized credit from the government or donors. Bangladesh's Grameen Bank in its early stages is one of the best-known microfinance banks that adopted this approach. The other one is the financial approach. In this approach, interest rates are set by the demand and supply of the credit; the institutions mobilize funds largely from the public. The interest spread must be able to cover all costs of the institutions, so the interest rates may be higher than the former approach. The Bank Rakyat's Unit Desa of Indonesia adopts this latter approach, and Robinson (2001) argues that it enables the institutions to extend credit to as many borrowers as possible in a sustainable manner. Since the 2000s, the financial approach has prevailed. Even with Grameen Bank, in its current state as Grameen II, the approach has been more financial.

In Cambodia, the microfinance industry has evolved rapidly. Some institutions have transformed from donor-assisted NGOs to specialized banks, or full-fledged commercial banks, extending financial services to the most remote areas of the county, and opening branches in neighboring countries. This growth leads to the growth of microfinance assets, loans and deposits, which indicate the increasing demand for microfinance among the active poor Cambodians, and that the industry has sufficient capacity to mobilize funds to supply this growing need. In many respects, microfinance has been widely used in Cambodia and its neighboring countries. However, there are emerging and potential problems, such as multiple loans and over-indebtedness due to low financial literacy, the tradeoff between funding micro business and SMEs, and the recent interest cap.

The recent interest cap, although controversial, shows that the government is paying close attention to the industry. In addition, other interventions, such as an effort to improve financial literacy, have also been implemented (Hor 2016; Hor 2017a). Improving financial literacy is a good policy, and like the interest cap, it is still too early to see the impact. We will have to follow up and evaluate the impact of both the interest cap and financial literacy education when enough time has elapsed. Also, the government should carefully study the tradeoff effect, because in the long run SMEs will be able to provide jobs and bring Cambodian products and services to the world market for long-term development. Promoting microfinance at the expense of financing SMEs is not a smart development policy.

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