

## Microfinance Alert in Cambodia: Real Issues or Scaremongering?



### *M-CRIL advisory on mitigation – 2*

In August 2019, a Cambodian NGO, LICADHO (Cambodian League for the Promotion and Defence of Human Rights) published a damning report on the conduct of Cambodian MFIs towards their borrowers. The report, titled: **COLLATERAL DAMAGE: Land loss and abuses in Cambodia's microfinance sector**<sup>1</sup>, accuses Cambodian MFIs of reckless lending by offering loans to clients who could not afford to repay them and then pressurising the clients into repaying loans through “coercive land sales or other unethical measures”.

In **Note 1**, we summarised the contents of the LICADHO report and reviewed **the evidence for the allegations made and the likely scale of the problem**. We noted the high leverage (large loan size relative to average incomes) of microfinance clients in Cambodia, particularly for some of the largest MFIs who are increasingly lending to individual borrowers. We also noted that with the qualitative research seeking out only those clients with stories of distress, our estimate of the scale of the problem is that such clients are likely to be a very very small percentage (0.27%) of total microfinance borrowers. Nevertheless, even if a small number of borrowers are affected (around one in 370), that is still too many. And the aim is to bring this down to zero. The question is how? In this **Note 2**, we consider

- **The action that MFIs and the international community need to take to mitigate and prevent the abuses alleged by the LICADHO report.**

### **Note 2:** Can there be a balanced approach to the problem?

The mission of microfinance is widely understood to be to enable low income families to improve their lives. **If, in any part of the world, microfinance results in the loss of livelihoods or becomes a cause of distress or abuse even for a single borrower it is a matter of very serious concern.** Indeed, if microfinance loans are pushed onto low income households beyond reasonable limits (at high levels of leverage), resulting in a loss of livelihoods or in various forms of abuse, it could be termed a violation of human rights (as suggested by the LICADHO document).

In practice, therefore, MFIs should be concerned if

- (i) there is any overselling of loans by their field staff
- (ii) their loan conditions/collateral conditions result in a loss of land, out-migration, child labour or a decline in the quality of food consumed by over-indebted borrowers.

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<sup>1</sup> [http://www.licadho-cambodia.org/reports/files/228Report\\_Collateral\\_Damage\\_LICADHO\\_STT\\_Eng\\_07082019.pdf](http://www.licadho-cambodia.org/reports/files/228Report_Collateral_Damage_LICADHO_STT_Eng_07082019.pdf)

## How does over-indebtedness happen?

All the leading MFIs in Cambodia have undergone certification under the SMART Campaign to ensure adherence to the Client Protection Principles (CPP). These are designed to ensure that the policies of certified MFIs are strong enough to prevent over-indebtedness and staff are trained to respect the dignity of clients at all times, particularly in case of default; therefore, abuses like those reported by LICADHO should not occur. But then, how does over-indebtedness and the potential for abuses (even of a few borrowers) happen...

**Perverse incentives:** All MFIs argue that their staff are not encouraged to apply pressure on clients to borrow. Nevertheless, most MFIs have high portfolio growth targets and field staff remuneration is significantly linked to productivity as defined by the number of clients and value of portfolio serviced by them. This creates the conditions that can result in over-selling in the field despite all the warnings against it issued by MFI managements to their field staff.

**Unintended consequences:** Even without socially perverse incentives, however, it is possible for borrowers to get into trouble through over-ambitious or even careless borrowing. It is also not easy for over-worked MFI field staff to determine the accuracy of incomes reported by borrowers and thereby to determine repayment capacity; this could result in over-lending despite efforts to avoid it. Given the vulnerability of low income households, personal disasters such as serious illness, accident, crop failure or animal fatalities can be crippling for low income households. Given this situation, one in 350 is not an unlikely proportion for those suffering from the unintended consequences of microfinance delivery.

**Possible mitigations** when clients do face difficulties in repayment are

- 1 For large MFIs to have specialised regional **Livelihood Restitution Teams (LRT)** to identify, follow up and assist in cases where such problems occur. The role of each LRT would be to follow up a limited number of cases – those identified as being under extreme stress – to determine the cause of the stress and to recommend one or more actions by the lending MFI (or MFIs) such as
  - Understanding the economic situation of the borrower and her family to determine resulting in the stress (which could even be such problems as poor health, short term severe illness or accident) and **determining what business support can be provided to enable a positive future cash flow** for the borrower (and her family)
  - Refinancing the original loan (or loans) to enable the borrower to recoup short term losses and become a regular borrower again
  - If absolutely necessary a write off of all (or part of a loan) to enable a fresh start by the borrower and her family.

This may appear to be an over-simplified solution but the suggestion cannot be dismissed without field testing. It is done occasionally by commercial banks and, with MFI leverage that is from two to five times per capita income in Cambodia, it is worth trying. Certainly, the profitability of Cambodian MFIs is sufficient to withstand any increase in MFI operating expenses resulting from the deployment of these LRTs; the benefits of such an

action would certainly be substantial in terms both of socially responsible outcomes and of good publicity.

- 2 Certainly, pressure should not be put on MFI field staff to ensure repayment in all cases; this is what results in pressure, in turn, on clients to dispose of their collateral (including land). Rather, field staff should be encouraged to report chronic cases of over-indebtedness to head office for refinancing, and/or write offs. The levels of write-off in Cambodia (at 0.23% of the portfolio) and rescheduling (at 0.06%) are very low relative to the extent of leveraging of MFI borrowers (see **Section 2** above).

**M-CRIL** is a responsible development research and analytics firm with around two decades of experience in Cambodia and a substantial record of analytics in international microfinance including client protection assessment and certification as well as microfinance ratings, programme evaluations and focused management training and capacity building support for MFIs.