

Cambodia joins microloan clean-up

By Stephen Kurczy

PHNOM PENH - Impoverished Cambodia has emerged as a global microfinance leader, becoming the first Asian nation to hold lenders accountable to their original mission of poverty reduction. If a new global initiative aimed at promoting greater transparency over microfinance institutions (MFIs) recently launched here gains traction, the multi-billion dollar industry could be set for a shake-out.

It has long been assumed that microfinance ventures, launched in the 1970s as non-profit enterprises to bring cheap credit to the poor, prioritize alleviating poverty over maximizing profits. In recent years, celebrities such as Robert Duvall, Natalie Portman and Yeadley Smith, (the voice of Lisa in animated television series *The Simpsons*), became official spokespeople for different MFIs such as Pro Mujer (Pro Women), Finca International, and the Grameen Foundation.

The United Nations Capital Development Fund has in recent years channeled millions of dollars in donor funds into MFIs. The International Finance Corporation (IFC), the private lending arm of the World Bank, says it has given more than US\$600 million to more than 100 MFIs worldwide and maintains a commitment to double that investment to \$1.2 billion by 2010, making IFC the largest investor in an industry servicing more than 80 million people around the world.

But so-called barefoot banking has come under growing criticism as MFIs reap huge profits. Reports have shown that many misrepresent their underlying loan fees, with some charging annual interest rates in excess of 100%. For instance, Mexico's Banco Compartamos, originally a non-profit institution, generated \$458 million in an April 2008 initial public offering. Private investors piled into the offering because the bank charges its 1.4 million poor borrowers up to 128% annual interest.

Chuck Waterfield, a microfinance expert and Columbia University professor, has found that many MFIs, including Compartamos, advertise as pro-poor enterprises with 4% monthly interest rates but when additional hidden fees were added those rates often topped 10% per month.

Waterfield recently devised a platform for borrowers and international donors - who underwrite and provide cheap capital for many microcredit banks to on-lend - to view more clearly individual MFIs' true underlying interest rates. "Compartamos was a watershed for the industry. It takes a crisis to make you do what you should have done 10 years ago," Waterfield told Asia Times Online.

In mid-2008, he launched MicroFinance Transparency, a database of interest rates charged by individual microlenders that aims through publicity to refocus microfinance on poverty

alleviation. The goal, he says, is to collect loan information from all microcredit lenders worldwide and publish their real annual percentage rates at his website, mftransparency.org.

"The organizations with the highest interest rates have the glossiest annual reports, with pictures of mothers with babies, and they talk about how they're helping those mothers while making boatloads of profits," Waterfield said on August 7 at a launch event in Phnom Penh. "So we put the prices up there and say, 'Nice annual report but you're charging twice the interest rate as anyone else to those mothers with babies'."

Waterfield hopes that all MFIs will openly join the initiative and prove they have nothing to hide. He first introduced the project in March in Peru, then in Bosnia in April, and this month in Cambodia before heading to another launch in Bangladesh. He acknowledges that he can't force microcredit lenders, many of whom bury hidden costs in the small print of their loan forms, to sign up to the initiative.

"We've got to build credibility and Cambodia helps us build credibility because it's a willing participant. The next country we go to will be a little less willing. And next year we'll go into the countries that are really reluctant to have us show up."

People over profits

While Cambodia is renowned for its endemic corruption and is often rated among the world's least transparent countries, Waterfield said he chose the country as the first Asian nation for his initiative because its registered MFIs rank among the world's top in terms of social performance, consumer protection and ethical practices.

Of the 12 Asian MFIs that have signed on to a social performance indicators program launched by the Washington DC-based Microfinance Information Exchange (MIX), a provider of MFI business information and data services, half hailed from Cambodia.

Five Cambodian banks are also included in MIX's ranking of the world's top 100 MFIs; only India, with six, claims more. In June, Angkor Microfinance Kampuchea was one of three MFIs worldwide to receive the first gold award for social performance reporting from the Michael & Susan Dell Foundation, the Ford Foundation, and Consultative Group to Assist the Poor.

"Cambodian MFIs have been at the forefront of industry reporting for many years," MIX's chief operating officer Blaine Stephens wrote in an e-mail in response to Asia Times Online questions. "My guess is that they will demonstrate as much commitment to reporting social performance as they have to reporting financial performance in an open and transparent manner."

Cambodian MFIs charge interest based on 30- or 31-day months. This may sound intuitive, but in Mexico and other developing countries most MFIs charge interest rates based on a four-week month, which effectively allows them to charge the borrower for an extra month every calendar year, Waterfield said.

The annual interest rates charged by MFIs in Cambodia are among the lowest worldwide at between 24% and 36%. While higher than normal rates on commercial consumer loans,

microloans are inherently more expensive because the lender receives less return while incurring overheads and transaction costs similar to those for larger loans.

"Here in Cambodia, we are committed to making sure that the financial services provided to the poor come as tools for their empowerment rather than shackles for their exploitation," Cambodian National Bank director general Tal Nay Im said on August 7. The National Bank has recently issued a legally binding sub-decree for MFIs to advertise their real effective interest rates.

Cambodia is the only country to outlaw flat interest rate loans, a credit structure where monthly interest is paid on the total loan amount even as the borrower pays down the principal - which means the borrower is effectively paying interest on money already paid back. In comparison, every MFI in Mexico charges a flat rate and only one microcredit bank in impoverished Bangladesh, the Grameen Bank, charges borrowers a declining rate where they pay less and less interest as the outstanding amount owed is paid down.

The Grameen Bank was founded in the 1970s by Muhammad Yunus, who was awarded the Nobel Peace Prize in 2006 and the US Presidential Medal for Freedom this week for his efforts to provide low interest loans to the poor. While many microcredit institutions claim to take inspiration from his example, Yunus has publicly lamented the industry trend towards profit maximization over uplift of the poor.

He, for one, has strongly endorsed Waterfield's new Microfinance Transparency initiative. "Microfinance emerged as a struggle against loan sharks, so we don't want to see new loan sharks created in the name of microcredit," Yunus told BusinessWeek at the time of the project's launch.

While Cambodia's 18 MFIs have agreed to submit their loan data to MicroFinance Transparency, the Bangladeshi government is drafting a law that will require all their MFIs to submit data to the initiative. In Bangladesh, banks do not at present advertise their true interest rates, Waterfield said, and there is the risk of a consumer backlash if published interest rates suddenly appear to double overnight.

Leaky lending

Not all MFIs are equally excited about Waterfield's transparency initiative, particularly those whose reputation would take a hit through greater disclosure. One of mftransparency.org's features will show, in graphical form, the relationship between loan size and interest rates charged. That presentation will show more clearly where MFIs' priorities lie.

Many MFIs had been so profitable that hedge funds, venture capital firms, and other big private equity investors have sought ways to enter the business. In Cambodia, private equity fund Leopard Capital announced in March that "we are currently evaluating several options to invest in the sector, including participating in any pre-IPO [initial public offering, or sale of shares to the public] capital raising by a leading MFI, acquiring an existing MFI or merging an existing MFI with a smaller commercial bank."

Despite Cambodia's lead on MFI transparency, the sector has been facing financial troubles wrought by the global economic crisis. The industry-wide at-risk portfolio for the nation's 1 million microloan borrowers rose from 0.5% in mid-2008 to 3.39% in mid-2009. That's exposed flaws in previous client screening.

Mai Yop, a 55-year-old salt farmer in southern Cambodia's Kampot province, admits to having lied to get a \$1,000 loan three years ago from microfinance bank Aceda. While microloans are extended solely for business purposes, such as the provision of new cattle or farming tools, Mai Yop says she used the money to pay for her husband's stomach surgery.

"I had to lie, or I wouldn't get any money," said Mai Yop, who now lives on a budget of \$5 a day. In order to pay back her first loan, she took loans from two other microlenders, and finally from a high-interest charging informal moneylender who eventually seized her farmland due to non-payment.

Some borrowers say they'd be in a better situation today if they'd never taken on a microloan. "We are poorer than ever," said Oum Siv, a 50-year-old grocery vendor in Kampot. Earlier this year, she said she owed \$10,000 to a private moneylender after taking out a series of microcredit loans for her husband's construction business, which failed to get off the ground amid the economic slowdown.

Cambodia's MFIs say they have since adopted more rigorous screening processes for potential borrowers. But the toll from years of lax screening has only now become apparent. The situation is similar in several Cambodian provinces, with tens of thousands of Cambodians unable to repay their microloans and now at risk of losing their homes and farmland.

Despite these challenges, Waterfield said that Cambodia remains a relative microcredit success story. Elsewhere, when it comes to openness and transparency, "some of these [lenders] say, 'We've been lying for 20 years for some legitimate reasons, so it's not so easy to start telling the truth.' Here, it was like, 'sure, what do you need, we'll give it to you.' There was no resistance, no nervousness. We'll never see that again ... anywhere we go."