

Formulating Pro-Poor Microfinance Policies in Cambodia

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A. Environment Scanning

1. Exogenous Factors/Occurrences

The effect of the global crisis is inevitable to any country despite the magnitude that may vary from one region, or country, to another. Having experienced robust economic growth with double digits over four consecutive years from 2004 to 2007, the Cambodian financial and economic sectors were also impacted by severe global financial and economic crisis. The crisis has created some levels of risks for the Cambodian financial and economic systems, particularly, the reduction of sources of capital financing and private capital inflows in the country. The key economic drivers such as garment, tourism, construction, and real estate sectors have also been suffering from the crisis. Fortunately, these impacts have not significantly been harmful to the financial and economic performance of Cambodia due to the limited international integration and the strength of the country's economic fundamentals on the agricultural field.

Microfinance has been one of the crucial components for poverty alleviation, as provision of its services such as credit, savings, insurance and money transfer can allow the poor to increase their productive activities, raise their consumption and better manage their risks. Microfinance services can also contribute nationally to the improvement of resource allocation, promotion of markets, and adoption of better technology, in which all these benefits will consequently help to promote economic growth and development.

These benefits are also likely to endure through the global crisis. Recent findings by academia and the microfinance community on the effects of financial crisis on microfinance show that negative spread has little impact on the microfinance sector. Along with this finding, the Cambodian microfinance industry was also able to prove its survival ability during the impact of the recent global financial and economic crisis. Yet, challenges and difficulties are inevitable for recovery and further development of the microfinance sector. Those areas that need focus are asset quality, portfolio growth, funding sources, interest rate, and also clients' interests.

The Cambodian government has committed to rural development, particularly the development of rural finance, since it is a key ingredient for sustainable economic development

and poverty alleviation. In addition, the government announced 2006 as the 'Year of Microfinance' in Cambodia' and has always supported the development of this sector through the introduction of policies to create a favorable environment for further growth. Since the announcement in 2006, Cambodian microfinance has grown remarkably. As of 2010, there were 20 licensed MFIs, of which six have currently licenses for savings mobilization, as well as 25 registered rural credit operators and around 60 NGOs freely operating microcredit.

2. Social Economic Profile

The Kingdom of Cambodia is a multi-party democratic monarchy. It is located in South East Asia. It has a tropical climate and receives monsoon rains. With an area of 181,035 square kilometers, Cambodia is polygonal in shape, with its center located near Kampong Thom Province. Thailand and Laos border it on the north, Viet Nam on the east, Viet Nam and the Gulf of Thailand on the south, and Thailand on the west. Cambodia is also home to the largest lake in Southeast Asia, the Tonle Sap (Great Lake), which connects with the Mekong River in Phnom Penh. The Mekong Basin is crucial for the Cambodian economy. The Mekong is one of the longest rivers in the world, with a length of 4,200 kilometers and flowing through China, Thailand, Myanmar, Laos, Cambodia, and Viet Nam.

Cambodia has a tropical monsoon climate, generally hot and humid, but the level of heat and humidity varies according to regions and seasons. The monsoon makes up Cambodia's climate cool and dry. The north eastern one is rather dry and comes from November to March and south western one brings heavy rain, high winds and high humidity from May to early October. December and January are considered to be the coolest months and fall in the dry monsoon season.

The Cambodian economy has undergone a dramatic and rapid transformation. The traditional economy, based on agriculture is now driven increasingly by the industrial and the tertiary sectors. With the return of peace, a sense of confidence and pride pervades the country, a feeling that bodes well for bright prospect for economic growth and job creation and a concrete vision of the promising future. The Government strategy is to help realize this vision by reinforcing Cambodia's comparative advantages both regionally and internationally.

During the last decade, Cambodia's GDP rose at an average annual growth rate of 9.3% (Naron, C. H., 2009). The annual per capita GDP of US\$ 700, Cambodia remains one of the least developed countries. Much remains to be done in order to ensure strong and lasting economic growth in the future in a global and regional climate increasingly fraught with challenges. Though Cambodia has made much progress, the reform effort must be sustained and strengthened in key areas in order to promote sustainable development.

The geographical distribution of the population is uneven. Cambodian population growth rate dropped from 2.4% in 1998 to 1.86% in late 2006, then to 1.54% in 2008 (Naron, C. H., 2009). The life expectancy is estimated at 54.5 years for men and 58.3 for women. The central Cambodia is much more populous than peripheral Cambodia, which is relatively sparsely populated. According to the population census in 2008, Cambodia population was around 13.3 million. The population density in the central plain was 261 per sq. kilometer in 2008; it was 62 per sq. kilometer for the Tonle Sap area, 47 per sq. kilometer for the coastal zones and 22 per sq. kilometer for the mountainous and plateau areas. The rate of urbanization in Cambodia is low. However, urban growth has accelerated in recent decades due mainly to an extensive rural exodus. Despite the growing industrialization, Cambodia is predominantly an agricultural country with the majority of the people eking out their livelihoods from agriculture. The urban population is more involved in trade and handicraft manufacture.

The agriculture sector is characterized by the coexistence of traditional agricultural, non-mechanized peasant farming, strongly dependent on climate conditions, carried out on small plots of land, along with large scale farms with technology designed to produce exports. The share of agriculture in GDP declined sharply from 45.8% in 1989 to 29.7% in 2007, while the labor force employed in the agricultural sector dropped from 80% to 60% (Naron C.H, 2009). Despite the drastic decline in share in GDP, agriculture continues to dominate the rural economy. Agriculture development is the key to sustainable and equitable growth in Cambodia.

Microfinance was embarked upon the projects of non-governmental organizations (NGOs) since the early 1990s in order to supplement the banking services in pursuit of greater access for rural inhabitants to financial services. The main rural financial services in Cambodia today are individual loans, group loans and collection of savings from members. In the early stages, microfinance had more of a social dimension, being operated by NGOs and humanitarian agencies. However, through reform of the Cambodian banking system in the early 1990s, the rural financial operators were transformed from non-government organizations (NGOs) to licensed and registered microfinance institutions under the regulatory framework of the National Bank of Cambodia.

B. Rural Financial System, Policies and Innovations to Cope with Changing Global Environment

1. Institutional Structure

The Cambodian banking system started in the early 1990s when the government launched an economic reform program from a centrally planned to a free market economy. The banking system consists of the Central Bank (National Bank of Cambodia), individual unit banks (commercial banks and specialized banks) and microfinance institutions (MFIs). As of 2010, Cambodia has 33 banks of which 27 are commercial banks, 6 specialized banks. Commercial

bank activities, however, are virtually confined in the cities. People in the rural areas have no access to commercial banks. There is also no State-owned agricultural bank that targets small farmers and fishermen. The only State-owned bank is the Rural Development Bank (RDB), which service the wholesales funds to MFIs for retailing to micro and small enterprises. In addition, there are 20 licensed MFIs of which 6 are deposit taking institutions, 25 registered credit operators and around 60 small unregistered NGOs operating in the rural areas.

The institutions that are able to address the financing requirements of the poor in the rural areas are, therefore, the MFIs. Most of these MFIs have been transformed from non-government organizations (NGOs) that were involved with humanitarian work among refugees in the Thai border. After the Paris Peace Accord in October 1991, the refugees had returned home. With the passage of time, NGOs have redefined their roles and have become very active in microfinance operations. Their main financial products include individual loans, group loans and savings from members.

In order to ensure a sustainable microfinance system, Cambodia recognizes the need to further strengthen the National Bank of Cambodia (NBC) to maintain its effectiveness and efficiency in the regulation and supervision of the microfinance sector. At the same time, authorities would like to make sure that all institutions taking deposits are properly guided and oriented and thus, should be subjected to graduated regulatory requirements and supervision based on the size and type of activities. There should also be a common standard for reporting in order to allow for sound financial performance analysis and information dissemination and consequently, help promote the sector's growth.

The National Bank of Cambodia (NBC): The NBC is the central bank of Cambodia. Through the law on the Organization and Conduct of the NBC, the main functions and duties were defined for the NBC. These are (1) to act as the monetary authority; (2) to act as the sole issuer of national currency of the country; (3) to act as the supervisory authority over the banking/ financial system; (4) to oversee the payment system of the country; and (5) to manage the international reserves of the country.

Commercial and Specialized Banks: Since the rehabilitation stage of Cambodia, the commercial banks have played a more actively role in providing the credit and saving products to the Cambodian population, but limited in the central areas. The commercial banks are different from the specialized banks because they can perform the banking operation, including credit, saving and payment; whereas, the specialized banks are allowed to perform only one of the three banking services. In Cambodia, specialized banks focus more on credit provision. Recently, commercial banks start to expand their operational outreach to rural areas due to competitive demand evident by microfinance institutions. Notably, ACLEDA Bank has proven a great success in term of transforming from NGOs to a specialized bank and then to a commercial bank.

Licensed Microfinance Institutions: Microfinance institutions were mostly transformed from NGOs, which then received their licenses from the National Bank of Cambodia. The licensed MFIs are categorized differently from the registered rural credit operators because their operations are greater and clients are more broadly based. Normally, the MFIs are allowed to provide credit and savings services to the rural people. In the late 2008, the National Bank of Cambodia issued a regulation to allow licensed MFIs to mobilize public savings in order to service their lending operations. The savings license is an additional license to the license for microfinance operations. In order to obtain this savings license, the MFIs need to fulfill certain criteria. This has brought up another category of MFIs in which they are the licensed MFIs and the deposit-taking MFIs (or so called MDI).

Registered Rural Credit Operators: Normally, the organizations come under the NGOs legal form, but they need to register with the National Bank of Cambodia. The organizations usually provide loan to their group members of the same occupation or type of business. The registered rural credit operators are also regulated by the NBC, but with lesser requirement than the licensed MFIs. The operations of those organizations are still small and more focus on their targeted group. The NBC may require those organizations to transform to licensed MFIs once their operations are significantly increased, exceeding the thresholds set for licensed MFIs.

Informal Money Lenders: There is still a market for informal moneylenders. However, due to the comparative advantage over the interest rate in the formal sector, people tend to access the formal financing. There is no specific statistics provided on informal moneylenders. The reasons of choosing informal money lenders are mainly because of less complicated process, less requirements and networking.

2. Rural Financial Policy Environment

To address the lack of rural financial services, the Royal Government of Cambodia (RGC) has adopted a series of policy measures over the last 15 years, supported by international donors: (i) establishment of the Credit Committee for Rural Development (CCRD) in 1995; (ii) introduction of a framework establishing laws to enable eligible NGOs and other rural finance providers to become regulated microfinance institutions (MFIs); (iii) creation of a unit in the National Bank of Cambodia (NBC) to supervise and monitor MFIs; and (iv) establishment of an apex institution to provide wholesale financing for MFIs, namely the Rural Development Bank (RDB).

The FSDP 2001-2010 identified rural finance as a critical sector requiring development and support. It was recognized that the banking system has not been able to address the demand for finance among the poor, to smoothen consumption, build assets and develop micro-enterprises. This has been expressed by the most obvious manifestations of poverty, such as

insufficient household income, lack of productive assets and inaccessibility of affordable financial services.

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

Since 2001, the microfinance sector has shown dynamism, with good results for a sector in its present stage of development. This has been mainly due to the government’s willingness to allow the commercialization of microfinance in the country with a private sector approach supported, where necessary, by the government and the donor community. The continued development of a supportive network by the government and donors, whilst allowing the private sector freedom to act within the legal and regulatory framework, aims at supporting additional rapid growth. The inter-linkage and integration of the microfinance sector with the commercial banking sector continue as a major priority.

It can be said that Cambodia is among the first countries that put in place the fundamentals of a market-oriented policy framework. It has adopted a market-oriented interest rates policy. Policy authorities in Cambodia are guided by the school of thought that most of funding sources for MFIs are private funds; whereby the interest rate cap could discourage growth. This is because when microfinance operations are not profitable, there will not be any further investments in this sector. Also, since it is market-driven, interest rates will be determined solely by competition in the market. With respect to branch networking, MFIs are actively encouraged to open branches in order to increase the outreach to the poor as well as to increase competition.

Moreover, the Government of Cambodia is not directly involved in microfinance operations or lending. Microfinance operators make their own credit decisions without influence from the government. The Government merely promotes the transformation of NGOs into MFIs, which are also categorized under the form of commercial enterprises by setting simple conditions for them to comply with. The Government has also focused on the establishment and provision of appropriate support services in the rural areas. For instance, national and rural road systems have been rebuilt in the remote areas. Better roads allow microfinance operators to enter and provide services at lower costs by bringing down the interest rates for the borrowers. In addition, the construction of irrigation systems such as canals and ponds also contributes to increasing capacity of microfinance borrowers to pay back their loans as they are able to enhance their production and raise their incomes. Other technical support services, such as training on new farming technology including the correct use of fertilizers as well as proper animal feeding, have

been given by the government and other development agencies in order to increase the livelihood skills for the poor.

Outlined below are requirements for the Cambodian microfinance sector's future development, categorizing into three levels: the macro level, the meso-level and the micro level. These potential developments should not be time-bound or time-constrained, but should be prioritized and sequenced based upon expected impacts and absorptive capacities.

Macro level

Support is needed for continued capacity development at NBC for effective regulation and supervision of the microfinance sector, while at the same time making sure that all institutions taking deposits are subject to graduated regulatory requirements and supervision based upon size and complexity of activities.

Microfinance markets throughout Cambodia must be properly identified and defined, and this is an area in which the MEF should provide significant support. There needs to be improved statistical analysis and market definitions, geographically, sectorally, in size and in scope. There is also a requirement to define and elaborate on the scope of alternative financing sources at the local levels (moneylenders, family, friends, village banks, cooperatives, etc). This will inform MFIs and provide the basis for product development, better policies and, for the government, the potential identification of incentives to promote development as well as appropriate regulation and supervision. Authorities must create capabilities to support other forms of microfinance institutions (community-based, non-registered, etc) to broaden the types of needs being met, and introduce greater variety and flexibility into the system.

Meso level

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

Management information systems (MIS) for MFIs must be improved. The quality of software and systems presently varies considerably, with some MFIs unable to access integrated accounting and loan portfolio systems, whilst others have very expensive and effective systems.

Minimum standards for MIS in the microfinance sector need to be established, particularly when improved common reporting standards are introduced. This may call for the holding of national licenses by meso or macro level organizations on behalf of the MFIs, in order to ensure minimum quality of support to those organizations.

Development of a wholesale market for loan financing, operated within the private sector and linking the MFIs with the commercial banking sector is required. At the moment, MFIs have difficulty in accessing credit in riel. A national wholesale payment system and money/interbank market should not only link the microfinance and banking sectors, but should also provide flexibility in the currency in which loans are provided. Additionally, linkages should be extended via measures enabling the banks to obtain experience of lending to, and working with MFIs. This requires a less collateral-based approach to lending and the development of a more cash flow/accounts analysis-based view. Potential for interim guarantee measures to enable banks to gain such experience will be considered.

The establishment of the Cambodian Microfinance Association (CMA) provides an opportunity for improved representation in the sector. CMA may be further developed to disseminate improved policy options, to improve dialogue, advocacy, and research and information exchange. A local MFI rating system is needed, based upon commercial ratings support and also linked to a credit information exchange. The information exchange should include both positive and negative information. If customers are to graduate to the commercial banking system, they will need to have established an accessible, good credit history.

Micro level

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

3. Regulatory Framework

Commercial banking and rural finance are both major elements of the financial system of the country. As such, the regulator must pay attention not only to banks but also other components of the financial system such as rural financial institutions providing funds for small and micro enterprises and credit to the rural poor.

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

In particular, for the improvement of financial transparency and disclosure, the NBC is strengthening the implementation of a uniform chart of accounts and the disclosure requirements for MFIs in line with the international accounting standards. Especially, all MFIs are required to have annual audited financial statements. The NBC is strengthening the management of the MFIs as well. It also has to conduct off-site supervision of regular reporting and on-site inspection. Moreover, field visits have been conducted to verify activities of MFIs applying for a license or registration.

With microfinance operations, however, the supervisory authority faces a dilemma. On the one hand, microfinance must be regulated in order to avoid incompetency, and in some cases the mismanagement, which can undermine the banking system. On the other hand, if regulation is too strict, and in particular if capital requirement is too high, microfinance might exhibit the same behavior as banks, fleeing from rural areas and concentrating their activities in major cities. Therefore, the NBC has released a set of regulations according to the size of MFIs.

For the first time, the NBC issued regulations on the classification of MFIs into three categories according to the level of their operations, and created criteria accordingly for licensing and registration. The main obstacle preventing NGOs from transforming into MFIs is ownership structure. At the beginning, it is difficult to identify the shareholders because the funds used by NGOs to operate microfinance programs are initially granted by international donors. But eventually, the organization is established as the owner of those funds, opening the way for NGOs to transform into MFIs.

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

To summarize, in terms of supervision and regulation, the NBC is responsible for maintaining integrity and a sound banking and financial system in order to encourage public

confidence, protect depositors from fraud and encourage good governance. To do this, complete sets of criteria have been issued such as licensing and registration procedures, minimum capital requirement, solvency ratio, liquidity ratio, uniform chart of accounts, reporting requirement, and so on. Furthermore, the NBC also conducts off-site and on-site supervision and inspections on a regular basis in order to ensure that all MFIs are operating professionally and prudentially. Those regulations are consistent with the scope of work of MFIs and support expansion of their activities in an appropriate manner.

4. Innovative Approaches to Encourage Credit for the Poor/Small Farmers and Fisher folk

Cambodian MFIs are quite mature in terms of lending to the rural poor, particularly the small entrepreneurs, farmers, traders, and the like. The basic loan methodologies such as individual and solidarity lending remain unchanged. However, they are better responding to the needs of particular types of clients following their income stream and repayment ability. The effort of employing technology in microfinance operations is gaining momentum. The MFIs are now starting to engage and employ mobile phone operations technology in order to service savings, transfer and payment. The piloting stage for loan transactions in this regard is seen emerging.

An example of WING's operation has been a remarkable stage for innovative product in rural Cambodia. WING is a mobile phone payment provider established by the ANZ, which launched its operations in Cambodia in early 2009. Customers can use WING's services for money transfers, cash in and out, and payment. WING's targeted customers are garment workers and rural people moving to work in urban areas. So far, WING has built and extended its operational network to include 567 WING Cash X-Press outlets across 19 of 24 provinces. WING's customers have increased to 71,067. Currently, two MFIs, the Vision Fund and PRASAC, have conducted piloting project with WING in using mobile financial services such as cash transfer and withdrawal. Later, the transaction of WING will be employed in lending to a larger group of rural people.

C. Major Issues and Constraints that Affect the Development of the Rural Financial Market

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

New product development

Electronic banking is a means by which banking business is transacted through automated processes, for example ATMs and electronic devices such as computers/internet, telephones and plastic card payment. As the number of banks and financial institutions and their branch networks increase, the banking business becomes more competitive. Banks and financial institutions seek to design and develop new financial products to satisfy their clients in terms of quicker services, speedier access to financial services and cheap costs. In view of the introduction of electronic banking and spread of IT in banks and financial institutions in Cambodia, it is important to establish a regulatory framework for electronic banking to protect depositors' money. The risks associated with electronic banking include all the inherent banking risks. The newly established mobile phone banking and micro insurance services are also an illustration of growing product diversification in the microfinance industry. But, these are yet to be brought under particular supervisory regulations or requirements.

In response to this emerging challenge, the next task of the NBC needs to be a further study of the possible application and impact of these new products and technologies in the Cambodian context, with a view to preserving the interests of banking and microfinance clients directly involved in these services. The NBC is in the process of discussing with banks and financial institutions about the establishment of a regulatory framework for mobile and e-banking to ensure safety of the payment system and depositors' money.

Enhanced commercial microfinance

Though financial services to the poor began with NGOs focused on relief and rehabilitation work, microfinance activities have now steadily and increasingly turned into an important industry in Cambodia. More and more NGOs have acquired licenses and transformed themselves into licensed MFIs. Some have even achieved financial stability and have effective self-regulation mechanisms in place. As the experience has shown, effective self-regulation mechanisms associated with the motive of attaining self-sustainability through commercialization of services are possible. Regulators see that micro-financial service providers need to develop themselves in order to meet the dynamic, changing operational conditions. They have to consider various elements when moving to commercialization, which include, among others, management information structures, institutional values, operating systems, and professional staff. Bilateral and multilateral agencies can play an active role in promoting the commercialization of micro-finance, in particular through equity participation. Just like the advantages of traditional forms of foreign direct investment in the manufacturing or formal banking sector for the host economy, such participation on the part of those agencies in the rural finance institution framework brings both financial benefits and technical expertise to the local service providers. The NBC also promotes participation of private investors involved in microfinance activity. Some of them have been transformed from informal moneylenders into formal microfinance lenders.

Improved financial sustainability of microfinance operators

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

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

Corporate governance

It has been observed that corporate governance in many microfinance institutions has not been well established. A non-existent code of ethics, improper lending to related parties and ineffective boards are major concerns. Management failure is usually a result of such poor corporate governance. To strengthen governance and prevent the related risks for banks and financial institutions, the NBC has already issued regulations on corporate governance (Prakas on Good Governance of Banks and Financial Institutions, 2008) and the regulations covering internal control systems and external auditors in line with international standards, especially the Basel Core Principles for Effective Banking Supervision. To ensure compliance with these regulations, MFIs will be required to establish policies and procedures that effectively delegate operations and also strengthen the board of directors, managers and staff capacity.

Credit Information System (CIS)

The National Bank of Cambodia has recently issued the regulation on Credit Reporting or Credit Information Sharing. The purpose of establishing a credit information sharing system is to promote sound credit activities and risk management of all entities participating in the financial

system by allowing authorized member banks and financial institutions to share positive and negative credit information relating to borrowers amongst their clients. The Credit Information System is an important tool in the loan approval process and thus in rural credit growth, especially when there is high competition between microfinance institutions in one operating area. However, due to the recent introduction of this service, there are a lot of issues arising and needing better understanding in pursuit of effectively using the system.

Supervisory Capacity

As new product development and the number and size of MFIs grow continuously, the regulatory authority needs sufficient supervisory resources in term of budget, human resources, and sound regulatory framework to catch up with the growth and changes. The fast development of financial services, the technology and modern electronic equipment require supervisory officers to upgrade their knowledge at every opportunity since these new services have created new risks. Thus, the training of supervisory officers drives effective supervision to catch up with the overall development of the financial sector. Besides an in-house training program, the NBC also receives training from other institutions such as the International Monetary Fund, the Asian Development Bank, SEACEN and other central banks and associations. The NBC also continues to host conferences on microfinance in Cambodia, to enhance the capacity of supervision officers to catch up with recent developments and contribute to the strengthening of a sound banking and financial system in the country, and to gain confidence from local and foreign investors. Nevertheless, capacity building at the NBC, in order to acquire adequate expertise and manpower to supervise MFIs, remains a challenge. Such a challenge can only be overcome with ongoing support and enhancement.

Regulation and supervision

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

banks and MFIs that are not yet in full compliance with laws and regulations, reviewing and issuing new regulations and continuing to publish supervision reports in the public domain.

D. Conclusions

Microfinance has provided benefits and contributed to the development of rural finance, which is one of the most important sectors in the poverty reduction policy of the Cambodian government. The microfinance sector in Cambodia has been internationally recognized and highly rated since it commenced towards a sound regulatory, supervisory, and managerial environment. And, the operational outreach goes beyond just the number of clients to reaching clients at the level of poverty.

The main benefit that clients receive from microfinance is improved living standard via access to credit services, if the borrowing fund is utilized in productive activities rather than in non-productivity. They also benefit from lower rates of interest charged by the MFIs compared to informal moneylenders. The lending methodology of microfinance is more customer-oriented with MFIs designing their products to meet the clients' actual demand. A good credit culture also indicates that the clients are taking responsibility in making principal and interest repayment when they come due. The good credit culture is observable in the high repayment rate of the poor who borrow money from MFIs.

A decreasing trend in microfinance interest rates has resulted from fair competition in the industry, physical infrastructure development, internal management improvement, and better cost control mechanisms. Also, the advantages of regulated MFIs come from the sound management and regulatory compliance, which subsequently contributed to better operations and more public confidence. These factors are important for microfinance institutions to access funding sources from the market. Also, the operational structures of regulated MFIs have been designed in a more efficient and prudential manner in pursuit of strengthening their institutional capacity. Moreover, since the transformational mechanism aims to make microcredit operations self-sufficient, virtually all MFIs are targeting commercial funding sources to prove the ability of the institutions to develop self-generating income and cover their expenses.

On top of the achievements and efforts of the MFIs within the industry, Cambodian microfinance cannot ignore the vital support of international donors and investors in the form of technical assistance and funding sources. In addition, the Government's well-directed policy, including the Financial Sector Development Strategy, has proven crucial in leading to the successful development of the financial sector, especially the role of microfinance in poverty reduction.

Despite these satisfactory developments, however, the industry remains at an initial stage and encounters a number of challenges. To overcome the challenges the sector must be encouraged to extend their branches in the remote areas and to mobilize savings; to promote new

product development; to enhance commercial and sustainable microfinance operations; to strengthen corporate governance; to further develop and implement credit information systems; and particularly to strengthen regulatory and supervisory framework and capacity.

About the National Bank of Cambodia:

The National Bank of Cambodia is the “Central Bank” which is an autonomous public entity of a commercial and industrial nature. The principal mission of the Central Bank is to determine and direct the monetary policy aimed at maintaining price stability in order to facilitate economic development within the framework of the Kingdom's economic and financial policy.

The Central Bank shall have the following functions and duties:

1. To determine monetary policy objectives, in consultation with the Royal Government and consideration of the framework of the economic and financial policy of the Kingdom;
2. To formulate, implement and monitor monetary and exchange policies aimed at the determined objectives;
3. To conduct regular economic and monetary analysis, make public the results, and submit proposals and measures to the Royal Government;
4. To license, de-license, regulate and supervise banks and financial institutions and other relevant establishments such as auditors and liquidators;
5. To oversee payments systems in the Kingdom, and to enhance interbank payments;
6. To act as the sole issuer of national currency of the Kingdom;
7. To undertake and perform, in the name of the Kingdom, transactions resulting from the participation of the Kingdom in public international institutions in the banking, credit, and monetary spheres;
8. To establish the balance of payments;

9. To participate in the management of external debt and claims;
10. To participate in the formation and supervision of the money and financial markets;
11. To license, de-license, regulate and supervise all those operating in the securities and foreign exchange markets, the market for precious stones and precious metals; and
12. To set interest rates.

About the Authors:

H.E Pal Buy Bonnang, is currently an Assistant Governor and Director General of Banking Supervision of the National Bank of Cambodia. Prior joining the National Bank of Cambodia in 1998, H.E Pal Buy Bonnang was a senior official at the Phnom Penh municipality since 1979. During his service at the NBC, he served various positions such as director of Center for Banking Study and General Director of Inspection. His intensive experience and enriched financial and banking background have allowed him to lead the senior positions in the NBC with a wise and respected name. H.E Bonnang possesses a master degree of Business Administration from Charles Sturt University of Australia in 2003.

Mr Kim Vada is currently a Deputy General Director in charge of banking supervision department of the National Bank of Cambodia. Prior to this post, he has served as Deputy Director and Director of the Banking Supervision Department. His thirty years of service has been committed to the banking system reform in Cambodia. In these last few years, Mr. Kim has been actively participating as a prominent speaker in various conferences and events in the country and international, pertaining the regulatory framework in banking and microfinance supervision and the mobile banking services. And, apart from the work with Central Bank, he was also a lecturer in three well-known universities in Cambodia. He owns a master degree of Business Administration from Charles Sturt University of Australia since 2003.