

This document is part of the Microenterprise Best Practices (MBP) Project's series of Technical Briefs on post-conflict microfinance, available at www.mip.org. The series discusses whether and how to use microfinance in post-conflict settings. The first seven briefs are designed primarily for microfinance practitioners. The final brief (#8) is designed for relief organizations considering microfinance for the first time. While experienced microfinance organizations are unlikely to find new information here, they may share this brief with non-microfinance organizations experimenting in this technical area.

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Developing a Post-Conflict Microfinance Industry: The Case of Cambodia

Microfinance in some form has been implemented following conflict in dozens of countries in Africa, Asia, Latin America, and in the former Soviet Bloc. This brief and its companion, Brief #3, reflect on some of these experiences. This brief provides an industry-wide look at how microfinance emerged in a post-conflict setting. Brief #3 provides institution-specific examples—examining the challenges and processes followed by two microfinance institutions in markedly different environments.

Microfinance has had a relatively short history in Cambodia. Yet, by the end of 2000 after only seven or eight years, the microfinance industry as a whole served some 340,000 clients, many of whom were very poor. Furthermore, several MFIs have achieved financial sustainability in this context. The experience of Cambodia demonstrates that when institutions are well-designed and well-operated, a microfinance industry can flourish and reach the poor in a viable manner even in a society and economy wracked by decades of conflict.



Widening the circle, moving ahead

MICROENTERPRISE BEST PRACTICES

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BACKGROUND

By the mid-1990s, Cambodia had suffered from 30 years of internal conflict. Many of these years also saw extreme international political and economic isolation which decimated the country's human resource base and left its physical infrastructure in ruins. Its financial system was virtually non-existent as a result first of the Khmer Rouge policies and then of those of the Vietnamese occupying government. The Khmer Rouge abolished money and banking during their reign of terror from 1975-1979. Following this, from 1979 to 1988 the Vietnamese instituted a centrally planned, mono-banking system, but by the late 1980s weak credit policies and mismanagement rendered this system moribund.

With the signing of the Paris Peace Accords in 1992 and the establishment of the UN peacekeeping operations, Cambodia emerged from its isolation. Hundreds of international organizations initiated relief and development programs to help reconstruct the country. They found formidable challenges to all types of development, including microfinance. First and foremost, security remained a concern as the Khmer Rouge continued to fight a low-intensity war. Transportation and communication were extremely difficult, and government institutions were weak. Most of the human resource base had either been killed or had fled the country. Inflation stood at 177% in 1993 and the local currency, the riel, was fluctuating wildly. Finally, no policy and legal framework for microfinance existed, and the communist-based frameworks of other related sectors were often incompatible with private enterprise and microfinance.

DEVELOPMENT OF THE INDUSTRY

Despite these challenges, a few organizations started experimenting with microfinance, primarily in the form of credit. These included the Group de Recherche et D'Echanges Technologiques (GRET) in 1991, World Relief in 1992 and the Association of Cambodian Local Enterprise Development Agencies (ACLEDA) and Catholic Relief Services (CRS) in 1993. Several modifications had to be made for Cambodia's difficult environment. One of the most dramatic was that many programs had to act temporarily as their own banks, flying in cash from Thailand and setting up vaults in their offices for the mountains of riel they handled.

Recognizing the low level of economic activity in the country, initial expectations were low: that microcredit would serve as a catalyst to spur economic activity. At that point, no program expected to reach financial viability.

In addition, some, such as ACLEDA,¹ tried initially to *target* specific disadvantaged groups. ACLEDA started as a reintegration and resettlement project of the International Labor Organization, focused on providing enterprise development training to returnees, demobilized soldiers, the disabled and widowers. Credit was intended to serve as a "carrot" to attract participants to business training courses.

By 1994, some 25-30 NGO microfinance programs were already reaching approximately 44,000 clients, yet felt that they were meeting only a fraction of the demand for

¹ Known at that point as LEDA, or Local Enterprise Development Agencies.

microfinance services. As a result, the major ones began to think of themselves not as temporary projects but as permanent MFIs. They started recasting their operations, eliminating or de-emphasizing non-financial services in order to focus increasingly on providing sustainable financial services. At about the same time, severe problems arose with those programs trying the targeting approach, which both reduced program scale and quality of the portfolio.

ACLEDA's changes were most drastic. It dropped the strategy of targeting groups and instead developed a broader-based approach of serving whole communities rather than just specific groups therein. In a two-year period, from the end of 1995 to the end of 1997, ACLEDA increased its operational self-sufficiency from 23 percent to 110 percent and its number of active clients from 6,500 to 44,500².

Changes in relations with the Cambodian Government also occurred over time. The government was initially suspicious of NGOs charging interest of about 4 to 5 percent a month, rates it considered usurious. In addition, several pyramid schemes emerged and subsequently collapsed in the early 1990s, casting aspersions on all financial activities and suggesting a need for better financial regulation. Consequently, the government attempted to increase oversight and control of microfinance operations. NGOs resisted this, since they were equally suspicious of any government interference and felt that the government would impose measures appropriate for commercial banking but not for microfinance. They successfully advocated for deferment of restrictive policies and regulations.

Free to operate in a liberal environment and now more focused on becoming permanent institutions, Cambodia's microfinance industry raced forward. By 1998, MFIs were serving more than 214,000 clients with a \$15.3 million loan portfolio. The leading five MFIs covered 80 percent of this market. However, questions began to arise concerning the ownership, governance,³ regulation, and supervision of these NGO/MFIs, leading stakeholders to recognize that a legal and regulatory framework for microfinance was needed. In response, the National Bank of Cambodia and others developed a framework that incorporated microfinance into the country's Financial Institutions (Banking) Law. A sub-decree was also issued to recognize the unique nature of microfinance and establish a legal basis for deposit-taking.

Today, the Cambodian microfinance industry continues to enjoy robust growth and a healthy environment. Several MFIs each serve tens of thousands of clients and have achieved financial sustainability. Some have started the process of transforming into formal financial institutions.

SOME LESSONS FROM CAMBODIA

Many lessons emerge from Cambodia's experience that might be valuable for microfinance in other post-conflict settings. Nine of these are provided here.

² "Microfinance in Cambodia." Peter Kooi. 2/1998.

³ In one case, an "institutional coup" occurred. A Cambodian executive director and some of his staff refused to accept the authority of the MFI's board of directors after it requested his resignation.

1. *Microfinance can be successfully implemented following conflict, despite the enormous obstacles that often exist.* Notwithstanding some failures and setbacks, microfinance in Cambodia has enabled significant, lasting changes in the lives of many very poor people.
2. *When it is properly designed and implemented, microfinance can benefit a country not only for relatively short immediate post-conflict period but also for the long run.* By focusing on institutional and financial sustainability, many Cambodian MFIs are now in a position to serve communities on a permanent basis.
3. *As with any business, a demand for financial services must exist.* A demand for financial services existed in Cambodia in the early 1990s. While the economy was in dire straits, it was sufficiently active to allow microenterprises to develop.
4. *Relative security and accessibility must be present.* MFIs had to choose geographical areas of operation that were sufficiently secure and accessible. This restricted initial operations to urban and semi-urban areas.
5. *Start slowly to set a foundation for future growth.* MFIs started cautiously with pilot programs and set very modest objectives. This allowed them to adjust policies and practices, systematize operations, train staff and understand the operating context. In due time, they were able to scale up, but only after building solid foundations.
6. *Where human resources are limited, it may be wise to invest in external technical assistance and in extensive staff development programs.* Every MFI contacted for this study cited limited human resource capacity as one of their greatest constraints, which is a common theme in post-conflict settings. At their peak, each of the Cambodian organizations had between three and twelve expatriate staff, significantly higher than the global norm. However, this level of support was required not only for initial operations but, more importantly, for training Cambodians for the long-term. Human resource development activities included in-country training and study programs and workshops, seminars, exchange visits, and courses abroad.
7. *“Conflict” doesn’t end after the fighting stops.* Violence can affect the way that the people of a country deal with disagreements long after the shooting has ended. Behavior of some (such as the case described in footnote 3 above) included lack of respect for the rule of law and incidents of threats, intimidation, and violence.
8. *Internal conflict can be reduced by developing strong internal controls and by conducting training in the areas of governance and management.* MFIs in Cambodia experienced a host of internal problems as they grew. However, many of these might have been averted if sufficient attention had been devoted to internal controls and to training staff in the basics of NGO governance.⁴

⁴ In the case of the institutional coup, one primary misunderstanding occurred over two different uses of the word “ownership.” Expatriate managers sought to develop “heart ownership” in their Cambodian colleagues—a sense of loyalty and commitment to the institution and a “pro-activeness” to help it develop. Instead, staff interpreted “ownership” to mean that the institution *belonged* to them in a legal sense. Consequently, they thought

9. *Governmental policy and regulatory frameworks may not be necessary at the outset, but will be required in due time.* The Cambodian government was not in any condition to develop an appropriate legal framework for microfinance when MFIs began operating. However, in time, it gained competence and was able to address this issue when it was needed. It appears that MFIs and the government found the right balance between needing a certain amount of *laissez faire* policies in the beginning but tighter controls as the industry expanded and matured.

While Cambodia's microfinance industry emerged more rapidly than is seen in many post-conflict situations, it provides a clear illustration that—when conditions are correct and institutions are willing to professionalize—microfinance can be a powerful tool in revitalizing economic activity in a post-conflict setting. Moreover, the Cambodia case illustrates that this can be achieved while meeting standard microfinance industry goals of scale, sustainability, and depth of outreach.

that they could do whatever they wanted with it, without regard to the MFI's mission or to the directives of the board.