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Supreme National Economic Council (SNEC)

POLICY NOTE #3

ACCESS TO FINANCE FOR FARMER ORGANIZATIONS AS ECONOMIC AND COMMERCIAL ACTORS IN VALUE-CHAINS

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ACRONYMS

AC	Agricultural Cooperative	FWUC	Farmer Water User Community
AFD	*Agence Française de Développement*	IRAM	*Institut de Recherche et d'Application des Méthodes de Développement*
AVSF	*Agronomes and Vétérinaires Sans Frontières*	MAFF	Ministry of Agriculture, Forestry and Fisheries
CFAP	Cambodian Farmers' Association Federation of Agricultural Producers	MEF	Ministry of Economy and Finances
DACP	Department of Agriculture Cooperatives Promotion (/MAFF)	MFI	Micro-Finance Institution
FAEC	Federation of farmer associations promoting family Agriculture Enterprises in Cambodia	NF3	National Farmer Organization Federation Forum
FCFD	Federation of Cambodian Farmer Organizations for Development	RDB	Rural Development Bank
FI	Financial Institutions	SNEC	Supreme National Economic Council
FNN	Farmers and Nature Network	SCCRP	Support to the Commercialization of Cambodian Rice Project
FO	Farmer Organization	SCM	Scoring Criteria Method
FWN	Farmer and Water Net		

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1. Context and rationale for a proactive policy on access to finance for Farmer Organizations

1.1. Development of professional Farmer Organizations engaged in value chains: a strong policy objective

The development of efficient and professional Farmer Organizations / Cooperatives is an important orientation of Cambodia's development policy. As an illustration, "to encourage and support the participation of Farmer and Farmer Organizations (/ Cooperatives) to protect their interests by creating an enabling environment for increased production and supply of high quality rice, including raising farmers' bargaining power on price negotiation" is one of the key principles enhanced in the Policy Paper on the Promotion of Paddy Production and Rice Export approved by the Council of Ministers on July 25, 2010.

The creation and support to Agriculture Cooperatives is also an important axis of MAFF's strategy. MAFF's Action Plan for the implementation of the Policy Paper on the Promotion of Paddy Production and Rice Export includes as a policy measure to "strengthen capacity of farmer and agricultural cooperatives to secure and utilize effectively loans from financial institutions" (FI).

Agricultural Cooperatives (and more largely Farmer Organizations)[2] can play a significant role in the commercialization of agricultural products as well as in the supply of inputs, strengthening farmers' access to information and bargaining power as they deal with bigger quantity of goods and can get in relation directly with wholesalers or large agro-industry, instead of dealing with local retailers or middlemen.

1.2. FOs / Cooperatives Access to finance: a major bottleneck

But this role of involvement of FOs as commercial actors in value chain, to be fully developed, may require a certain financial capacities of FOs for investment or at least working capital. Hence, **access to finance is a major bottleneck for the development of Agricultural Cooperatives'** commercial activities. Cooperatives have generally very limited capital, and have in most cases no (or maybe very limited) access to loans[3] from formal Banks or MFIs, first of all because of the lack of assets Cooperatives can use as collateral. Besides, if ever a Cooperative can become eligible for a loan from a Bank or MFI, the financial costs (in particular the interest rates) are still relatively high (loans to Small or Medium Enterprises are frequently at rates around 1 to 1.5 % per month, for a capital lent in a range of approximately 10,000 to 30,000 USD)…

On the other hand, Rice millers have access to loans (notably loans provided by the Rural Development Bank – RDB) at rates of 6 to 9%/year. Indeed, rice millers are likely to borrow large amounts of money and to be able to provide legally strong collateral. This difference of access to finance creates a distortion in bargaining power between millers and cooperatives. Farmers may access a credit for the supply of inputs (such as seeds or fertilizer) from a rice miller or from village collectors, but may then be "trapped" by **this financial dependence that reduces the bargaining power of farmers on prices, in contradiction with the principle enhanced in the Policy Paper** on the Promotion of Paddy Production and Rice Exports.

Without access to finance, Agricultural Cooperatives cannot progress through the initial stage of their development from the stage of micro-scaled cooperatives at village level to the stage of efficient small to medium scale cooperatives able to undertake activities at the level of an SME. And then the objective to see Cooperatives emerge as stronger commercial actors in value-chains remains a wishful thinking. Moreover, for them to access resources at the same cost as rice millers would require to subsidize the interest rates on their loans.

[2] Agricultural Cooperatives are registered with the Ministry of Agriculture, now in the frame of the law on Agricultural Cooperatives of 2013. Farmer Organizations is understood more broadly as any kind of Farmer Organizations (not referring to a particular legal framework): this term can encompass Agricultural Cooperatives, Associations, Farmer Water User Communities, etc.

[3] Agricultural Cooperatives are legally entitled to access credit, but regulations may limit the ratio between the total amount of credit they receive and their own capital.

2. SCCRP PROJECT EXPERIENCE IN DEVELOPMENT OF CREDIT TO FOS

2.1. THE PILOT EXPERIENCE OF RDB'S CREDIT OFFER TO FARMER ORGANIZATIONS

In order to address this issue of access to finance to FO and improve the coherence between the policy objectives and the instruments deployed through the State owned Rural Development Bank, the SCCRP project has supported the development of a new financial offer from RDB, dedicated to Farmer Organizations.

This credit offer was adopted in June 2016. The main features of the financial product proposed are described in Box 1 next page.

This credit mechanism has been implemented at a pilot stage since then. Since RDB has no branch office in provinces, a challenge to address was the distribution of the credit. For this, an informal partnership has been established between RDB and two Federations of Farmer Organizations: FAEC and FCFD. The two federations have conveyed information on RDB credit offer to their members, notably through workshops at provincial level (in some case organized in presence of a credit officer from the Bank). After providing information on the conditions proposed by RDB, the Federations identified FOs/ Cooperatives which were willing to develop a commercial activity (in most of the cases for input supply or commercialization of agricultural products), and might have a need for financial services. Then they provided support to these FOs to prepare business plan and loan application, then file the application with RDB. In some cases, for FOs that are judged too weak in their managerial capacities, Federations may encourage them to delay their project and first consolidate their capacities and experience at a smaller scale, before contemplating scaling up with a loan.

After one year and half of implementation, RDB had received 14 applications from Agricultural Cooperatives and had approved 7 loans, for a total amount of 74,000 USD (See Table 1).

Table 1: Statement on applications received by RDB from FOs and loans accepted (since adoption of RDB's new credit policy to FOs in June 2016, and as of 31 December 2017)

Nº	Name of AC	Province	Date of request submission	Member of	SCM score	Amount of loan requested	Type of business	Type of collateral	RDB decision	Guarantee mobilized	Amount of the loan accepted	Capital already reimbursed	
1	Samaky Rithy Ta Orng	Prey Veng	30-Aug-16	FCFD	78	$ 5,000.00	Fertilizer trade	Hard-title	No				
2	Punleu Samaky Meanchey Prech	Prey Veng	30-Aug-16	FCFD	73	$ 5,000.00	Fertilizer trade	Hard-title	No				
3	Baphnom Meanchey	Prey Veng	14-Sep-16	FCFD	68	$ 5,000.00	Fertilizer trade	Hard-title	Yes	Yes (40%)	$ 5,000.00	$ 5,000.00	✓
4	Sahakum Ksikam Samaky Thkov	Prey Veng	14-Sep-16	FCFD	62	$ 5,000.00	Fertilizer trade	Hard-title	No				
5	Chamroeun Phal Raingkesei	Battambang	20-Sep-16	FAEC	87	$ 9,070.00	Rice trade	Soft-title	Yes	Yes (50%)	$ 6,000.00	$ 6,000.00	✓
6	Trapaing Russey	Kpg Thom	17-Oct-16	FCFD	89	$ 30,000.00	Paddy + seeds trade	Hard-title	No				
7	Oudom Sorya	Takeo	20-Mar-17	FAEC	83	$ 7,000.00	Rice trade	Soft-title	Yes	No	$ 7,000.00		
8	Baksey Reakreay	Takeo	20-Mar-17	FAEC	66	$ 20,000.00	Fertilizer & rice trade, mill	Soft-title	Yes	No	$ 11,000.00		
9	Trapeang Kranhoung	Takeo	23-Mar-17	FCFD	90	$ 10,000.00	Fertilizer & rice trade	Soft-title	Yes	No	$ 10,000.00		
10	Sangkahak Kaksekor Samyorng	Svay Rieng	24-Mar-17	FAEC	71	$ 15,000.00	Fertilizer & rice trade, mill	Soft-title	No				
11	Phnom Krapeu AC	Battambang	13-Jul-17	FAEC		$ 5,000.00	Fertilizer & rice seeds trade	Soft-title	No				
12	Kampong Speu Sugar P	K. Speu	9-Oct-17	FAEC	81	$ 30,000.00	Fertilizer trade, Sugar and buy high ladder	Soft-title	Yes	No	$ 20,000.00		
13	Trapaing Russey	Kpg Thom	6-Nov-17	FCFD	89	$ 20,000.00	Paddy + seeds trade	Hard-title	Yes	No	$ 15,000.00		
14	Sambour Meas Mean Cl	Kpg Thom	6-Nov-17	FCFD	62	$ 5,000.00	Fertilizer Trade	Soft-title	No				

In the early stages of implementation, the process of assessment of loan application was quite time consuming. This partly explains the low rate of success for the applications received by RDB in 2016 (some loan applications were withdrawn because the decision was not made on time for the (seasonal) activity to implement or rejected by RDB for that reason). In 2017, the procedures in RDB have been improved and the delay for decision making was improved (yet still quite long: about one month, with a target to reduce it further to 2 to 3 weeks).

In some cases, in order to reduce the collateral requirement, a credit guarantee was used. In a pilot stage, for the first two loans, the guarantee was provided by the SCCRP project directly. Meanwhile, the project is working with the Ministry of Economy and Finance to set up an institutionalized guarantee mechanism, which could (partly) be used to guarantee the credit to FOs in the longer term (See Box 2: Setting up a Credit Guarantee mechanism page 5).

Box 1: RDB Credit offer to Farmer Organizations

Objective: Credit to finance commercial activities of Agricultural Cooperatives or legally registered FOs.

Minimum criteria:
- properly registered as an Agricultural Cooperative with MAFF, or other FO with legal personality;
- has at least 1 year of experience in commercial activity;
- can provide financial information, including assets, liabilities, capital, income and expenses;
- has collateral (real estate).

Short-term loan criteria
- for working capital needs;
- minimum loan amount of US$5,000 (per cooperative and no need to have multiple, group loan applications);
- maximum loan amount of US$50,000;
- final loan amount shall depend on past and projected cashflows of the cooperative, shall not be more than 4 times the capital of the cooperative and shall not be greater than 80% of working capital needs;
- duration not exceeding 12 months;
- interest rate of 10.5% for USD loans and an additional 3% for KHR loans (service fee and guarantee fee are included);
- repayment of principal can be all at maturity or amortised depending on type of business and cash flows; interest is to be paid monthly;
- late repayments of over 15 days may attract double interest penalty.

Long-term/investment loan criteria
- for investment in real estate, machines, equipment to be used for commercial activities;
- minimum loan amount of US$10,000 (per cooperative and no need to have multiple, group loan applications);
- maximum loan amount of US$100,000;
- final loan amount shall depend on past and projected cashflows of the cooperative, shall not be more than 4 times the capital of the cooperative and shall not be greater than 80% of planned investment;
- duration 1-5 years, including option of grace period up to a maximum of 1 year;
- interest rate of 10.0% for USD loans and an additional 3% for KHR loans (service fee and guarantee fee are included);
- repayment of principal shall be amortised quarterly or semi-annually depending on type of business and cash flows; interest is to be paid monthly;
- late repayments of over 15 days may attract double interest penalty.

Collateral (for both short- and long-term loans; for both new and old customers)
- collateral can be in the form of real estate, guarantee letter, fixed deposits, gold, equipment and inventory (the latter two are difficult to implement at the moment);
- non-real-estate collateral can be up to a maximum of 30% of required collateral coverage;
- for loans less than US$10,000 soft title is sufficient;
- the loan-to-collateral-value ratio is 70% for real estate located in cities/provincial capitals that have shopfronts, factories, industrial buildings or residential buildings;

…/…

…/…
- the loan-to-collateral-value ratio is 60% for real estate located outside cities/provincial capitals but still have shopfronts, factories, industrial buildings or residential buildings;
- the loan-to-collateral-value ratio is 50% for real estate suitable for agricultural purposes;
- a guarantee fund can be used to increase the loan-to-collateral-value ratios above in proportion to the percentage amount of the loan guarantee, e.g. with a 50% guarantee fund coverage, a 50% requirement can be increased to 75%.

Box 2: Setting up a credit guarantee mechanisms

As indicated in the last point of Box 1 above, a guarantee mechanism can be used in order to lower (but not to completely waive) the collateral requirements for loans to FOs, considering that the mobilization of sufficient collaterals is an important constraint for FOs.

For the first two loans provided by RDB under this new credit scheme, 40 to 50% of the capital lent was guaranteed directly by SCCRP project, as a transitory solution to test the implementation of a guarantee fund. MEF is now considering the creation of a Guarantee Fund, one part of which could be dedicated to provide guarantee (when needed) for loans to Farmer Organizations. It is expected that the guarantee mechanism could be formally established by early 2018.

Foreseen principles of the guarantee mechanisms include:

▪ Further collateral (to complete the part covered by the guarantee) shall be required from the borrower, according to the Financial Institution's collateral policy.

▪ In case of default, the guarantee fund will cover the contractual percentage of the remaining outstanding capital at the date of the claim.

▪ The loss is shared from the first USD.

▪ All amounts recovered, before and after payment from the guarantee fund, will be shared between the guarantee fund and the financial institution, in proportion to the agreed coverage percentage appearing in the guarantee grant letter.

3. First lessons from RDB's activities with FOs during the pilot phase

The pilot stage supported by SCCRP has generated several lessons that should be considered within the perspective of scaling up FOs' access to finance.

3.1. Credit application assessment and decision making

As mentioned above, the loan application appraisal and loan granting process remains complicated and time-consuming, and one can say that there are still significant barriers to entry for FOs to access loans from RDB:

Counterpart evaluation takes time, mainly due to the fact that the loan applicants most often do not have complete and up to date legal documentation. This is linked to the recentness of the cooperative movement in Cambodia; the pilot phase of the loan partnership with RDB has made the partner FO Federations conscious of this situation and led them to solicit the MAFF's Department for Agricultural Cooperatives Promotion to deliver on training on AC legal documentation to their members. RDB on its side has designed formats for documents that are often missing and instructed its credit officers to support ACs to fill in the gaps during the field visit, which should lead to a reduction in duration of the process. Other loan providers to FOs (MFIs, Buddhism for Development Foundation), though their effective supply is very limited, do not rely on legal documentation to assess the counterpart's solidity but rather on elements collected in the field.

Another factor explaining the time required to assess loan applications is the fact that small farmers and FOs are a relatively new market for RDB, and that FOs are moreover rather recent and little experienced. It is thus necessary for RDB to invest prudently in knowledge of this clientele so the activity can start on a sound basis, before reducing the analysis.

As a consequence, the loan process has often been too long for loan decision to be made on time for disbursement in the season of the proposed activities.

Collateral based on land titles: In Cambodia, collateral requirements are high, both in the banking and in the microfinance sectors. It thus seems natural to the farmers that land titles should be required to access a loan. The federations' board members agreed that they would not be in favor of giving out a loan to an AC without collateral commitment. In this context, it does not seem to be difficult to mobilize land titles from Board members in order to provide collateral for the loan requested when an AC does not have their own land to use as a collateral; this presents the advantage of making sure that these members are all involved in the loan and thus reducing the risk of misuse. It however impacts the time required for preparing a loan application: as most FOs need to pool land titles from their members to cover RDB's collateral requirements, it makes the procedure more complicated: most of the time, the 2 spouses need to sign for each title and members sometimes withdraw their title in the process, making it necessary to do the process over again with a new title. Moreover collateral based on land title oblige RDB to assess the economic value of the land, which requires a physical visit on the spot (often to remote and scattered rural land plots) and to appreciate trends of the local land markets. RDB states that they now ask the FOs to provide titles for land that is not too far from the village, which has made it possible to reduce the time required for physical evaluation of collateral to 1-2 hours per application.

FOs' low capacity: Most of the time in Cambodia, FOs are still at a relatively early stage of their development and professionalization. Their managerial and accountancy capacities are often still limited, which makes the risk appreciation more difficult, and in itself represents a factor of risk for the Financial Institution.

3.2. Interaction with FO federations

As mentioned above, FO federations have played an important role of **interface** between RDB and their members in information dissemination, identification of possible eligible FOs, provision of technical support during the application process and provision of technical, management and governance support in the implementation of the (sometimes new) activities. However, it must be underlined that this backstopping was made possible thanks to external support from SCCRP, meaning that if Federations are supposed to pursue this important interface function, not only should they be remunerated for that, but specific support to federations should also be continued as long as federations cannot be autonomous on that matter. Up to now, FAEC and FCFD have charged a small fee of 1% of the value of the loan to their members who successfully applied for a loan with their support. This contribution remains at the moment insufficient to cover the costs incurred by the Federations, especially with loan amounts that remain relatively small, and a rate of success of applications that was quite low in the early stage, as the procedures were still in their trial run.

Financial projections have been developed based on an analysis of the pilot experience in terms of tasks and costs, and an estimate per disbursed loan. The budget for the implementation of the partnership by the federations has then been drawn up with two different hypotheses in terms of organization that need to be analyzed more deeply with the federations: (1) all operations performed by provincial representatives (no staff), (2) operations split between provincial representatives and « specialists » or staff. The overall budget derived from these hypotheses shows that the federations could link 59 FOs to the bank over 5 years, who would receive 195 loans. The proposed organization in option 1 requires revenues amounting to USD 1,000 over 5 years while option 2 requires USD 15,000. Option 1 can thus cover costs with a remuneration at 0.5% of loans disbursed and repaid, on top of the success fee that the federations' members already pay their federation.

Box 3: The FO scoring system used by FO Federations, and its possible interest to support credit to FOs

FCFD and FAEC have in common that they use a similar system to evaluate and monitor the institutional capacities of their members. This system, known as the "Scoring Criteria Method" (SCM) was developed by the development NGO AVSF as part of a program of support to Farmer Organizations. This monitoring system was initially seen as an asset that could be valued by the bank. RDB was even consulted in 2014 while the Federations were reviewing the criteria used. But it turns out that the SCM scores obtained by FOs applying for loans has not really been considered by RDB as an element in decision making. They were only taken into account by the SCCRP project for the decision to provide guarantee to the loans, at the stage of pilot implementation of the guarantee system in 2016.

The use of the SCM system could present an interest for the bank (among other sources of information), but finally its use has not be retained considering that:

- the bank criteria were not necessarily in line with the federations';
- the federations are not very strong and may not be in a position to maintain scoring in the coming years if external support is not continued;
- credit to FOs is not reserved for FAEC and FCFD members, whereas only applicants who belong to federations are scored, and even FAEC and FCFD members are not necessarily scored every year;
- the use of the Federation scoring could be seen as a situation of conflict of interest for FO Federations.

3.3. Pilot guarantee mechanism

As for the temporary guarantee provided directly by the SCCRP project, the **Guarantee committee** only examined the first two loan applications, as the guarantee was not available any more for any credit whose maturity would be beyond September 2017, due to the planned end of project.

Discussions in the guarantee committee were limited to checking that the guarantee criteria were fulfilled, which included verification of the minimum score obtained by the applicant in the evaluation implemented by FAEC or FCFD (based on the SCM scoring system – See Box 3, previous page). Only the first guarantee decision was made during a physical meeting, while the following one was made by e-mail. Therefore, guarantee decisions were made relatively rapidly (a few days only) but this has to be added to the loan decision process and contributes to the length of the overall decision process. For the time being, given the low level of activity, proceeding with individual guarantees is reasonable. But it would involve unreasonably high administrative costs and time for decision-making once the number of applications increases significantly. A portfolio guarantee system could be considered for smaller loans, whereas above a certain threshold, bigger loans would be subject to an individual guarantee.

In this very pilot stage, the two FO Federations (FAEC and FCFD) were involved in the guarantee committee (only one Federation representative: FAEC when the applicant was from FCFD and vice-versa), and the SCM score obtained by the applicant was part of the criteria for guarantee eligibility. The fact that FO Federations are involved in the guarantee decisions for loans that concern their own members could be seen as a factor of risk. The rationale for this was that initially, it was foreseen that the Federations would contribute own funds in the guarantee fund; the commitment of their own capital in the guarantee was a way to ensure their commitment to perform well in the support to FOs to prepare applications and present RDB only applications from reliable FOs. This might not be as relevant if Federations do not commit their own capital in the guarantee mechanism. Yet, even without investing their own funds in the guarantee, the Federations still have an objective incentive to make the loan mechanism efficient and reliable by performing a good preselection of clients in that access to finance is one of their members' main expectations from them. Facilitating access to finance sustainably implies building the partner financial institutions' trust and demonstrating the reliability of the FOs as borrowers.

Another impact of involving the Federations in guarantee decisions is that it could reduce the confidentiality of the guarantee vis a vis the borrower. Indeed, the principle of a silent guarantee, which is often preferred for a non-financially literate clientele, is that only the bank would know which credit benefits from the guarantee, but not the beneficiary of the credit. This principle also applies for portfolio guarantees. If FO Federations are involved, it is more likely that the guarantee will not remain confidential.

4. Policy Recommendations for FO financing

4.1. To maintain and scale up RDB credit offer to Farmer Organizations is highly necessary

4.1.1. A necessity to unlock the potential of development of FOs

Farmer Organizations represent a strong potential of development and strengthening of smallholder farmers' positions and incomes in Cambodia. This is well identified in policies and strategy documents from the Ministry of Agriculture Forestry and Fisheries. The statement made in the beginning of the present note (See § 1.1. and 1.2.), which was at the origin of the engagement of the SCCRP project for the development of credit to Farmer Organizations, remains valid and actual.

Access to finance remains a major bottleneck for Agricultural Cooperatives and more broadly Farmer Organizations, which has to be addressed if we want to achieve the objective of their development as economic and commercial stakeholders in agricultural value-chains.

4.1.2. The coherence with RDB's specific mandate

As part of the process of reforms and up-grading of the Rural Development Bank supported by SCCRP project, the strategic orientation of RDB activities toward support to policy objectives has been reaffirmed. The Rural Development Bank has a clear mandate to address financial needs of private economic stakeholders in agriculture sector and rural areas to finance activities that can contribute to achieve policy objectives, in particular when these needs are not addressed by the private financial sector.

Hence, given the policy orientation toward agricultural cooperatives development, and the relative reluctance of commercial banks and MFIs to lend to farmer organizations at the moment, it is definitely relevant and well aligned with its mandate that RDB initiates and develops a credit service offer dedicated to FOs. This has been formally initiated in 2016 with the support of the project, but still at a very pilot stage and with limited number of loans and amount allocated to ACs.

RDB has expressed the intention to continue to scale up its portfolio of credit to FOs (with an objective of a total lending to FOs of 2 million USD in 2018) and this orientation has to be encouraged and supported. Further scaling up can then be considered, at a pace that shall be adjusted to the growth of FO demand and credit absorption capacity. This could be done in parallel with a policy to attract other Financial Institutions to the FO market.

4.2. About the conditions and modalities of credit distribution to FOs

4.2.1. Interest rates: consider how to further reduce the costs of credit to FOs

RDB has developed a credit offer to FOs at a cost (interest rate) of approximately 10%/year (for loans in USD). At present, this is probably the best credit offer FOs can get. Yet this is still significantly above the rate at which other economic stakeholders (such as rice millers) can get finance from the banking sector. On the one hand (from the bank management and economy point of view) this is perfectly understandable, as the amounts of the loans are generally much lower than the loans provided to millers or agro-industry companies, with a much costlier (per Dollar lent) loan assessment process including an indispensable field visit to meet the FOs, and maybe as RDB may still estimate that the risk with FOs is higher. But on the other hand, if the purpose is to strengthen the bargaining power and competitiveness of FOs, this asymmetry of financial costs contributes to maintain a "competitive disadvantage" for FOs. Higher costs supported by RDB to serve FOs have to be considered. But if providing a more affordable credit access for FOs is a policy objective, additional subsidy to RDB could be considered in order for the bank to be able to further reduce interest rate of these loans while covering its operation costs. In this matter, there is a debate between i) on the one hand those who consider that, as a public and policy oriented bank, RDB shall go further than what the private financial institutions might; ii) on the other hand those for whom market distortions should be avoided, and subsidies should be considered only on a short term/transitory basis and open equally to public and private financial institutions. This option would require a clear decision of the Government and allocation of specific budget (which is not presently the case with RDB loans to FOs that RDB is just expected to cover costs for from its general activity). It has to be recalled here that, generally, interest rate subsidies are a tool that needs to be used prudently to avoid adverse effects. In order for them to reach their policy objectives, they need to be precisely targeted, in terms of beneficiaries as well as in terms of purpose. Here, the fact that rice millers benefit from interest rate subsidies is an argument pleading for providing FOs also with similar support.

4.2.2. Collateral and guarantees: how to further ease accessibility of loans

In most of the cases, Farmer Organizations do not own their own land, and have to require some of their members to pledge their own land title as collateral. The MEF guarantee fund will allow a reduction of the level of collateral required by 50%. But even so it remains a difficulty for FOs to gather sufficient collateral. Also, in some cases, it has been observed that it induces a bias in the FO business model, as the members who are asked to pledge their own title expect a financial compensation. This is not a problem if this can be clarified and formalized in a transparent way within the FO (for instance some FOs have defined that 10% of the net profit from the activity that is financed by the credit will remunerate the members who have accepted to pledge their own title). But in some other case the weight of land owners in the management of the activity and the appropriation of the profits it generates is disproportional, and the activity turns to become the private business of few members instead of the real collective business of the FO.

Other innovative options to reduce the collateral requirement in the form of land titles would contribute to alleviate this risk, either via a secondary guarantee mechanism (an option that was evoked was a guarantee fund owned by FO Federation and which could cover an additional portion of the loans), or by encouraging the FO to deposit cash as a guarantee (which can more easily be contributed by a larger number of members, notably by contributing to AC shares of capital). But discussions with FO representatives have shown that the leverage effect (ratio amount of the loan / amount of the cash deposit) has to be sufficient to make the operation attractive. It seems that a deposit of 20% of the total amount of the loan would be the very maximum that FOs would be able to accept.

The fact that many FOs have developed a cash lending activity to their members for which the demand is high and not satisfied by available funds, often more profitable than a commercial activity within the agricultural value chain, thus enabling a high remuneration of depositors (1.5 – 2.5%/month), limits their willingness to engage more of their own capital in the commercial activity.

4.2.3. Distribution of credit to FOs (1) consolidate the partnership with FO Federations

From 2016, after RDB has endorsed it credit policy for FOs, an informal partnership has been implemented between RDB and two FO Federations (FAEC and FCFD). FO Federations have contributed to disseminate the RDB credit offer to their members and have supported their members to prepare business plans and applications and convey them to RDB.

This partnership deserves to be consolidated and formalized, and can truly benefit both parties. In November 2017, SCCRP has commissioned a last mission of HORUS Development Finance which was notably focused on the drafting of a MoU format that could be signed between a FO Federation and RDB to further strengthen the partnership.

RDB should be encouraged to engage in this formalization, and should not underestimate the value of this partnership. FO Federations can be an efficient business introducer for the bank and, thanks to the knowledge they have of their members, can be a factor of credit risk reduction, in particular if the terms of the partnership include an incentive for Federations not only on the value of the credit portfolio they bring, but also on the quality of this portfolio (which is the case in the proposed terms of MoU developed by HORUS).

FO Federation should also be further supported to improve their capacities to undertake their roles in this partnership and scale up their ability to serve FOs. One of the important risk reduction elements in agriculture finance aimed at smallholder farmers and their organizations is the provision of support to borrowers to successfully lead and efficiently manage their activities. The federations play this important role but would need institutional support (capacity building and human resources) to implement it in a more efficient way (see § 4.3., next page).

4.2.4. Distribution of credit to FOs (2) envisage alternative distribution channels

Whereas the partnership with FO Federations is seen as a valuable way to build the link between RDB and FOs, it shall not be the exclusive channel for RDB to distribute credit to FOs. RDB shall in parallel be encouraged to develop and implement other ways to reach FOs in the various provinces of the country. The recent creation of RDB "mobile units" is an element of a strategy to increase the outreach to potential client-FOs.

Other modalities could also be considered, like mobilizing other institutions to work as agents for RDB. The idea here would be to build on other FIs' networks to serve a scattered clientele that it is difficult for RDB to serve directly given its very limited network. The feasibility and relevance of this option however remains to be confirmed as decentralized FIs may prove reluctant to engage in this type of partnership for different reasons: (i) they may not wish to distribute RDB loans at interest rates lower than the ones they can offer directly, (ii) they may not wish to associate their image with that of a State Bank with an increased risk of non-repayment due to the image of the State. Even if the partnership were implemented, the risk of increased risk if the FIs only perform a distributor role should not be under-estimated.

Another option to leverage the existing large rural network of the Cambodian financial sector to provide loans to FOs would be to attract decentralized FIs to this clientele. This could be endeavored through appropriate support including low interest funding that could entail counterparts in terms of interest rate reduction for the client.

RDB is also considering the establishment of branches in province, which would greatly improve its capacity to reach FOs. But this is a longer term objective and is not likely to be achieved in the next few years.

4.3. Develop and implement a support program to FOs in parallel of addressing financial needs.

It has to be acknowledged that managerial capacities of Farmer Organizations in Cambodia are still limited.

The development of access to credit for FOs is an important element to contribute to consolidate their development and strengthen smallholder farmers' positions in agricultural value chains. But it is not sufficient by itself to ensure the desired development of Agricultural Cooperatives or FOs in the country.

Extensive FO capacity building programs are necessary to accompany the development of Farmer Organizations' abilities to develop and implement collective activities and emerge as more efficient and reliable stakeholders in the agricultural economy and value chains. Some programs are on-going (supported by various development partners and targeting specific value chains and/or specific provinces), which incorporate (or could incorporate) such capacity building activities for FOs.

Elaboration of a more comprehensive and nationwide program focused on capacity building for FOs business development could be explored (and possibly incorporated in the design of up-coming projects) with the objectives, as far as possible, to consolidate and sustain institutionalized mechanisms to cover key needs of FOs, such as:

- A continued support towards farmers and FOs to strengthen their capacities in business plans conception, budget management and basic financial literacy (cash flow planning and management for optimization of use of credit and saving capacities) with the objective to improve their management and reinforce their credibility toward financial institutions.
- Capacity to access the banking system also depends on farmers and FOs ability to produce reliable information about livelihood economy, farming process, collective projects, etc.
- Such long term support process could be conducted with or by FO Federations, with adequate and structural financial support from public authorities and/or projects.

If it is set up, such a FO capacity building and support program could be partly connected with RDB credit to FOs: the fact that a FO is being coached / backstopped for the development of its business activity could then be acknowledged as a factor of risk reduction, which could materializes in improved conditions for access to loans (lower risks assessed can justify lower collateral requirement and/or reduced interest rate). Overall, it would contribute to upgrade Agricultural Cooperatives / FOs and increase their reliability and the trust of RDB (and progressively other Financial Institutions), hence ultimately increase the pool of "bankable" FOs and the potential market they represent for FIs.