Short-term Trend or Long-term Shift?: Institutional Credit in Rural Cambodia

There is evidence that rural households are borrowing more often from institutional sources. In this article, Brett Ballard looks at changes in the structure of rural credit markets in terms of loan source, use and size.*

Introduction

Two recent CDRI studies show that people in agriculture and business continue to rely primarily on their own resources for expenditures and investments, followed by borrowing from family and friends and institutional sources (Ballard and So, 2004; Kang, forthcoming). While own sources and informal credit arrangements with trusted sources may provide sufficient capital for financing small-scale activities, larger amounts of capital are often required for improving agricultural productivity and business expansion. Although some degree of economic growth occurs in the absence of a well-developed banking system (Kang, forthcoming), the low level of integration between investors and institutional credit is an obstacle to long-term equitable growth and poverty reduction.

There are some indications, however, that an increasing number of borrowers are now obtaining credit from institutional sources. This may signal an important step in the institutional development of credit markets in rural Cambodia, although the scope and scale of this trend are not yet clear. Such a transition raises important policy and programming questions for government planners and donors about the extent to and pace at which farmers should be encouraged to borrow in the formal sector. Another question concerns the conditions under which such objectives can be achieved most efficiently.

This article looks at changes in rural credit markets in terms of loan source, use and size. It observes that small-scale NGO savings-and-loan groups and microfinance institutions (MFIs), as well as specialised and commercial banks, all have important roles in meeting the credit needs of rural investors. Additional efforts are required, however, to make affordable credit available to more people in rural areas if pro-poor economic and social policies are to be achieved.

Credit Sources in Cambodia

The range of informal and institutional sources of credit is modeled in Figure 1. Researchers have identified a wide range of sources in the informal sector (Murshid, 1998), including family and friends, moneylenders and traders/merchants. Credit arrangements with family and friends are characterised by low or non-existent interest rates, little or no collateral and flexible usage and repayment terms. Moneylenders may allow some flexibility in terms of repayment and use, but they tend to charge higher interest rates, in the range of 10–20 percent per month, and may require collateral. Traders or merchants provide cash or in-kind loans of varying amounts for specific uses, with a wide range of repayment arrangements.

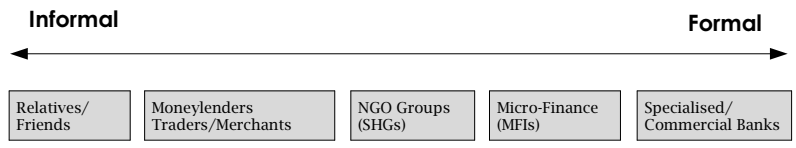
The institutional sector is currently composed of nine MFIs and four specialised banks, including the state-owned Rural Development Bank (RDB), and several commercial banks, including ACLEDA. The MFIs have evolved from smaller NGO-sponsored credit associations and often retain certain elements of their original structure (e.g., small groups) and objectives (e.g., modest loans targeting the poor). The MFIs are licensed by the National Bank of Cambodia (NBC) and as such are eligible to borrow capital funds from the RDB. The MFIs and banks usually require some form of collateral and charge interest rates in the range of 3–5 percent per month. They may also lend only for specific purposes, and some have ceilings on the size of loans. Although their interest rates are lower than those often found in the informal sector (e.g., moneylenders), they are still too high for many low-income households, especially when collateral requirements and transaction costs (e.g., travel time, paper work) are added (Kang, 2002).

The institutional sector also includes approximately 90 NGOs, 18 of which are registered with the NBC. Beresford *et al.* (2004) classify these credit sources as "semi-formal" along with MFIs, while Urashima (2002) excludes MFIs from her definition of semi-formal institutions. Regardless of their exact location on the credit continuum, these groups generally receive advice, training and various modes of capital assistance from NGOs or other donors, often in conjunction with other community development projects. They tend to provide smaller loans with flexible terms (e.g., interests rates of 1–3 percent, minimal or no collateral) that enable people to obtain credit for a variety of purposes in ways that are both economically manageable and socially familiar. In this way, these programs perform an important "bridging function" by providing rural people experience with structured credit arrangements.

Loan Source

Table 1 below suggests that significant changes in the distribution of credit sources along this continuum have

Figure 1: Continuum of Credit Sources in Cambodia



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occurred since 1996. The 1996 SESC (NIS, 1997) survey found that 813,148 (about 47 percent) of all rural households obtained loans in 1994-95. Of these loans, 88 percent were obtained in the informal sector. CDRI's 2001 rural livelihoods survey (RLS) of 1,005 households found that 50–52 percent of households had obtained cash loans during the previous wet and dry seasons, with some seasonal variation. Some 77.6 percent of the loans were obtained in the informal sector. CDRI's land titling survey (LTS) of 1,232 rural households in early 2004 found that 52.7 percent of households had obtained cash loans in the six-month period prior to the study. About 62.1 percent of these loans were obtained in the informal sector. The reduced percentage of borrowing from informal sources corresponds to an increase of borrowing from semi-formal and formal institutional sources between 1996 (11 percent) and 2004 (37.9 percent).

Table 1: Credit Sources (percentage of loans)

Lenders	SESC: 1996	Rural Livelihoods	LTS 2004
Relatives	51	44.5	46.5
Friends	15		
Moneylenders	15	33.1	15.6
Traders	7		
NGOs	10	8.6	9.4
MFIs			22.9
ACLEDA		7.1	5.6
Others	1	6.6	
Banks	1		

The two CDRI surveys found a similar percentage of households obtaining cash loans (50 and 52.7 percent), which was higher than the 1996 SES study. The two studies differ, however, in that the frequency of loans from institutional sources increased from 15.7 percent in the 2001 RLS to 37.9 percent in the 2004 LTS. This appears to be largely a function of people borrowing less often from moneylenders (and perhaps traders to a certain extent) and more from NGO groups and MFIs. People's apparent preference for NGOs groups and MFIs compared to moneylenders could be attributed to lower interest rates and a wider range of services and products, as well as organisational reach at the local level.

Such factors may also, under certain circumstances, adequately explain why people might borrow less from traders.[1] Any such shifts, however, could represent short-term fluctuations in market cycles, or may depend on the location and type of products being traded. Fishers and resin tappers, for example, with few viable credit alternatives, may prefer cash or in-kind credit from traders as easier and less costly to arrange. Such arrangements may also help ensure market access for their products (Prom and McKenney, 2003). Farmers, however, might prefer cash credit from institutional sources for purchasing productive inputs rather than take such inputs on credit from traders or merchants at higher interest rates.

People across all income levels and/or landholding sizes borrow from multiple sources depending on needs and circumstances (e.g., emergencies, seasonality). As a result, decisions about the source and use of loans are both strategic (e.g., investments) and tactical (e.g., household cash flows). For example, although some people may prefer borrowing from an NGO or MFI, medical emergencies or an inability to meet collateral requirements for agricultural inputs may push them to continue borrowing from moneylenders or traders. Rural financial markets remain highly fragmented, and therefore any long-term shift from informal to formal borrowing sources may not follow a linear progression.

The observed trend toward more borrowing from institutional sources may be more clearly attributed to the increasing supply of lower cost credit and range of products and client services. For example, ACLEDA's growth from 14 branches in 34 districts in 2000 to 15 branches in 82 districts has been accompanied by an increase in the number of loans from 102,473 in 2000 to 159,510 in 2003, an increase of 55.6 percent. During the same period, the average size of loans increased from $299 to $466. There is also some indication of expansion among MFIs. For seven of the nine MFIs, NBC data show a combined total of 151,102 borrowers at the end of 2002 and 184,348 in June 2004, an increase of 22.0 percent.[2]

As for NGO groups, there is evidence to suggest that some degree of expansion is taking place in at least some areas. For example, Padek reported 1,363 membership loans in 22 groups in Kompong Speu in 1997 (Rao and Swift, 1998). Since then, there have been an additional 4,429 membership loans in 445 new self-help groups (SHGs) in five provinces (Padek, forthcoming). Beresford et al. (2004), however, have also observed that some NGO groups are only "marginally viable" and may be near collapse. This suggests that donors need to complement their financial assistance with additional technical support to help semi-formal credit associations, as well as MFIs, improve management practices.

One final comment is warranted regarding the impact that semi-formal and formal institutions might have on informal sector interest rates as they expand their operations in rural areas. There is anecdotal evidence to suggest that some moneylenders have reduced interest rates in order to compete with institutional lenders. However, the distribution and impact of the benefits to rural households from lower informal interest rates from such competition are not clear. For example, Murshid (1998) and Sophal and Acharya (2002) have observed that poor households are routinely charged higher rates than richer households. By how much are interest rates actually reduced, and to what extent are such reductions passed on to poorer households? More research on such questions is clearly required.

Loan Use

Any assessment of reported loan use must bear in mind that people sometimes give one reason for borrowing but then use the money for other purposes. The difference between production and consumption loans is also sometimes blurred, as in the case of loans for transporta-

tion. Nevertheless, the distinction remains sufficiently useful for the purpose of identifying general patterns in loan use.

The LTS data show that loans for productive investments accounted for 37.1 percent of all reported credit activity, including rice farming and other cultivation (16.2 percent), small-business-related activities (11.6 percent) and animal raising (9.3 percent). Consumption expenditures accounted for almost 40 percent of all credit activity, including "distress borrowing" for health care (20.9 percent) and food shortages (16.8 percent). Housing accounted for 6.5 percent of loans, while other activities (e.g., ceremonies, transportation), accounted for the remaining 18.7 percent.

This contrasts with an EMT study (Benkirane, 2003) that found that 64 percent of loans were for productive purposes, including 28 percent for crop cultivation, 27.6 percent for animals and 8.4 percent for "investment," which probably included micro or small business. About 20 percent of loans were for consumption, although the study did not break this category down further. The remaining 15.9 percent of loans were for other reasons. This distribution of production and consumption loans roughly approximates the distribution found in the Padek SHGs since 2000 (Padek, forthcoming).

The difference in the distribution between production and consumption loans in the LTS, on the one hand, and EMT and the Padek SHGs on the other, may be explained in part by the role that groups play in assessing members' loan usage. Although there is some flexibility that allows loans for consumption, the emphasis within these groups tends to be more on income-generating activities. Some NGOs, including Padek, also provide extension services (e.g., small business management, cultivation, animal health) that support loans for productive purposes. This impression holds for NGOs and PRASAC in the LTS, in which 65.9 and 64.0 percent respectively of their loans were for production. However, only 42.3 percent of the MFI loans were for production. The relatively high percentage (40 percent) of loans for food and health costs among the MFIs may be related to seasonal or locational variations (see below).

The questions associated with loan use are especially problematic when people borrow for social ceremonies (e.g., weddings) or immediate costs (e.g., health care, food shortages), and then have to sell productive assets such as animals or land to repay. Researchers have observed that short-term distress borrowing places a significant burden on the poor and may crowd out potentially productive investment (Murshid, 1998, Chan and Acharya, 2002). Researchers have also linked health care costs with asset sales (e.g., Biddulph, 2004). Health care and food security are thus two areas requiring concerted attention if policies designed to direct financial resources to their most productive uses are to succeed.

Loan Size

The LTS data in Table 2 show that loan size varies according to source and use. People tend to obtain larger loans from institutional sources than they do from informal sources, although the frequency of borrowing is higher in the informal sector. The largest loans were obtained from ACLEDA, averaging 85 moeun riels. The average size of NGO and MFI loans was 24.69 and 20.6 moeun riels respectively. This figure, however, excludes the 25 PRASAC NGO loans, which averaged 79.6 moeun riels. In the informal sector, the average size of loans from relatives and friends was 32.6 and 19.8 moeun riels respectively. The average size of loans from moneylenders was 24.65 moeun riels, which is almost the same as NGO sources at 24.69 moeun riels. The data suggest, then, that the location of the loan source on the credit continuum is not necessarily a good indicator of loan size.

ACLEDA also provided the largest loans (68.5 moeun riels) in the 2002 RLS, followed by moneylenders and then relatives and friends. This differs from the LTS pattern, where loans from relatives and friends were, on average, larger than the loans from moneylenders. Although the RLS does not specifically refer to other MFIs or NGOs, this change could reflect the fact that people are using the increased supply of institu-

Table 2: Loan Size by Credit Source & Loan Use

Purpose	Family/Friend		Moneylender		NGOs		MFIs		ACLEDA		Total **	
	No.	Amt.*	No.	Amt.	No.	Amt.	No.	Amt.	No.	Amt.	No.	Amt.
Agriculture	62	17.7	27	20.5	23	15.4	22	24.8	7	53.6	147	22.5
Business	29	57.8	15	23.5	14	20.8	26	21.3	16	128.2	105	49.7
Food	84	12.3	26	20.3	4	30.5	26	11.3	10	27.7	152	15.2
Health	99	29.7	24	20.6	9	35.9	47	13.2	7	45.0	189	25.6
Livestock	20	48.1	7	16.1	19	19.8	29	19.8	4	140.0	84	35.5
Housing	40	68.5	5	44.4	5	40.0	9	48.3	0	0.0	59	60.9
Other	87	33.6	37	32.8	11	39.4	23	31.4	7	107.9	169	47.7
Total/average	421	31.8	141	24.7	85	24.7	182	20.6	51	85.0	905	32.1
% of Total	46.5		15.6		9.4		20.1		5.6			

** Average amount in moeun riels. 1 moeun riels = 10,000 riels = $2.50; ** Includes 25 PRASAC loans not included under NGOs*
Source: CDRI Land Titling Baseline Survey (Jan.-Feb. 2004)

tional credit (i.e., NGOs and MFIs) to obtain lower cost loans when possible. Once again, this observation suggests that any shift from informal to institutional sources is not necessarily following a linear progression.

The largest loans in the LTS were for housing (60.9 moeun riels) and productive purposes, including business activities (49.7 moeun riels), followed by livestock (35.5 moeun riels) and rice farming and other cultivation (22.5 moeun riels). Loans for consumption purposes were generally less for health (25.6 moeun riels) and food (15.2 moeun riels). The largest loans for rice farming and other cultivation were obtained from institutional sources, although there was a higher frequency of loans for such purposes in the informal sector. People borrowed more frequently from family and friends for short-term needs (e.g., food, health), although the average amounts were between ACLEDA and the MFIs. These observations generally coincide with the RLS, which speculated that loans from institutional sources are generally larger because they are intended for productive uses, while loans from informal sources are generally used to cover short-term or seasonal needs.

Such a relationship between loan source, use and size, however, may not always hold. For example, in the LTS, people obtained larger loans from relatives and friends for housing (68.5 moeun riels) than they did from MFIs (48.3 moeun riels). In the business sector, the largest loans were indeed obtained from ACLEDA and PRASAC (128.2 and 59.0 moeun riels respectively). People then, however, obtained larger loans more frequently for business investments from family and friends (57.8 moeun riels) than from NGOs and MFIs (20.8 and 21.3 moeun riels respectively). This observation may provide some support for Kang's (forthcoming) hypothesis that when people borrow for business purposes, they tend to borrow more from trusted family and friends for start-ups, while obtaining larger loans from institutional sources for maintenance and/or expansion. If this is the case, any evidence of increased borrowing from institutional sources for business start-ups would indicate a significant achievement in the development of rural financial markets.

Locational Variation

The RLS observed that people tend to borrow more in villages where activities are commercialised because of a larger degree of market integration. People also borrowed larger amounts in some villages compared to others. Chan and Acharya (2002) suggest that the frequency, size and use of loans may be related to the degree of modernisation of agriculture or the vibrancy of non-farm activities.

Table 3: Distribution of Loans by Commune and Source (%)

Commune	Informal	Semi-Formal	Formal	Total Loans	
				No.	No/HH
Trap. Sab	52.7	13.7	33.6	131	1.03
Roveang	69.7	8.3	22.0	109	1.18
Srayov	58.1	11.8	30.1	93	1.50
Ti Pou	80.5	2.6	16.9	77	.65
Sambour	70.2	0	29.8	114	1.16
Srangle	85.7	1.1	13.2	91	1.12

The LTS also found some variation in loan sources and uses across communes. For example, Trapeang Sab (Takeo), Srayov (Kompong Thom) and Sambour (Kompong Cham) are among the most economically active areas in the survey sample in terms of their location along major highways and proximity to commercial centres. They have three of the highest loan frequencies, three of the highest borrowing rates (number of loans per borrowing household) and the highest percentages of loans from formal sources, which in this case include MFIs and ACLEDA. Ti Pou (Kompong Thom) is less integrated with area markets and less economically diverse due to its location. Ti Pou also has the lowest frequency of borrowing and the lowest percentage of formal borrowing.

The distribution of borrowing for production and consumption also varies somewhat according to commune. For example, in Sambour and Srayov, production accounted for 56.1 and 36.6 percent of the loans respectively. In Ti Pou, however, only 14.3 of the loans were for production, while 63.6 percent were for consumption.

Conclusion

Borrowers in the rural sector are likely to shift increasingly to institutional sources over the next few years. The pace and direction at which people move along the credit continuum in any particular area will depend on factors including (1) the range of available credit options, (2) the level of economic activity and market integration and (3) people's propensity (e.g., institutional trust, expected returns, information) and capacity (e.g., wealth, assets, occupation) to borrow. The distribution of the benefits of increased access to institutional credit, particularly among poorer households, will also depend on a variety of factors, including food security and access to affordable health care.

NGO and MFI credit programs are reaching an increasing number of people in the rural areas. The organisational reach of these programs, however, is still limited, and despite the general flexibility of terms, some programs remain too costly for the rural poor. Donors can continue playing a vital role in the development of rural credit markets by increasing their financial and technical support for micro-finance programs, especially in areas where other institutional options are not available. The government can also help to promote credit associations by establishing a legal status and associated regulations that would enable them to obtain credit from specialised or commercial banks without incurring the administrative costs of the current MFI model. This would promote sustainability and release donor resources to support new rural credit programmes.

The specialised and commercial banks should continue expanding their operations in rural areas and liberalise their terms of credit (e.g., reducing interest rates, amending collateral requirements) as appropriate so that more rural people have access to loans. For example, the

rate at which the RDB lends to MFIs could be lowered, which in turn would enable them to lower interest rates for rural customers. These institutions should also continue their efforts to provide expanded services and products to rural clients. More competition in rural credit would also stimulate better terms and services for customers. Government also has an important role to play in ensuring that liberalisation and competition do not induce irresponsible lending.

In terms of improving access to formal credit, the government is already taking important steps by providing land titles that can be used as collateral. If anything, these efforts should be expanded and accelerated, particularly in areas where semi-formal and formal credit institutions exist alongside developing markets. Such efforts would be most effective in areas with accessible and affordable extension (e.g., crops, livestock) and social services (e.g., health care) .

Endnotes

1. Traders may have been included with moneylenders and others in the RLS, while traders are not referred to in the LTS, perhaps in part because LTS data refer to cash rather than in-kind loans.
2. Of the seven MFIs, four were registered as NGOs in 2002 and have since become licensed MFIs.

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Options for Initial Development ...

- ensuring the transparency and accountability of fund management;
- educating CS residents about the purposes and uses of the new sources of revenue;
- reducing the collection of informal revenues that divert resources needed by the CS councils.

This study has helped promising and feasible pilot projects to progress despite the remaining challenges and issues that need to be dealt with in the course of developing CS own-source revenues. Several follow-up studies have been identified to address issues that this study does not address. These include: (i) assessment of CS responsiveness and accountability after introducing CS own-source revenues, (ii) impact and outcome indicators on improved livelihoods and poverty reduction, (iii) assessment of the tax burden on local people and businesses, (iv) efficiency and effectiveness of tax collection in comparison between PM and CS levels, (v) identification and assessment of other feasible options for CS own-source revenues and (vi) assessment of the distribution and allocation of CS own-source revenues.

Endnotes

1. Provincial governor's office.
2. An annual business licence tax collected from all established businesses.
3. A daily market fee collected from vendors.
4. Target amounts are the amount of tax revenue that each PM tax branch is responsible for collecting. It is based on the previous year's collection, adjusted for changes in the tax base.
5. According to the Law on Taxation (1997), the tax regime is a system which categorises businesses and taxpayers into different legal obligations for tax collection purposes.