USAID/CAMBODIA
SPECIAL OBJECTIVE (SPO) CLOSE OUT REPORT

SpO Name: Expanded Access to Sustainable Financial Services

SpO Number: 442-007

Approval Date: Initiated in1993; approved as part of Rural Economic Growth Strategic Objective (REG SO) in 1997, and revised as an SpO in 1999

Geographic Area: Nationwide

Total Cost: $ 6,554,460

USAID:

Mission Funding	DA	$ 1,398,579
	ESF	3,715,881
Global Funding	DA	1,440,000
Total USAID Funding		$ 6,554,460

NOTE: This amount includes $1,750,000 of ESF funds obligated for financial services activities under 442-004 in 2000/01, when the Mission proposed to combine SpOs 442-004 and 442-007.

Principle Implementing Partners:

Association of Cambodian Local Economic Development Agencies (ACLEDA)
Catholic Relief Services (CRS)
World Relief (WR)

Background

USAID initiated support for microfinance in 1993 to promote rural development and economic growth. The Special Objective (SpO) was intended to address pervasive poverty in rural areas where 85% of Cambodia's population lives. The rural sector is characterized by the scarcity of formal savings and credit programs available to the poor. Many rural Cambodians had access only to informal credit or credit from shop keepers that could cost as much as 100% for an advance of rice seeds (e.g., twice the amount had to be repaid after harvest), or up to 30% a month for store credits. Some rural Cambodians are allegedly forced to sell their land as a result of excessive debt payments due to high interest rates. Rural women in particular are in need of credit as a means to expand their meager incomes.

Through this program, USAID initiated support for three NGOs at the time of the first UN-monitored national elections of 1993. During the strategy period covering 1994-1997, USAID targeted assistance to democracy/governance, economic growth and health services. The 1997-2002 Strategic Plan continued these areas. Most of the economic growth SO was subjected to program cutbacks after the 1997 political disturbances. The microfinance activities constituted the only component of the EG SO that was retained after 1997.

Each of the three NGO partners under this SpO have developed into effective microfinance institutions (MFIs), with programs directed at serving the needs of the poor. These programs have expanded significantly over the past 8 years, and have nearly achieved long-term sustainability.

Summary of overall impact at SpO level and IR level

The achievement of results under the SpO and IR have achieved the intended overall impact, as discussed below. A list of key SpO activities and outputs is set forth in Table 1 below.

SpO: Expanded access to sustainable financial services.
USAID partner programs increased the percentage of households with access to loans from 7.8% in 1996 to 21% in 2001. The majority of loan recipients also participate in savings programs, some because some credit programs are built on savings (for example, CRS), and others because they value savings programs and choose to participate in them.

IR 1: Increased access of the rural poor to credit and savings facilities.

SpO activities have significantly increased the access of the rural poor to credit and savings facilities. The number of clients served by USAID-funded microfinance providers increased from 87,787 in 1998 to 102,715 in 2001. Outstanding loan balance of partner organizations increased from $4.8 million in 1998 to $8.8 million in 2001.

Association of Cambodian Local Economic Development Agencies (ACLEDA) is the largest provider of credit to the rural poor. ACLEDA has experienced a rapid average annual growth rate of client outreach since 1995. It currently operates 45 branch offices in 13 provinces (of a total of 22 provinces in Cambodia), and has provided over 50,000 group loans, with an outstanding loan portfolio of over $4.5 million. ACLEDA is the first microfinance organization in the country to become a licensed financial institution.

Catholic Relief Service (CRS) has established over 800 village banks, of which an estimated 420 new village banks were established in FY2002. The Thaneakea Phum Project (which means Village Bank in Khmer) currently serves 27,500 active clients, and has an outstanding portfolio of $773,000. Since 1996, over $5 million of credit has been disbursed, with a historical repayment rate of more than 95%. Despite concurrent flood and drought conditions during the past year, the on-time repayment rate remains at 90%. CRS and Thaneakea Phum staff made substantial contribution to policy and licensing or formalization in the sector through eight surveys and studies. These included policy and position papers on interest rate caps, incentives to operate in rural areas, institutionalization of rural credit, and constraints and implications of the draft financial institution law.

World Relief (WR) has provided over 25,000 women with access to savings and credit, working through over 40,000 maternal and child health training programs that are integrated with village bank meetings. During the past year, they served 7,000 clients with an outstanding portfolio of $630,000 and client savings of $101,000. Facing the same constraints of flood and drought conditions, WR is behind projections for repayments for the year and has written off one of its loans. WR continues to build institutional strength, expand its market share and move towards incorporation as a limited liability microfinance institution.

Another important result of the SpO is that poor rural women can now access reliable financial services. This is particularly attributable to the fact that CRS and World Relief have successfully adapted the village-banking system in Cambodia with a focus on rural women and their needs.

Table 1: Summary of Activities to Achieve SpO Results

<u>Activities</u>	<u>Major Outputs</u>
Technical assistance and training to Association of Cambodian Local Economic Development Agencies (ACLEDA), in collaboration with UNDP, to facilitate its transformation into a licensed financial entity.	♦ *ACLEDA is the first microfinance organization in the country to become a licensed financial institution and is recognized worldwide for its performance.* ♦ *Operating 45 branch offices in 13 provinces, it is the largest provider of credit to the rural poor.* ♦ *Outstanding loan portfolio of over $4.5 million with more than 50,000 group loans provided.* ♦ *Rapid average annual growth rate of client outreach since 1995.*
Support to Catholic Relief Services' poverty lending program in seven provinces.	♦ *More than 800 village banks established with more than 27,500 active members.* ♦ *Over $5 million in loans disbursed with a repayment rate more than 95%.* ♦ *44 training courses provided to more than 500 staff to increase organizational capacity.* ♦ *2 local NGO partners to merge into a single financial institution.*
Support to World Relief's innovative community banking/maternal and child health care training program.	♦ *Over 25,000 women provided access to credit and savings facilities.* ♦ *More than 40,000 maternal and child health care training programs integrated with village banking meetings.* ♦ *Over 50,000 loans disbursed with a loan recovery rate of more than 95%.*

IR 2: Increased self-sufficiency of microfinance institutions.

USAID partners are self-sufficient from several perspectives, including financial cost coverage, formal licensing as an MFI, and a demonstrated ability to grow. The partners have worked to ensure that micro-finance institutions (MFIs) will be a sustainable source of financial services for the rural poor. Training is one end to such means – judged by the results, the training which partner NGOs have provided has been effective in maintaining cost efficiency of operations and good loan repayment rates.

Overall, partners increased financial cost self-sufficiency from 70% in 1997 to 90% in 2001. This means that 90% of operational costs are covered. ACLEDA has already achieved financial self-sufficiency, and CRS and WR anticipate doing so by the end of this year.

USAID's partner ACLEDA was the first NGO microfinance program to become approved as a formally licensed financial institution. ACLEDA is widely recognized for its outstanding performance, with favorable press coverage and participation in international conferences.

The two Cambodian partners benefiting from CRS support have agreed to merge into a single financial institution, and are preparing to apply for licensing and to expand outreach. World Relief has also made substantial progress towards licensing as a financial institution. Both partners expect to complete licensing procedures within six months.

Financial self-sufficiency has been challenged recently by three factors which partners have identified. First, the Government has recently implemented controls on interest rates and the methods used for calculation of interest rates. Although lowering interest rates has reduced operating margins and incomes, USAID partners have adapted and continue to improve their operational efficiency. There is no indication that the government will impose artificially low interest rates as is the case in Vietnam. However, given the unique niche that MFIs have in the overall financial market, it is clear that the cost of doing business is higher with the responsibility of administering many small loans. MFIs may have to consider other compensating options. One option to consider may be to impose administrative, handling or training fees, because micro finance loans are more expensive to handle, and some business training may be required as part of the loan package. Such fees could be added on to the loan amount to be paid back. USAID programs have taken this approach in countries where interest rate limits are insufficient to provide micro loans. These small fees and the coaching to improve business skills are well worth these extra costs to rural borrowers, given how difficult it is to acquire credit from other sources.

Another factor is reduced incomes and increased cost due to competition. Increased costs have limited the capacity of World Relief to include health messages as part of micro credit programs. Micro credit provides a valuable network for health education messages, but separate funds are needed to support the cost of health education. Coordination with NGOs active in the health sector, that also promote income generating activities (such as Helen Keller International, which supports gardens as part of preventive nutrition programs) may help these partners to address this cost issue.

Another cost factor is the facilitation fees that CRS identified as one of the major costs of micro credit programs. While cooperation with and involvement of local officials is key to the success of rural credit programs, excessive facilitation fees could limit outreach and sustainability. Exploring options for reducing costs or

With the establishment of financial self-sufficiency and licensing as a formal MFI, all three partners appear to be in a position to continue to expand outreach and to grow institutionally. The ability to grow with primary reliance on internal resource generation is the ultimate indication of sustainability and self-sufficiency.

IR 3: An enhanced enabling environment for providing financial services to the poor.

The Royal Government of Cambodia (RGC) has made significant progress in the institutionalization of micro credit programs, with the aim of converting all programs into micro finance institutions. All three USAID partners have, or are currently making the transition and should benefit from the increased structure of the sector. MFIs will have access to funds at favorable rates through the Rural Development Bank of Cambodia. There are currently nine MFIs in Cambodia, a sufficient number to ensure competition as they grow, which will spawn efficiency in service provision. It is also a sufficient number to provide coverage for the entire country over time.

The RGC has adopted a number of new laws and regulations in recent years to establish a prudent regulatory regime for the operation and supervision of financial organizations. These include regulations governing licensing and supervision of microfinance institutions. A coherent framework now exists for supporting MFI development and full service coverage in rural areas. Our partner organizations have contributed to the evolution of this enabling legal and regulatory framework through the development of studies, analyses and surveys, and analyzing proposed legislation and regulations.

This enabling legal and regulatory environment provides a sound framework for the continued growth and development of the nine micro-finance institutions which currently operate in Cambodia. With the three USAID-supported institutions providing services to 21% of Cambodia's total rural population, and the existence of six other MFIs, it is possible that all rural and urban Cambodians will have access to savings and credit services within a few years.

Significant changes in the Results Framework during the life of the SpO

This SpO was originally part of the Rural Economic Growth (REG) Strategic Objective, which was approved in early 1997. The results framework for the REG SO was not implemented, since the political events in mid-1997 led to the termination of all REG activities with the exception of NGO activities in the development of microfinance institutions.

The revised SpO results framework for MFIs was approved in FY 1999. This framework has retained the essential elements of the MFI component of the REG SO, as witnessed by the IRs.

Prospects for long-term sustainability of impact and principal threats to sustainability

The Microfinance institutions and the Royal Government of Cambodia have made significant progress in the institutionalization of micro credit programs with the aim of converting all programs into micro finance institutions. All three USAID partners are expected to make the transition and stand to benefit from the inproved structure of the sector. MFIs will have access to funds at favorable rates through the Rural Development Bank of Cambodia. This access to loan funds is expected to boost their outreach if other costs can be contained.

While financial and operational sustainability have been attained by one partner, and appears to be close for the other two partners, there is never a guarantee for financial sustainability. Competition may increase, and loan programs are always vulnerable to events such as natural disasters which may reduce repayment rates. What is important to institutionalize is resilience and the ability to adapt to unforeseen circumstances, such as the RGC imposing interest rate ceilings. USAID partners have developed greater understanding of their financial and operational environment through participating in policy formulation and meeting the requirements for licensing. Hopefully, they will continue to adapt to their unique business worlds and will continue to serve the credit needs of the rural population.

Ultimately, the ideal outcome from USAID's perspective is the institutionalization of credit and savings services for all rural Cambodians. What are the prospects for significantly higher coverage of MFI services? The USAID program has been successful in reaching 21% of the country's rural population with access to basic credit and savings facilities. USAID partners have also contributed to the enabling environment for other MFIs to expand and deepen their work. Currently, there are nine MFIs working in Cambodia to ensure that micro-finance institutions will be a sustainable source of financial services for the rural poor. Thus, the prospects for greater MFI coverage appear to be good.

The potential for successful loans is increasing in terms of macro-economic conditions. The Cambodian economy has been growing at about 5% per year, roads and infrastructure are improving, and security is expanding access to remote areas. These factors all translate into expanded economic opportunities. While some MFIs may drop out of the sector as a result of greater competition, the overall prospects for the sector are promising.

The potential demand among the rural poor is at once promising and disheartening. Education and training opportunities are expanding, and there is a large demand emanating from need. However, rural poverty has perhaps increased over recent years, and some 15% of rural households are estimated to be landless. This has occurred as USAID's MFI partners expand their services. Thus, there is both a large unmet need and perhaps an inability on the part of many poor rural Cambodians to act effectively to meet that need.

There continues to be a long way to go in terms of impact on poverty. NGO leaders advise that some households are forced to sell their last resource, their land, to meet payments of hawkers who charge as much as 30% per month for basic consumer credit to meet food requirements. These households, including women-headed households, constitute major potential beneficiaries of improved and expanded financial services. The majority of micro-enterprise operators are women, and females head 17% of all households in rural Cambodia. Reducing poverty and expanding access to basic services are key to the sustained improvement of living standards in Cambodia.

Lessons learned

A prolonged internal ownership dispute between World Relief and its local NGO partner provided some important insights into issues surrounding the localization of microfinance programs. In particular, the experience of these two organizations highlighted the importance of how advisory boards and boards of directors are constituted; the importance of effective channels of communication between international and local partner NGOs; and, the effective use of negotiated mediation to resolve internal disputes. The lessons learned will improve program performance throughout the sector.

Performance indicators

Indicator 1: 20% minimum average annual growth rate in client outreach.
This indicator provides a direct measure of the extent of microenterprise outreach programs to the rural poor.

- This indicator may inaccurately show progress when expansion is not smooth, as when additional offices or areas of coverage are added to programs. 20% growth within a fixed population with access to micro credit is a rapid expansion, but 20% expansion when

expanding into an area without previous access is more achievable. Expansion within existing areas of service and the increase of total clients might be better indicators.
- External factors beyond the control of MFIs can have a profound effect on growth rates, including expansion of the economy, climatic factors, overall growth and competition in the sector, access to markets for small enterprises, and the cost and availability of funds. These factors are not taken into account in the indicator.
- This is a relatively useful indicator of performance, but a description of the micro credit environment should be included.
- This indicator could also be refined to track access to credit by poor and illiterate women.

Indicator 2: 20% minimum average annual growth rate in outstanding loan balances.
This indicator provides a direct measure of the rate of the expansion of capital flows that provide the rural poor with increased access to investment credit opportunities.
- Although helpful for an individual project this is not a good indicator for comparison between projects. 3 USAID partners concentrate on small and medium enterprises, urban women, and rural women. Growth of outstanding loan balance cannot be equally compared between the three.
- This is a relatively useful indicator of performance, but a description of the micro credit environment should be included.
- Number of average loan size and client on average borrow small sums of money could be another indicator.

Indicator 3: Percent of operational self-sufficiency achieved by credit providers.
This indicator provides a direct measure of the capacity of USAID-funded organizations to sustain credit operations without donor support, and to achieve financial self-sufficiency in the long run.

Good indicator:
- Measures the progress of credit operation of USAID funded partners for reaching sustainability to construct financial self-sufficiency.

Evaluations and special studies

USAID Reports
R4 Reports: February 1998, April 1999, April 2000, April 2001

Partner Evaluations
- World Relief Final Evaluation Survey for Gateway Project, 1996
- CRS Evaluation of Credit Program, 1998
- Mid-term Evaluation, 1998
- ACLEDA Closeout Report 1998-2001

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