Has the pandemic spared Cambodia?
Liquidity considerations of Cambodia's large MFIs

mid-September 2020: M-CRIL Advisory Note on liquidity/growth of MFIs in Cambodia

Synopsis: Anecdotal evidence on Covid-19 and its impact on life in Cambodia suggests that the impact on the country has been limited. The ravages of the pandemic on the microfinance sector in Asia resulting in low recovery rates of loans and liquidity challenges for inclusive financial service providers may not, therefore, impact Cambodian microfinance substantially. The analysis in this note indicates that, in the absence of a sharp turn for the worse, Cambodian microfinance is in a relatively comfortable position compared to other Asian microfinance sectors. Whether the effect of large loan size and potentially extensive business failure and/or loan restructuring in the medium term will come back to bite the sector 12-18 months from now remains to be seen.

No lockdown in Cambodia – public asked to exercise caution while continuing their daily business. Two main industries – garments and tourism – severely affected by the collapse of international orders and tourist arrivals respectively.

Most likely scenario – assumptions	
• Client collections (January-December 2020)	avge 85%
• Redemption of deposits, net	5%
• Disbursements, % of normal annual disbursements	90%
• Borrowings repaid, net	nil
• Cash buffer, % of total funds	~7%

Analysis sample	9 largest MFSPs*
Liquidity shortfall	
• **MFSPs#** – 3 of 9 have cash short-falls in excess of 5% of funds; 7 have some shortfalls Total 9 MFSPs, active loan accounts = 2.2 million; portfolio, $11.4 bn/KHR 46 trillion	**Total: ~$320 million** or KHR 1.3 trillion just 2.1% of total assets $149 mn = largest shortfall for an individual MFSP

* MFSPs are Microfinance Service Providers – microfinance institutions as well as banks with predominantly microfinance portfolios including ACLEDA Bank, Sathapana Bank and deposit taking MFIs: AMK, HKL Kredit and WB Finance, now part of regional banking groups. The other three in the sample, Amret, LOLC and Prasac also have strong external backers.

This analysis is based on the understanding that

a) Covid lockdowns have not posed ***substantial*** challenges for **collections of repayment from clients** during April-September 2020; some loans have been restructured and will contribute to potential liquidity issues for the microfinance sector as a whole. The extent of this restructuring lies in the range 5-20%.
b) Because of lockdown conditions, it has been difficult for MFSPs to manage their businesses normally; this has put a limited **brake on disbursements** resulting, for now, in below normal flows of fresh loans to microfinance clients. While MFSPs are able to recover most of the loan instalments due (after restructuring some loans), their confidence both in extending repeat loans to existing clients and in issuing fresh loans to new clients has been affected.
c) The reduced inflow of collections has resulted in **some decline in disbursement levels** with MFSPs juggling their cash flows to determine the optimum level. While reducing disbursements conserves cash, the greater the reduction in disbursement the greater will be the compression of the microfinance business in the medium term.
d) There has not been, and is unlikely in the future, to be an extra-ordinary **withdrawal of deposits** from MFSPs.
e) Due to concerns about Covid-19 and the decline of economies worldwide, the businesses of microfinance borrowers will take months, if not a couple of years, to recover fully from the economic disruption caused by the crisis.

In undertaking this analysis we have taken into account the **maturity profile of assets and liabilities** over a **one year timeframe**.

This note parallels the analysis in the other recent Advisory Notes by M-CRIL – the details of the calculation method and other assumptions about loans without collateral and no default by trade debtors are set out in the **Annex**.

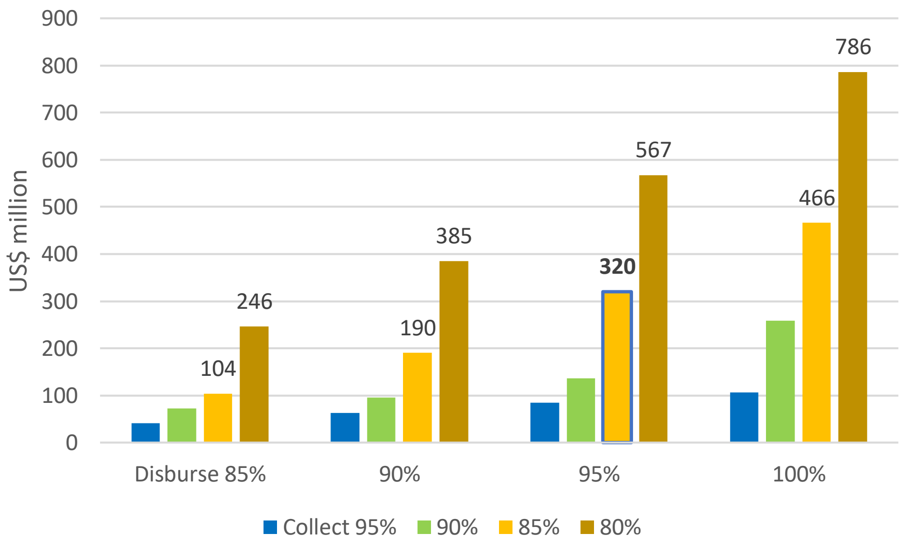
Table 1 and **Figure 1** show some limited liquidity issues arising for MFIs in the following conditions

- **Most likely**: With 85% of the amounts due collected during the one year analysis period, and 95% of expected disbursements paid out, 3 of the 9 MFSPs in our sample have significant liquidity shortfalls (>5% of total funds) resulting in the need for a liquidity fund amounting to **$320 million** (KHR 13 trillion) for all the MFSPs in the sample to tide over the crisis.

Table 1: # MFSPs in sample of 9 largest in Cambodia facing >5% liquidity shortfalls

	Disburse 85%	90%	95%	100%
Collect 95%	0	1	1	1
90%	1	1	1	2
85%	1	1	3	5
80%	1	3	6	7

Figure 1: Estimated liquidity shortfall of the 9 MFSPs covered by this analysis



- **Maintaining disbursements at the 95%** level seems optimal since reaching 100% results in a sharp increase in the liquidity shortfall upwards of $450 million (KHR 18 trillion); a lower level of disbursement (even 90%) substantially reduces the liquidity shortfall but would lead to a significant compression in operations over the next 12-18 months with implications for profitability. A 95% disbursement level also impacts profitability but not substantially.

The Covid liquidity paradox…

Based on the above analysis, **the key pre-existing factors that enable institutions to manage Covid conditions** are as follows

- While commercial logic dictates that a high proportion of assets should be in portfolio since that is what generates income for MFIs (and has higher interest yields than any bank deposits are likely to provide), at a time like this, **a lower proportion of assets in loan portfolio** is beneficial for managing liquidity. The one MFSP that can withstand even an 80% collection rate and a 100% disbursement level had 18% of its assets in cash at end-December 2019.

- **A high maturity period of portfolio is also helpful** at a time like this since that reduces the need for loan rescheduling. MFSPs with >40% of portfolio in <180 day maturities have greater potential for a liquidity crisis than those with lower proportions in short maturity loans. This is contrary to received microfinance wisdom of short maturity loans being more profitable than those with longer maturities.

- Deposit withdrawals have not been a major consequence of the pandemic. As a result, **with deposit funding at the 50-70% level** and borrowings around 25-30%, Cambodia's **MFSPs are less challenged** than the higher leveraged
    - large MFIs of Nepal (30-60% borrowings),
    - India's large MFIs (70-90% borrowings) and at a
    - somewhat similar level to India's Small Finance Banks (50-75% deposit funding) though the latter have to contend with major restructuring recommended (if not mandated) by the regulator.

The numbers in this analysis indicate the **additional** funds from investors and international lenders that some MFSPs will need to access **in order to grow** beyond survival.

With average levels of cash shortfall around 4-5% of assets even under fairly stringent conditions, **Cambodia's microfinance sector is not significantly challenged**. However, with lower disbursements and an uncertain business environment for microenterprises the sector **cannot look forward to the galloping growth** it has grown accustomed to. Over the next two years provisioning for loan losses as well as liquidity challenges affecting disbursements will limit profitability well below the current 20-30% **returns on equity** – a range of 5-10% is more likely with possible breakeven challenges for a couple of the large MFSPs covered by this analysis.

The purpose of this exercise is to facilitate decision making in the Cambodian micro-lending value chain; it is also to enable understanding of the finances of MFSPs in Cambodia and the potential role and expectations of investors in supporting the microfinance eco-system of the country.

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Annex – methodology & assumptions not stated in the text above

As mentioned in the main text, this Cambodia MFSP liquidity assessment is for a one year period (calendar year 2020) and beyond into 2021 on the assumption that the liquidity challenge is immediate and it is during this period that additional liquidity support may be necessary. Specifically, we have used the following (estimated for the analysis period based on MFSP financial statements (in the public domain) for 2019 after applying a growth factor of 33% per annum.

Inflows over one year =
+ **opening balances** (cash + cash equivalents)
+ **portfolio** (repayment) **collections**
+ **interest income on loan portfolio** collected during the period
+ **deposits collected** (as discussed above)
+ **other income** (total for the year)

Outflows over one year =
+ **interest paid on borrowings** over one year
+ **deposits matured** during the period (95% renewed)
+ **interest paid on deposits** (total for the year)
+ **operating expenses** (annual staff salaries, establishment expenses, travel).

Since calendar year 2020 is ongoing we have used published 2019 data for this analysis. The **assumptions** are

- The contours of the 2019 balance sheets/financial statements remain largely unchanged in 2020; we recognise this may not always be true but the objective here is to indicate the dimensions of the liquidity problem rather than to provide accurate information. In order to make a realistic estimate of orders of magnitude a 33% average growth rate for 2020 has been assumed (based on aggregate growth numbers available for the past two years).
- Nearly 100% of these MFSP portfolios are with micro-borrowers with no collateral for loans below $750 and (usually) agricultural land as collateral for the (now mostly) larger loans.
- Due to the impact of the pandemic on micro-businesses, particularly those with linkages to the garment and tourism sectors, MFI (including MFSP) collections have declined. As recommended by the regulator, National Bank of Cambodia, most institutions in the sector have restructured part of their portfolios (proportions in the range 5-20%) for periods of 3-6 months. This has depressed collections for the short to medium term and has an impact on the liquidity of MFIs. M-CRIL's assessment is that collections will most likely average 85% of normal levels during 2020. Some readers may disagree; for this reason, we have provided the impact on liquidity of a range of disbursements and collections so that they can make their own determination of the impact of the crisis on liquidity.
- There will be no default on MFSP **receivables** from debtors on non-operational transactions.
- **Other income** (commissions & miscellaneous) do not decline significantly.

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- current local market intelligence from Shayandeep Chakraborty and
- data support from Vanshika Agarwal

A disclaimer for readers…

These findings provide a guide for the managements of micro-lending institutions, for wholesale lenders to them and for investors in such institutions to understand the liquidity challenges of the lockdown. As indicated by the qualifying statement earlier in this note, the analysis here is based largely on the 2019 balance sheets of the MFSPs in the sample. This document does not purport to set out rules of operation for MFSPs in normal times, it is meant mainly as an indicator for all stakeholders of the microfinance industry in Cambodia of the challenges involved and the orders of magnitude of funds of additional investment or lending to be considered. ***However, actions taken by stakeholders are at their own risk and M-CRIL will not be responsible for decisions based on the contents of this note***.

M-CRIL is a responsible development research and analytics firm with a concern for **inclusive microeconomics**. Along with its parent firm, EDA Rural Systems, M-CRIL has over 40 years of experience of international issues in microenterprise promotion and financial inclusion through a substantial record of analytics in this field including microfinance ratings, programme evaluations and focused management training and capacity building support for MFIs. Its work in support of smallholder farmers and with agricultural value chains in South and Southeast Asia also emphasises its commitment to supporting the lives and livelihoods of low income families.