SWISS CAPACITY BUILDING FACILITY
Association for Income and Employment Generation

SCBF project: 2011-03 **04 July 2013**

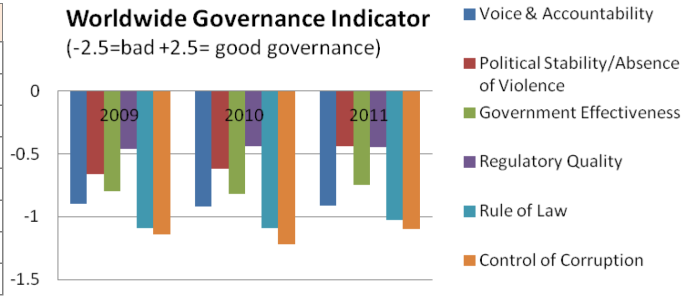
Cambodia: Developing a sustainable savings mobilisation strategy with Hattha Kaksekar Limited (HKL)

1. Development context and relevance

Economic and poverty context: After civil war and genocide, political stability increased since the 2000s and Cambodia experienced steady economic growth between 6-10% p.a. over the past decade. The country recuperated well from the global financial crisis with a slight dip in foreign investments in 2009. Foreign direct investments of currently around 7% of GDP are however expected to grow further driven by Asian investors.

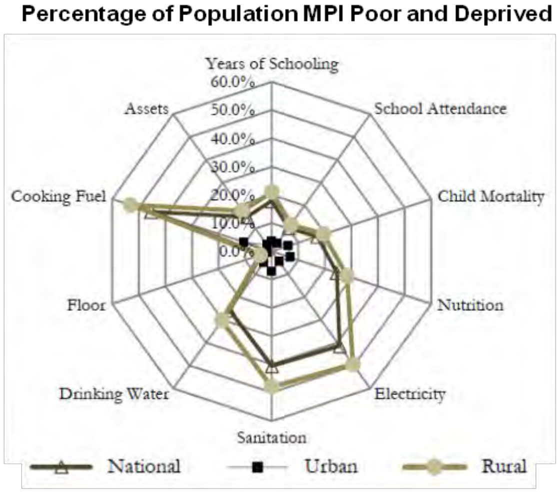
Cambodia has still a predominantly informal economy and young rural population. Agriculture accounts for about 35% of GDP and 55% of the employed workforce. The secondary and tertiary sectors create a structural vulnerability due to the concentration on export-oriented garments and textile and very localised tourism around Angkor Wat. Inflation is low with about 3%, as the local currency Riel is pegged to the USD. Nevertheless, rising food and fuel prices have affected poor people over-proportionately. The negative trade balance remains manageable. Annual Official Development Assistance has been quite stable since 2008 of around USD 730 million. In light of widespread seasonal labour migration to Thailand, workers' remittances seem underreported with 1,2% of GDP.

Population and Economic indicators	
Population (2011)	**14'700'000**
GDP growth (average: 2009-2012 / 2002-2008)	**4,8% / 9,5%**
Inflation (average, 2009-2012 / 2002-2008)	**3,4% / 4,1%**
Trade balance (% of GDP) (2011)	**-1,5%**
Foreign Direct Investment (net) (% of GDP) (2011)	**7%**
Net ODA & official aid received (% of GDP) (2010)	**5,5%**
Workers' remittances (% of GDP) (2011)	**1,2%**
Economic Freedom Index[i] (Rank among 185 countries)	**95**



Cambodia is still struggling with its post-conflict situation. It has a liberal regulatory framework, but the effectiveness of policy implementation and public service provision remain poor. It is very difficult to do business in Cambodia[1] mainly due to its persistent poor track record in the rule of law and high corruption levels. Moreover, the citizens are mostly excluded to participate politically and human rights are often not granted or even violated.

Recent economic growth mainly benefitted urban areas, however, around one third of Cambodians still fall below the national poverty line, notably in rural areas where about 80% live. Already high income disparities (37,9 % Gini Index) will grow further in light of rudimentary tax collection and little social funds available at the local government level. The Multidimensional Poverty Index[ii] reveals that poor rural Cambodians are mostly deprived of safe cooking facilities and access to electricity and sanitation. Access to financial services, especially saving and insurance, could help them mitigate some key risks they face daily and smooth their household cash flows.



Source: Oxford Poverty & Human Development Initiative

Poverty indicators	
GDP per capita (current USD) (2011)	**897**
Gini Index (0= equality 100= inequality) (2008)	**37,9%**
Multidimensional Poverty Index (1=poor 0=not poor) (2010)	**0,212**
International (at 1,25 USD/day), **national and rural poverty headcount ratio** (2007/2008)	**22,8%-35%**

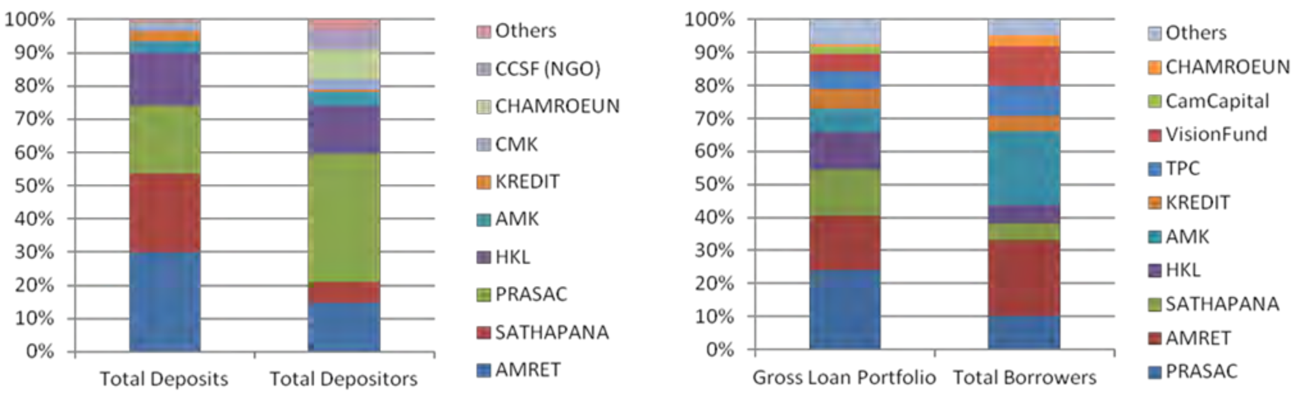
[1] Cambodia ranks 133rd (of 185) globally and 20th (of 24) within Asian & Pacific countries (World Bank, Ease of Doing Business)

Financial sector context: Cambodians have a high propensity to save[iii], but the penetration of formal saving products is taking off only slowly due to low public trust in any institutions, as a result of the recent history. About 1/3 of population was able to save money within the past year, however less than 1% saved through formal financial institutions. Less than 4% (urban 10%, rural 2.5%, bottom 40% 1.7%) had an account with a formal financial institution[iv]. The lack of access to appropriate formal saving, insurance, and money transfer services complicates poor people’s life. Access to microcredit is well developed with a nearly 40% household penetration ratio, including the micro loans of ACLEDA Bank. Client over-indebtedness is thus a rising concern and poor households still depend very much on money-lenders to borrow for emergencies.

Cambodia has an enabling business environment for financial inclusion, ranking 8th globally[v], with a very strong regulatory regime in place but often lacking in the execution. Its Financial Sector Development Strategy 2011-2020 aims at strengthening the regulatory and supervisory framework, consumer protection, the quality and efficiency of service providers as well as deepening and broadening services, notably microinsurance. A central credit registry has finally been established. Relatively well functioning industry associations exist for banks, insurers and microfinance institutions. There are 35 licensed banks (2010), one public development bank, one re-insurer, 5 insurance companies, 28 licensed MFIs, 28 registered and about 60 non-registered NGO microcredit providers (2011)[vi]. ACLEDA Bank is the market leader in savings mobilisation, SME lending, and payment services.

Financial institutions reach more than 77% of all villages (10874 out of 14073) with the largest branch networks of ACLEDA Bank and the five leading MFIs Prasac, Amret, Sathapana, HKL, and AMK. At the end of 2012, MFIs served 1’598’164 borrowers with a total amount of USD 1’481 million loans and 1’685’892 depositors with USD 1’740 million savings[vii]. Driven by the very high profitability of the sector, the consolidation process recently became reversed due to new market entrants in consumer lending with the risk of further intensifying client over-indebtedness. On the other hand, the financial depth rate of the Cambodian commercial banking sector stays relatively low[viii] at around 25% with very limited access of small and medium-sized enterprises to investment loans beyond one year. The insurance sector is still under-developed. However, with the circular of 29 June 2011 from the ministry of economy and finance any entity is now entitled to obtain a microinsurance licence. Thereafter, first microinsurance products were launched with support from American International Group Inc. (AIG) to Forté Insurance (Cambodia) Plc to work with microfinance institutions to promote microinsurance to low-income clients.

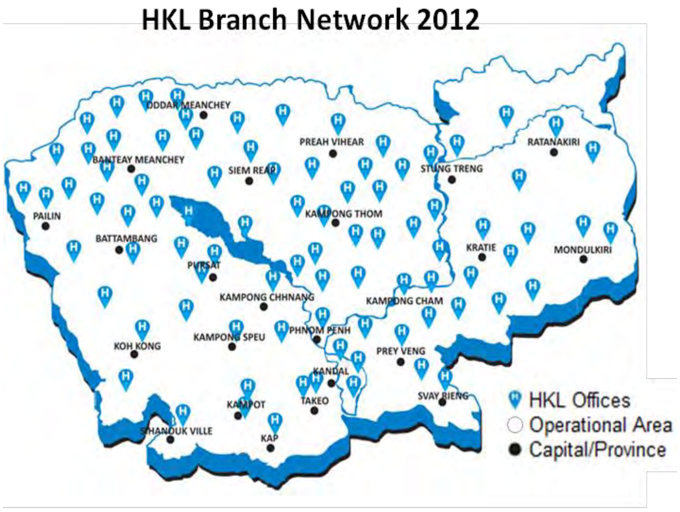
Cambodian MFI market shares



Source: 2012, Cambodia Microfinance Association (without ACLEDA)

Partner financial intermediary (data in USD)			
	2009	**2012**	**2016**
Total assets	33’444’160	122’972’865	283,526,073
Gross loan portfolio	17’467’999	102’838’110	216,738,062
Total deposits value	1’506’614	44’250’000	173,362,487
Total staff/women	510 / 130	1278 / 318	2,731 / --
Total Office	54	122	151

Partner financial institution: Hattha Kaksekar Limited (HKL) is the 4th largest MFI with a mission to target specifically low-income households in rural areas and women. With a considerable market share and a good outreach through 122 branches, HKL contributes to increased financial inclusion: more than 74’000 borrowers (76% women) and 108’000 depositors (74% women). It also offers insurance products, transfer and exchange services as well as non-financial services regarding health, enterprise etc. HKL is committed to client protection standards and social



performance, hence endorsing the SMART Campaign and reporting on "Progress out of Poverty Indicators". HKL has also entered the lower SME lending sector with business loans up to 30'000 USD. In 2011, ResponsAbility Social Investments AG became a shareholder, besides Oikocredit, ANM (Triple Jump), NORFUND, Hattha Kaksekar NGO Holding, SIDI, HK SA and Dr. Dy Davuth, by holding a 10.17% equity stake of 9'552'504 USD totally (share capital and premium).

ResponsAbility applied for SCBF technical assistance for HKL to strengthen its savings strategy as well as treasury and risk management systems operations as pre-condition for a massive up-scaling of small-deposit mobilisation in a sustainable way.

2. Intervention approach and additionality

Capacity building needs: In 2010, HKL received a permanent Micro-Deposit Taking Institution Licence and started to engage pro-actively in saving products, after more cautious trials since 2001. In order to better serve low-income savers with appropriate products and distribution channels and to reduce its financing costs as key strategy for its long-term goal of transforming into a microfinance bank, HKL had to strengthen its product offering on the liability side by developing a sustainable savings mobilisation strategy. As HKL was still pre-dominantly a lending organization, this required an appropriate adaption of its internal setup and the in-house acquisition of relevant knowledge and expertise.

Intervention approach: The SCBF mobilised experts for a) market analyses regarding savings demand to develop a sustainable long-term savings strategy and b) analyses and implementation of the necessary changes to operational processes. A core group of eight HKL executives, senior managers and subject matter specialists serving as internal knowledge multipliers received intensive individual or group coaching. Another 15 middle and top management staff participated in two feedback and planning seminars on risk management methodologies and savings product design.

The aim was to produce at least two new savings products, including a microinsurance element, and adapt existing ones as well as their delivery mechanisms, policies and procedures. Consequently, HKL was compelled to conceptualise a new marketing strategy and train its staff in all new aspects. Furthermore, with the shift to a deposit-taking institution, adaptations and training in risk management regarding interest rate, liquidity, foreign exchange rate and operational risk management were required. Hence, treasury management policies and procedures were revised and staff coached.

Additionality: The SCBF intends to accelerate the introduction of best practices in savings and insurance products as well as solid risk management systems within HKL as a leading MFI, with expected positive demonstration effects on other MFIs. Furthermore, a solid self-financing mechanism is highly desirable regarding business sustainability and decreased dependency on foreign portfolio investments which will lead to increased competitiveness and subsequent lower priced products for low-income clients.

3. Results achieved

3.1. Client level

HKL's Environmental and Social Unit, established in 2010, has been implementing results measurement mechanisms regarding various social and environmental aspects of their business. The "Progress out of Poverty" indicator will be captured for the first time in 2013. Detailed client data has not been available yet.

The client focus groups for micro-insurance products showed that especially borrowers and people with very low savings are welcoming the idea of insurance-coupled products, as their financial vulnerability to health and life risks is comparatively higher. Being able to mitigate such risks via innovative financial products would greatly relieve the distress of loss of income and reduce supplementary expenses.

Outreach of HKL	2009	2012	2016
Number of borrowers	41'110	74'559	127'809
% of female borrowers	77%	75.5%	75.5%
Average loan balance per borrower	758 USD	1379 USD	2'205 USD
Number of savings & deposit accounts	47'835	108'037	165'048
% of female depositors	77%	73.6%	74%
Average deposit balance per depositor	32 USD	409 USD	1'536 USD
Rural clients	~80%	80%	80%
Clients according to income level			
-below NPL	n/a	3%	
-below 2.5 USD/day	n/a	31,1%	
-below 3.75 USD/day	n/a	55,9%	
Outreach by business sector			
-agriculture	n/a	41,65%	
-household/family	n/a	19,7%	
-trade and commerce	n/a	18,62%	

Source: Mix Market, Cambodia Microfinance Association, preliminary PPI results HKL 2012

"97% of HKL's clients surveyed which disbursed from July to December 2012 were likely to be above the Cambodia's poverty line of 2,470.20 Riles per day (PPP). Notice that the calculation refers to Consumer Price Index between Dec 2004 and July 2012.

However, in terms of the International poverty line, there were about 31% below 2.50 USD a day (PPP) while approximately 69% were more likely to be above the line."

Hout Ieng Tong, CEO of HKL

3.2. Partner financial institution level

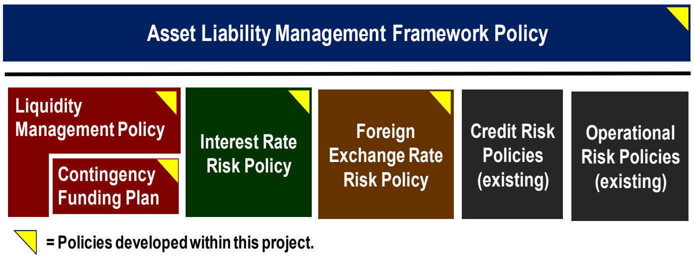
Market Positioning: HKL now has a clearly articulated savings strategy approved and in place as well as improved corresponding risk management and staff incentive policies. The transaction component of HKL's savings strategy plays on the safekeeping and convenience motive of savers. With the new core banking system in place, the first ATMs being installed and the merchant cash point network about to be rolled out, HKL can credibly position and upscale the basic demand savings account as the financial transaction platform for all clients. Regarding micro-accumulation and convenience, HKL will gradually deploy a culturally appropriate 'pro-poor' savings mobilisation approach in form of a home collection service throughout their network. The new marketing strategy targets geographically and demographically concentrated clusters of potential clients with (micro-) bankable revenues. Moreover, the HKL Board approved a detailed business case for micro-insurance in December 2012.

New/improved products and distribution channel: With its new *charity time deposit* and the entry level *HKL SAFE-12 deposit* (that buys one unit of personal accident insurance), HKL offers an innovative value proposition for the low-income mass market that combines the four main savings motivations: investment return, targeted accumulation, safety, and convenience of access. HKL is preparing to launch two micro-insurance products[2] - *micro-loan repayment waiver and loan portfolio cash benefit rider*. The *Time Deposit Mobilisation* has been adapted to promote rather mid-sized, mid-maturity deposits in KHR to provide a growing, stable and low-cost funding base.

Key performance indicators of HKL	2011	2012	2016
Return on Assets	4.50%	4.21%	4.05%
Debt to Equity Ratio	4.14	4.62	4.25
Deposits to Loan Ratio	20.95%	43.48%	90%
Deposits to Total Assets Ratio	18.18%	35.99%	66.23%
GLP to Total Assets Ratio	86.78%	82.77%	73.60%
Financial Cost Margin	17.89%	17.22%	14.58%

Operational capacity: An Asset Liability Management Framework Policy has been developed as platform for all risk management activities and as framework for the newly developed liquidity management policy, the contingency funding plan, and the interest rate and foreign exchange rate risk policies. The credit risk and operational policies have been revised and early warning systems introduced for credit risks, vintage curves and transition matrixes. An operational loss event data base was initiated to link the internal audit with the risk management field inspectors to strengthen operational risk reporting. Today, a global financial model

[2] Micro-Loan Repayment Waiver: Any outstanding loan balance will be written off if the principal borrower dies or becomes permanently disabled / Loan Portfolio Cash Benefit Rider: Includes personal accident insurance that covers accidental death, disability and hospitalization. "HKL SAFE 12" is a special entry level product also including standard personal accident cover



implements all risk metrics and directly attaches them to the management accounts and rolling monthly business forecast. HKL can now implement a data-driven approach to customer service, marketing, risk analysis and development impact assessment. This database extension could also serve as Customer-Relationship-Management solution for the coming years.

Investments mobilized: Since the capital injection in December 2011, there has not been another increase in equity capital yet. Despite rapid balance sheet growth, net senior borrowings rose only slightly in 2012 due to the success in deposit mobilization.

3.3. Financial sector level

It is expected that the project will have an innovatory effect on the market regarding new services and products, especially in micro-savings and micro-insurance. Yet, it is too early to draw conclusions on the industry impact in 2013.

4. Lessons learnt and future challenges

The project execution has been more difficult than it may appear. In a mature financial institution such as HKL, consensus at working level has to be built first before senior management can be convinced of changes. In addition, the savings strategy articulated by the Technical Assistance (TA) team was somewhat counter to the conventional wisdom of the former success story in deposit mobilisation which unfortunately did not specifically target low-income market segments and needed redirection. However, with a committed TA team and the cooperation of an enthusiastic HKL staff, the challenges could be successfully overcome and the targets achieved. Nonetheless, the work of building and sustaining a low-income savings franchise is never finished. To keep the momentum, HKL should explore new product ideas during 2013 and 2014, once the two new saving products have succeeded in the market.

"With this project, HKL could implement tools to manage ALM functions properly as well as concepts to develop and orient new products to the target market.
That is very helpful for sustainable and ongoing growth."
Hout Ieng Tong, CEO of HKL

[i] Heritage Foundation, 2013 Index of Economic Freedom, http://www.heritage.org/index/ranking
[ii] Oxford Human & Poverty Development Initiative, Multidimensional Poverty Index, http://www.ophi.org.uk/
[iii] BWTP Network (2010), Industry Update – Cambodian Microfinance, www.ratinginitiative.org/uploads/tx_dbreports/HKL__Cambodia__Social_Rating_Executive_Summary__April_2011.pdf (11.02.2013)
[iv] World Bank (2013), Global Financial Inclusion Database
[v] EIU (2012), Global microscope on the microfinance business environment 2012
[vi] Kingdom of Cambodia (2011), Financial Sector Development Strategy 2011-2020
[vii] Cambodia Microfinance Association (2013), Sector statistics
[viii] International Finance Corporation (2008), Cambodia - Financial Sector Diagnostic