

TRANSFORMATION OF PRASAC CREDIT PROGRAMME INTO A LICENSED PRIVATE SECTOR MFI

by

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Executive summary

PRASAC started in early 1995 as rehabilitation programme and relief operation in six provinces in Southern Cambodia after 20 years of civil war and destruction. Phase I (1/1995 to 4/1999) and phase II (5/1999 to 12/2003) are supported by the European Union with a total of Euro 80 million. PRASAC's executing agencies are the Ministries of Agriculture, Fisheries & Forestry, Rural Development and Water Resources & Metereology and the Rural Development Bank. Around 600 public servants were seconded to PRASAC's six main components of:

- (1) Domestic water supply.
- (2) Irrigation systems.
- (3) Agricultural intensification and diversification.
- (4) Rural credit and promotion of micro-enterprises.
- (5) Village-based community development.
- (6) Institutional strengthening and capacity-building.

The objective of PRASAC Credit Programme during phase I has been the establishment of 150-200 'village cash facilities' per province in order to enable 50 to 60.000 families to get out of the cycle of indebtedness caused by excessive money lending practices. Following a co-operative village bank methodology, PRASAC Credit Programme has been providing the following two main services until mid 2000:

- (1) To establish and strengthen co-operative village banks in villages where PRASAC had already helped established Village Development Committees. Village banks were supported technically and financially by way of:
 - ☞ Regular checks whether the various accounting books were correctly filed in and updated regularly and delivery of corresponding training on-the-job.
 - ☞ Advice in loan management on request by village bank committees.
 - ☞ Allocation of financial support in the form of high rebates (40% of total interest paid until June 1999 and 25% until April 2000) for timely repayment of loans granted by PRASAC Credit Programme.
- (2) To lend to the co-operative village banks.

The development objective of PRASAC's phase II is to implement sustainable rural development activities as a strategic re-orientation from emergency relief towards rural development. It is envisaged to consolidate and sustain phase I achievements, including full integration of project activities in national partner organizations, and strengthening

government and civil institutions. Development strategies were developed for all provinces and components in mid 2000 in order to ensure a sustainable development impact of key interventions beyond 2003.

A strategic re-orientation has been developed for the Credit Programme in mid 2000 so as to ensure long-term access to affordable credit by rural communities and micro-enterprises at the conclusion of PRASAC in December 2003. It called for the separation of the Credit Programme into two operations:

- (1) A financially sustainable credit operation that will be either transferred to an existing MFI or transformed into a newly created MFI based on the assessment that only the 'financial services' (and not the co-operative village bank) methodology can succeed within a limited time period. The second option of creating a new MFI was considered to better ensure synergies with the development support of PRASAC in the agricultural and micro-enterprises sectors, whereas the first option of transfer to an already established MFI was considered less risky and preferable option from a sectoral viewpoint due to:
 - ☞ Technical feasibility without the time intensive challenges of 'building' a senior management team and the search for a foreign strategic investor.
 - ☞ Creation of a larger and more competitive MFI that could compete with ACLEDA, the market leader, on a more equal footing.
- (2) A village bank support system financed and managed by PRASAC's 'Community Development component' because of the potential contribution of co-operative village banks to community development in terms of:
 - ☞ Creation of self-help capacity in limited financial intermediation.
 - ☞ Enhanced literacy in simple bookkeeping and financial management.
 - ☞ Increased capacity in community mobilisation, management and solidarity.

The stakeholders of PRASAC adopted the strategic re-orientation of the Credit Programme in October 2000, and voted for the option of its transformation into a newly created MFI within the remaining period of PRASAC.

The decision to transform PRASAC Credit Programme into a licensed private sector MFI was triggered by the conclusion that the co-operative village bank methodology has not worked well within the limited time given because:

- ☞ Trust among villagers is often limited as a result of the past 20 years of civil war.
- ☞ Village communities are not 'rooted' due to significant migration caused by civil war. Village self-help capabilities are therefore limited.
- ☞ Very low literacy levels of villagers reduce significantly the number of villagers that are capable of managing a co-operative village bank.
- ☞ Co-operatives are not popular if perceived similar with ex-socialist organisations.

The newly evolving regulatory framework for micro-finance has greatly facilitated the decision-making process of the stakeholders of PRASAC since it encourages the entry of licensed private sector MFIs into the rural credit and savings sector. It has supported

the understanding that the role of government is to set the regulatory framework and to leave micro-finance operations to the private (and/or co-operative) sector.

The transformation of the Credit Programme constitutes a profound change for the credit staff and the new management team to be mastered in a short span of three years. Its main elements are as follows:

- (1) **Introduction of micro-finance best practise** comprising the:
 - ☞ Elimination of subsidised lending operations with village banks.
 - ☞ Reform of the group loan delivery mechanism by redefining the exact role and procedures for credit officers and village bank representatives for each step of the group loan management cycle.
 - ☞ Introduction of an alternative group loan delivery mechanism in the form of informal self-help village associations that consist of several guarantor group.
 - ☞ Introduction of banking practise for business loan management and corresponding staff capacity building.
- (2) **Introduction and/or improvement of key management systems** required by a licensed MFI, such as (a) well linked management and accounting systems, (b) internal control and audit systems, (c) consistent and transparent staff performance-based salary and incentive systems, (d) effective liquidity management and treasury systems, and (e) risk management systems to support strategic planning and management of loan portfolio policies.
- (3) **Establishment of managerial sustainability** by recruiting selected senior staff and carrying out a comprehensive training programme that comprises formal training courses, informal workshops, generic management training, practical training on-the-job and exposure visits to MFIs in Cambodia and abroad. Noteworthy is that the speed of the ‘learning curve’ of the staff, particularly the top management team, constitutes the key time constraint in the whole transformation process.
- (4) **Two-step institutionalisation** of the Credit Programme into PRASAC Credit Association (PCA) and then PCA into PRASAC MFI Ltd. when shareholders, including a strategic foreign investor, could be mobilised. As first step, PCA is currently be established legally as an association that is seeking registration as a (non-licensed) MFI by the central bank. Institutionalisation of the Credit Programme will be completed with the incorporation of a limited liability company in the name of PRASAC MFI Ltd.
- (5) **Obtaining the license** to operate as a MFI.

This first-step institutionalisation of PRASAC Credit Programme into PCA will be completed with legal registration. In addition, PCA is running already as a MFI with most transformation requirements in place. The highlights of transformation achievements to date can be summarised as follows:

- ☞ Full separation of PCA’s accounting system from that of PRASAC.
- ☞ Establishment of all 12 branches as full profit centres.

- ☞ Upgraded MIS and internal control systems that already meet reporting requirements for licensed MFIs.
- ☞ Significant improvement of micro-finance practise by reforming lending operations and particularly group loan delivery mechanisms.
- ☞ Transfer of all fixed assets from PRASAC to PCA.
- ☞ Preparation of 2001 financial statements of PCA according to the chart of accounts required for licensed MFIs.
- ☞ Physical separation of head office and most branch offices from PRASAC.
- ☞ Establishment of a near complete Cambodian management team.
- ☞ Substantial enhancement of staff productivity and capacity through streamlined lending and staff supervision procedures and comprehensive training activities.
- ☞ Achievement of operational self-sufficiency already during 2000.
- ☞ Three-year business plan covering the years 2002, 2003 and 2004.

PCA has currently 12 branches with 16 sub-branches operating in 34 districts of the six target provinces of PRASAC. Total staff amount to 111 with 99 at branch level. PCA is targeting 'medium and very poor' villagers for group loans that finance income-generating activities and households cash-flow needs. Individual investment and working capital loans are offered to micro-enterprises. Mobilisation of savings is planned for 2003. The key client target groups are defined as follows:

- ☞ 'Medium and very poor' village households that constitute on average 50 to 70% of a village population. At least one person of such household is working in the semi-subsistence village economy by employing some productive assets of the household, such as land, tools, livestock and so forth. Cash income is mainly generated from the purchase of surplus rice or other food items, but occasionally supplemented by part-time trading and/or service activities.
- ☞ Micro-enterprises that produce (or offer services) predominantly for a market. The large majority of them are non-registered sole proprietorships where family members help out in the running of the business. They are mainly located in market places in or nearby district and provincial centres.

PCA's outreach and outstanding portfolio as of the end of 2001 are as follows:

Outreach (active borrowers)	group loan borrowers		individual loan borrowers		total borrowers	
	37.552		6.217		43.769	
Outstanding Portfolio	group loan portfolio		individual loan portfolio		total portfolio	
	\$2.059.000		\$1.496.000		\$3.555.000	
average loan size	\$55		\$241		\$81	
portfolio per sector	rice production	agriculture excl. rice		services/trade	manufacturing	
	\$1.907.000	\$420.000		\$1.082.000	\$146.000	

On the basis of the current exchange rate of 1\$ to 3.900 Riel

Contrary to smaller NGO operations that address particular target groups (e.g. the 'poorest'), the separation of micro-finance functions from all other rural development functions of PRASAC does not create any trade-off because its development purpose is

identical with the mission of PCA to create sustainable access to financial services (at reasonable rates) for rural communities and micro-enterprises. Its success is already evident since the Credit Programme already achieved full operational self-sufficiency during 2000. This leaves more financial resources for PRASAC's rural development interventions.

PRASAC's successful separation of micro-finance from rural development functions also supports commonly accepted 'best-practise' by recommending separate credit/micro-finance projects that support already existing MFI rather than to launch credit/micro-finance activities as integrated component of rural development projects.

Key challenges of the transformation of PRASAC Credit Programme are as follows:

- ☞ 'Building' of a top management team that can lead a large MFI in two years time.
- ☞ Speedy upgrading of all management systems to professional standards of a MFI.
- ☞ Identification of a strategic foreign investor of good reputation. Presently, it is difficult to find strategic investors in Cambodia that would meet the requirements for 'good' governance.
- ☞ Effective marketing of PCA's corporate identity so that its clients and the general public at large start perceiving PCA as a Cambodian MFI with long-term ambitions to offer micro-finance services at affordable, but at the same time financially sustainable rates and not as a time limited operation supported by donor grants.
- ☞ Continued dialogue with the executing agencies to maintain support for the transformation process at every step.
- ☞ Building up sufficient financial reserves to cope with potential loan losses that could be caused by external threats of (a) natural disasters (particularly flooding and drought), (b) political instability, (c) overwhelming competitive pressure by the market leader, and (d) 'bad' practise by micro-finance operators that may affect the loan repayment morale of PCA's clients.

Successful transformation will open up the outstanding opportunities for PCA:

- ☞ To establish itself as the largest MFI (after ACLEDA that is a specialised bank) thanks due to the generous allocation of credit funds from PRASAC.
- ☞ To benefit from business opportunities developed by PRASAC in the agricultural and micro business sectors. Lending risks can be reduced significant, if PRASAC or other partner institutions can provide technical and marketing support to clients.
- ☞ To have clients with a generally high loan repayment morale.
- ☞ To expand operations supported by an enabling regulatory framework and good prospects of an improving business environment due to political stability.