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Impact of microcredit borrowing on wellbeing in Cambodia

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Key messages

- Access to credit improves wellbeing outcomes for borrowing households and should be supported by the government.
- MFIs should be encouraged to continue to offer and expand their loan portfolios to female borrowers.
- Expanding credit access is essential to increasing off-farm self-employment.

Microcredit booming in Cambodia

Limited access to finance has been one of the main factors constraining business growth and expansion in Cambodia. Small-scale businesses and self-employed workers, particularly in rural areas, are constrained by the limited, and sometimes even inadequate, financial services available.

Microcredit has been a key component of Cambodia's post-war reconstruction and rehabilitation. As of the first quarter of 2016, there were 70 Microfinance Institutions (MFIs) in Cambodia, lending a total of 3.1 billion USD, serving two million customers and employing 26,940 people across the country.

Proponents of microcredit argue that the increased competition within the MFI sector and between MFIs and banks has contributed to lower and decreasing interest rates on loans. They also argue that MFIs enable rural populations to access financial services that would otherwise be unavailable. Critics of the system accuse MFIs of charging above-market interest rates and implementing repayment policies that are profit-oriented and do not encourage borrowers to grow their small-scale businesses.

There has not been a consensus among scholars as to the effects of credit access as a policy tool for wellbeing. As such, a team of local PEP researchers set out to investigate the impact of microcredit borrowing on wellbeing in Cambodia. To do so, the team investigated three propositions in relation to wellbeing: 1) the impact of microcredit participation, 2) the effect of borrowing from multiple (formal and informal) sources, and 3) the role of gender in use of credit.

Data and methodology

Although sometimes used interchangeably, the research team defines "microcredit" as the provision only of small loans and "microfinance" as a service that includes more than just loan provision (e.g. training and deposits). This study assesses the impact of microcredit, not microfinance, on the wellbeing of borrowers.

The research team analyzed household panel data from 2011 and 2014 on eleven (mostly rural) villages in Cambodia. The data source provides a wealth of information including household demographics and conditions, non-land assets, livestock ownership, household income, agricultural production, wages, and self-employment.

The researchers used difference-in-difference and triple-difference approaches to compare outcomes for households with similar characteristics before and after using microcredit.

Key findings

The research team's findings indicate that **access to credit improves wellbeing outcomes for borrowing households** in comparison with non-borrowing households. Improved wellbeing outcomes include:

- A 26.1% increase in paddy income.
- A 68.9% increase in paddy quantity.
- A 26.5% increase in spending on paddy production inputs (e.g. fertilizers, water, hired labor).

Poorer borrowing households benefitted more from credit access than richer borrowing households. The research team suggests this is because poorer households faced more significant constraints to accessing credit and easing these constraints helped to boost production.

The team also observed an increase in agricultural equipment (e.g. hand tractors) among borrowing households, relative to non-borrowing households.

There was little evidence supporting the hypothesis that female-headed households benefit more from credit access than male-headed households. However, borrowing households with a female head were more likely to set up (informal) self-employment activities. Credit access for women, although not sufficient by itself, seems to be linked to increased self-employment income.

While borrowing from formal and informal sources does increase paddy income and quantity, the researchers urge caution. Borrowing from informal sources is the most expensive source of credit with MFIs charging 2.6% per month in 2014, compared to the 6.6% charged per month by moneylenders. As such, borrowing from multiple sources can lead to repayment problems.

There is little evidence that MFIs charge above-market interest rates or other excessive lending practices that could contribute to over-indebtedness and repayment difficulties.

Finally, the team found that continuous microcredit participants tended to benefit more than those who dropped out of a microcredit program.

Implications for policy

The results of this study indicate that **credit access is an important factor in increased borrower wellbeing**, particularly in terms of easing financial constraints in paddy production and should be supported.

Similarly, Microfinance Institutions (MFIs) **should be encouraged to continue to offer and expand their loan portfolios to female borrowers** with the aim of encouraging more women to move into self-employment activities.

Expanding credit access is essential to increasing off-farm self-employment. However, if this is the objective of policymakers, additional measures are needed to support off-farm self-employment growth. Currently, credit access benefits some households more than others and the effects are quite modest, suggesting that access to microcredit is not the quick fix as argued by some proponents.

For MFIs, the research team recommends creating products that are tailored to borrowing households that have an average annual real paddy income of 63 million KHR (15,000 USD), households that receive remittances from emigrated family members, and households whose head has completed upper secondary or higher education.

Further research should be undertaken as the findings of this study cannot be generalized at the commune, provincial or national level due to the data coming from eleven, mostly rural, villages.

Nonetheless, the data used in this study is currently the most comprehensive panel data available for Cambodia as nationally representative panel data remains limited.

The Cambodia Socio-Economic Survey (CSES) may offer a solution for more generalized findings, as it is nationally representative. However, use of the CSES is limited by the fact that it is a cross-sectional data set and MFI loan sources were not recorded in the family loan portfolio in 2014.

The researchers suggest further analysis be undertaken on the costs and benefits of microcredit borrowing and to investigate over-indebtedness among borrowing households or individuals.

In 2012, with support of the UK Department for international Development (DfID) **and the International Development Research Centre** (IDRC) **of Canada, PEP launched a new program to support and build capacities in "Policy Analyses on Growth and Employment"** (PAGE) **in developing countries.**

This brief summarizes the outcomes of PMMA-12791 supported under the 3rd round of the PAGE initiative (2015-2016). To find out more about the research methods and findings, read the full paper, published as part of the PEP working paper series.