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### Impact of COVID-19 on Access to SME Finance in Cambodia

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*\* Opinions and findings in this paper are those of the authors, and do not reflect the views of the institution the authors are affiliated with.*

## **Abstract**

The significant contribution of SMEs to Cambodia's social and economic development is undeniable. Yet, pressing challenges, including getting access to finance, limit SMEs' potentials in contributing to job creation and poverty alleviation for the country. Covid-19 made the challenge even harder to be addressed as all relevant stakeholders have been either directly or indirectly impacted. Despite SMEs' important role in Cambodia economy and increasing recognition of their struggles during the pandemic, research about Covid-19 impacts on them is immensely marginal. Thus, this paper, firstly, aims to examine the impacts of Covid-19 on demand and supply of credit to consumer businesses (SMEs) in Cambodia. Secondly, the paper aims to review relevant research and initiatives to support SMEs access to finance, and provides preliminary recommendations on future trends and growth opportunities on SMEs access to finance in the country. Key observations from this paper includes slower demand and supply in consumer business credit, with slight drop of credit quality. Although there have been a number of initiatives and policy responses from the government and key stakeholders in relation to financial and non-financial factors, encouraging SMEs to adapt to the new normal will be the way forward.

**List of Figures:**

*Figure 1: Quarter-on-quarter change of key macro indicators..... 5*  
*Figure 2: Quarterly Credit Enquiry to Consumer Business ..... 6*  
*Figure 3: Quarterly Loan Balance of Credit to Consumer Business..... 7*  
*Figure 4: Quarter-over-quarter Small Business Credit Enquiry..... 7*  
*Figure 5: Annual Growth Rate of Loan Balance to Consumer Business by Regions..... 8*  
*Figure 6: Annual Growth Rate of Loan Balance to Consumer Business by Institutions..... 8*

**List of Tables:**

*Table 1: Annual Growth Rate of Credit Enquiry to Consumer Business by Regions..... 8*  
*Table 2: Annual Growth Rate of Credit Enquiry to Consumer Business by Institutions..... 8*

## **I. Introduction**

The prolonged situation of COVID-19 has posed a number of challenges for the world economy as well as for the Cambodian economy. During the period of 2011-2019, annual GDP in Cambodia experienced one of the world's highest and robust growth with the rate of approximately 7% on average<sup>1</sup>. Severely hit by the pandemic, Cambodia's GDP saw negative growth rate of -3.14% in 2020 as recorded by World Bank database. According to ILO (2020), COVID-19 leads to rise in global unemployment, and adversely impacts business operations especially of Small and Medium Enterprises. This is due to the adverse impact of health's containment measures to cope with the pandemic including restricted local mobility as well as domestic and international travel including quarantine requirement that result in fewer commercial transactions.

Intuitively, COVID-19 disrupts businesses including SMEs in both supply and demand sides. Lockdown measures result in fewer workers, which then scale down the production of businesses (supply side). On the other hand, in response to containment measures and consumption/income expectation, people spend less, which mean the demand weakens (demand side). Given SMEs' fewer suppliers, smaller size and less capital reserves compared to large businesses, the pandemic makes them even more vulnerable. However, the effect of the pandemic on SMEs varies across sectors, as some can be more exposed to the containment measures than some others. For instance, during the pandemic, tourism sector is reported among the most affected sectors, causing 100-120 million loss of jobs in tourism sector alone globally (UNWTO, 2020). Share of Cambodia SMEs in tourism related sector is rather small. However, the indirect effect from tourism sector to SMEs in other sectors can be significant. According to National Institute of Statistics (2015), among micro establishments in Cambodia, wholesale and retail trade has the largest share (60.7%), followed by Manufacturing (14%), and accommodation and food service activities (10.9%), whereas among small and medium establishments in the country, education shares the largest part (33.7%), followed by manufacturing (13.5%). 99.8 percent of establishments in Cambodia are Small and Medium Enterprises<sup>2</sup>, providing jobs to Cambodians with total share of more than 70 percent (NIS, 2015).

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<sup>1</sup> World Bank Data

<sup>2</sup> In this paper, SMEs include Micro establishments

Even prior to the pandemic, access to finance has always been a challenge for Cambodian SMEs. One of the reasons is that majority of SMEs in the country are in informal sector, not registered with the respective ministry or agency. With lack of sufficient legal documentations and collateral, getting access to formal loan is a challenge for SMEs. This is because large number of Cambodians SMEs are in informal sector lacking necessary documentations and collateral, impeding them from getting formal financial institutions' loans.

Getting access to finance is crucially important for SMEs. As economic impact resulting from the pandemic continues to affect SMEs, the role of access to finance has never been more vital. The demand for goods/services is expected to drop during the pandemic as people tend to save more than spending due to restricted consumers' capability to spend and their change in spending behavior as a result of anticipated economic shock to their future incomes. As such, businesses may encounter loss due to lower demand. Their commercial transactions are reduced, meaning they do not need credit as much as they should have required. On the other hand, for some businesses, to sustain their operations, they need credit from financial institutions. This can be implied that credit demand could be higher. To sum up, the effect from the pandemic for credit demand is ambiguous due to the aforementioned reasons.

To contribute to the understanding of how supply and demand of credit to SMEs is impacted by the pandemic, the authors propose trend analysis method to investigate the behavioral change of credit variables, overall consumer credit and credit to consumer businesses. The following sections are the reviews of studies on SME development in Cambodia, and their access to finance in overall. Next, the paper focuses on proposed analytical method, before proceeding to the policy review section. Lastly, there will be conclusion and preliminary recommendations.

## **II. SMEs Development**

Prior to the investigation of the development of SMEs in Cambodia, it is important to start with a definition. There are several different definitions of SMEs, defined by different key institutions. For instance, the Ministry of Industry, Science, Technology and Innovation (formerly known as Ministry of Industry and Handicraft) determined the scale of businesses by number of employees and assets (excluding land). Furthermore, Sub-Committee of the SMEs Development Framework 2005 (NIS, 2015) specified that number of employees determines the scale of SMEs for statistical purpose, while assets (excluding land) shall be used for other purposes. Meanwhile, the General Taxation Department of the Ministry of Economy

and Finance (2018) determines SMEs by number of employees and annual turnover. Financial institutions, on the other hand, define SMEs by loan sizes, which could vary by institutions. Unclear and different definitions of SMEs make comprehensive analysis of SMEs particularly challenging. Given accessible data, the quantitative section of this paper will be based on business credit to consumer borrowers only, assuming SMEs' owner are individual borrowers.

The rapid development of Cambodia SMEs can be traced back to around 70 years ago. Baily (2008) claimed that the expansion of Cambodia SMEs started after the independence declaration from France in 1954. He reported that the number of registered SMEs increased from 369 in 1950s to more than 1,000 in 1958. Manufacturing sector played an important part in SMEs during the time. Subsequently, after major destruction of infrastructure in the country in Khmer Rouge regime, Cambodian SMEs started to build up again starting from late 1980s (Baily, 2008). In 2014, number of SMEs rose to over 500 thousand, capturing 99.8% of all establishments (NIS, 2015).

Recognizing the essence of SMEs' contribution in local economy, the Royal Government of Cambodia (RGC) have developed and implemented a number of policies and initiatives. In Cambodia Industrial Development Policy 2015-2025, SMEs expansion and modernization is among the key policy measures set by the RGC to support the transformation of the country's labor-intensive to skill-driven industry, as to support economic growth and development (RGC, 2015). The specific measures to support SMEs include providing tax incentives for those in prioritized sectors, promoting official registration, developing industrial zones and park to attract SMEs, and connecting SMEs to regional production network and value chain. In addition, the RGC launched Techo Startup Centre as well as Khmer Enterprise in 2018 and 2019 respectively, aiming to promote research and innovation to expand startup, and to support SMEs in terms of both financial and non-financial needs (Techo Startup Centre, 2018; Khmer Enterprise, 2019). Access to finance is known as one of the main challenges faced by Cambodia SMEs. Under the Cambodia Industrial Development Policy guidance, SMEs Bank was launched in 2020 to assist SMEs in getting access to finance and banking services.

### **III. Financial System and Access to Finance**

There are a number of financial institutions operating across Cambodia. As of December 2020, there were 65 commercial and specialized banks, 6 representative offices, 81 MFIs, 15 Leasing companies, and 245 rural credit institutions (NBC, 2020). Based on data from Financial Stability Report (NBC, 2020), banks shared more than 80% of assets and credit as of the last

quarter of 2020. This indicates that banking system dominates financial system in Cambodia. Additionally, the report highlighted that credit to banking sector was concentrated in construction, real estate activities, mortgage and trades, whereas credit to microfinance sector was found mostly in household, trade, and agriculture.

Despite large number of financial institution with branches across the country, access to finance is still a challenge. According to FinScope report, 29% of all adults are financially excluded, meaning they have never used any financial products from either formal or informal sources, while 12% used financial products/services from informal institutions (UNCDF, 2015). In the aspect of borrowing and credit, the report recorded 58% of adults not borrowing at all, at the time of the survey. For SMEs, data on financial access is not available. However, the owners of SMEs are normally individual (Ung & Hay, 2011). The authors argued that this could cause discrimination in loan approval from banks.

During Covid-19, SMEs' limited access to formal loans is one problem, another is the potential impact that the pandemic imposed on access to finance for those SMEs that are already formally covered. To understand the latter is the scope of this paper.

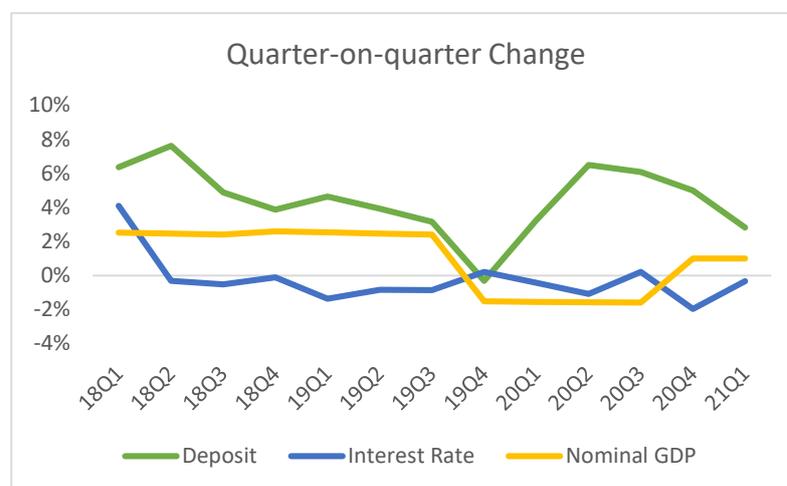
## **VI. Proposed Methodology**

The authors proposed trend analytical methods to examine the Covid-19 impacts on credit to small businesses in Cambodia using data from Credit Bureau (Cambodia) Co., Ltd (CBC). The proposed trend analysis method studies variables of interest, along with the investigation of cross-linkage with ongoing economic situation in Cambodia. With time series data from 1<sup>st</sup> quarter of 2018 to 2<sup>nd</sup> quarter of 2021 from CBC, we can observe the trend and movement of variables of interest (loan balance and credit enquiries). This trend analysis enables us to observe the potential behavioral changes to credit market by comparing the trend prior to and since the onset of the global pandemic. In addition, the paper will also investigate annual credit data to small business, specifically, aiming to study the behavioral change of loan to consumer small businesses during the pandemic. Lastly, this paper examines loan quality as to understand whether the pandemic affects payment capability of borrowers (small businesses).

### **1. Cross-linkage Indicators**

Several indicators including country's economic output, deposit rate, and interest rate on loan are useful for the investigation of the change of loan from time to time. These indicators reflect the changes caused by the pandemic in macro level. The changes in these indicators, in turn,

affect credit market. Thus, prior to the examination of change in credit to small businesses, it is important to observe the behavioural changes in aforementioned factors. Deposit growth rate is the quarterly growth rate of deposit in all financial institutions. The higher the deposit, the more credit the financial institutions can supply to borrowers, thus higher credit growth. In terms of quarterly growth rate, below figure shows that in the 1<sup>st</sup> quarter of 2020 deposit has not achieved positive growth as it normally has in previous quarters. There is obviously no sign that consumers withdraw their money out of financial institution due to the pandemic situation. The stagnant deposit suggests the wait-and-see behavior of the market. The next factor is nominal GDP, representing the country's economic output. There is no quarterly data for Cambodia GDP. However, for the sake of consistent analysis, we interpolated annualized data using linear interpolation method to convert to quarterly data. Higher nominal GDP suggests greater number of economic transactions, thus higher demand for loan. As expected, GDP annual growth rate in 2020 dropped, according to the World Bank, by 3.1%. From macro perspective, this more or less have adverse impact on credit market, assuming ceteris paribus. Another variable to study is interest rate on loan. The rate on loan in USD is used, as majority of loan is issued in USD. The lower the interest rate on loan, the higher the demand for credit. Below figure, which shows the quarterly change of interest rate compared to same quarter in



previous years, indicates that there was drop in interest rate from the 2<sup>nd</sup> quarter to the last quarter of 2019, before it stagnated in the 1<sup>st</sup> and 2<sup>nd</sup> quarter of 2020.

Figure 1: Quarter-on-quarter change of key macro indicators

(Source: National Bank of Cambodia)

## 2. Overall Consumer Credit

The overall credit enquiry includes enquiries made in the categories of personal finance, credit card, mortgage, and small business. The last category, small business, shares over 50% of total

credit enquiry. Overall credit enquiry trends upward from the last quarter of 2018 to the first quarter of 2020, before it suddenly dropped in the second quarter of 2020 (Figure 2). The drop of total number of credit applications is quite significant, from approximately 1.5 million to 0.9 million. However, part of the decline can be affected by seasonality, as slower demand in credit has been seen as a pattern in quarter 2 compared to quarter 1 in the previous years.

In terms of loan balance, the trend has been upward since the first quarter of 2018 (Figure 3). Despite in relatively small scale, consumer business loan balance managed to rise in the second quarter of 2020, when credit applications saw negative growth. The upward trend nature of loan balance makes it challenging to observe the effect of the pandemic on consumer credit. However, its slower growth rate in the first and second quarters of 2020 suggest slowdown in demand for credit in consumer business.

The lag of the effect felt in the demand for credit is due to the lag of behavioral change in credit market. This was aligned with Cambodia’s local transmission situation as well as policy responses. According to WHO (2020), during the first quarter of 2020 Cambodia had been dealing with comparatively small number of cases compared to the world. Moreover, in early March 2020, the country had just started to ban incoming travelers from some high-risk countries.<sup>3</sup> These suggest the lag of the impact from the pandemic on Cambodia economy, as on credit market in overall.

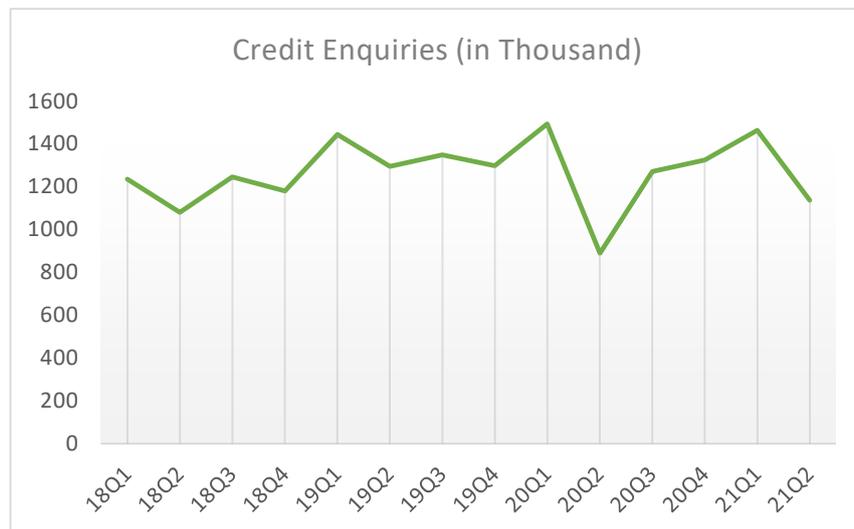


Figure 2: Quarterly Credit Enquiry to Consumer Business

<sup>3</sup> [Cambodia Bans Entry From Five Countries, Records Two New Virus Cases \(voacambodia.com\)](https://voacambodia.com/news/cambodia-bans-entry-from-five-countries-records-two-new-virus-cases/)

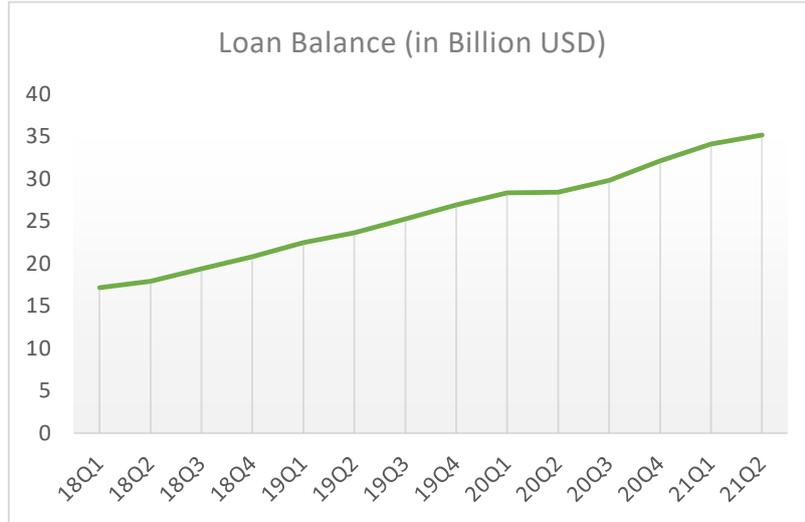


Figure 3: Quarterly Loan Balance of Credit to Consumer Business

### 3. Small Business Credit

In CBC database, credit category of small business refers to business loan approved to individual borrowers. Indicating the intention to obtain loan, credit enquiry to small business well represents the demand for credit from borrowers. Below graph indicates the drop of 29% in number of enquiries to small businesses in the second quarter of 2020. The change is compared to same quarter in previous year.

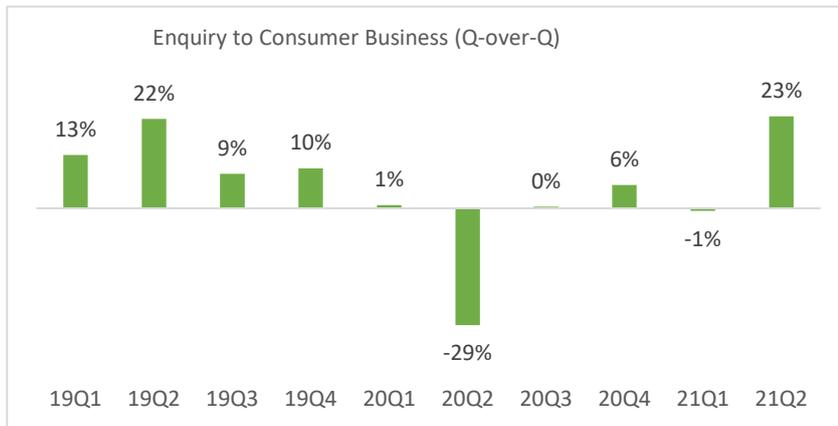


Figure 4: Quarter-over-quarter Small Business Credit Enquiry

In 2019, credit enquires to small business experienced remarkable increase, with an annual growth rate of 13%, reaching 2.48 million applications. Subsequently, in 2020, the enquiries slightly dropped by 6%. The enquiry concentrated in Plain region, followed by Tonle Sap. Its growth rate fell in all main regions, except in Plateau where there was 1 percent growth. More than 50% of credit enquiry for small business purpose were seen in Microfinance Deposit Taking Institutions (MDIs), followed by banks.

Region	Growth rate in 2019	Growth rate in 2020
Tonle sap	14%	-3%
Plain	12%	-9%
Coastal	11%	-5%
Plateau	21%	1%

Table 1: Annual Growth Rate of Small Business Credit Enquiry by Regions

Institution	Growth rate in 2019	Growth rate in 2020
Banks	-2%	9%
MDIs	28%	-15%
MFIs	-10%	6%
Others	50%	31%

Table 2: Annual Growth Rate of Credit Enquiry to Consumer Business by Institutions

(Source: Authors' calculation based on CBC data)

Loan balance to small business partly represents credit supply from financial institution to consumer borrowers for business purpose. However, the decrease or increase of loan balance can also depend on demand for credit in the first place. According to CBC data, loan balance in small business credit saw positive annual growth rate, 27% and 19% in 2019 and 2020 respectively. Despite remaining positive, growth of small business loan balance relatively slowed. The slower growth rate was seen across the main regions, and institutions.

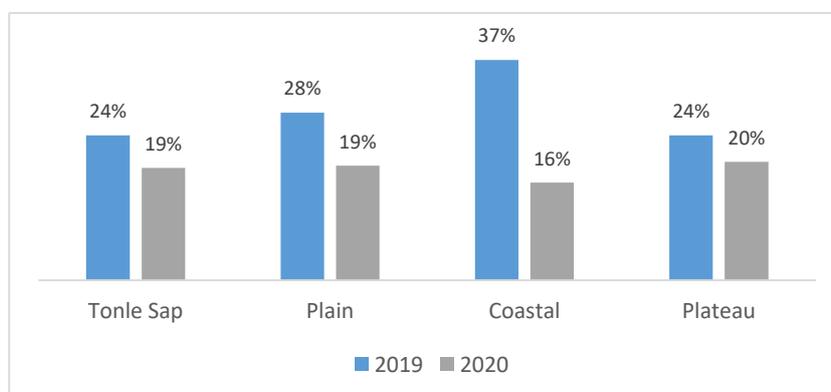


Figure 5: Annual Growth Rate of Loan Balance to Consumer Business by Regions

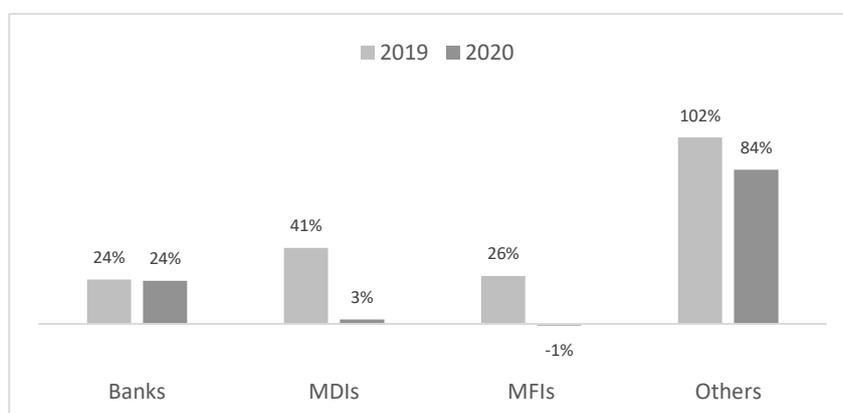


Figure 6: Annual Growth Rate of Loan Balance to Consumer Business by Institutions

Apart from the demand and supply for credit, loan quality is another important indicator to investigate, as it demonstrates the potential impact on loan quality, as on borrowers' capability to pay back loans for business purpose. 30+ DPD ratio, showing the ratio of loans with late payment 30 days past due date, is used at CBC to indicate the portfolio's risk of default. 30+ DPD ratio in both overall credit and credit to consumer business had gone down 2019 compared to 2018. In 2020, the ratio went up from 1.27% to 1.69% for overall credit, and from 1.36% to 1.61% for credit to consumer business. DPD ratio can be higher without the NBC's restructured loan policy. For small business credit, restructured loan rose from approximately \$2.2 billion in second quarter of 2020 to \$3.6 billion in second quarter of 2021.

#### **4. Limitations**

The methodology used enables us to examine the observable impact of the pandemic, with the cross-linkage to key macro indicators. However, there are limitations in this proposed method. We can only investigate the trend and movement of the variable of interests. This would be important for primarily observation; however, we cannot conclude that any potential impact is totally from the pandemic as there are other factors contributing to the trend as well. Furthermore, to what extent the impact from the pandemic have on credit to consumer businesses are still unknown.

#### **VI. Initiative and Policy Response Review**

To mitigate risks posed by the COVID-19 pandemic as to help businesses particularly SMEs to cope with the on-going pandemic, Cambodia government has commenced a number of policy responses and initiatives. In March, 2021, first state-owned credit guarantee enterprise, Credit Guarantee Corporation of Cambodia Plc. (CGCC), launched its first guarantee scheme called Business Recovery Guarantee Scheme (CGCC, 2021). The first scheme, with total scheme size of 200 million USD, aims to help businesses to get access to formal loans in the forms of working capital or investment or business expansion. This scheme will be valid until end of 2022. Subsequently, in September 2021, the second scheme, called Co-Financing Guarantee Scheme (CFGs), which targets loans under the SMEs Co-Financing Scheme Phase II of the SME Bank of Cambodia, was introduced. With the same purpose to enhance access to credit for SMEs, this 50-million-USD-size scheme will be valid until the amount is fully consumed. These two schemes enable SMEs with limited collateral to get loans as to support business and economic recovery from the pandemic.

In addition, The National Bank of Cambodia (NBC) also intervenes in the aspect of easing monetary policy, supporting borrowers, financial institutions and the stability of financial sector as a whole during such difficult time. In March 2020, the NBC issued a circular, encouraging financial institutions to restructure loans to customers that have been affected by the pandemic. Loan restructuring can be in the forms of delaying interest, principal payment, or other charges payment. This circular was set to be valid till mid of 2021. Afterward, given on-going pandemic situation, in May 2021, the NBC decided to extend loan restructuring till end of 2021. Loan restructuring helps reducing loan default as the economic shock of the pandemic hit borrowers' repayment capability. Another measure of the central bank is to maintain reserve requirement at 7 percent for both deposit and borrowing. Additionally, the NBC carries on with the intervention in exchange market in order to maintain exchange rate stability. The above-mentioned easing measures contribute to the economic recovery, by supporting borrowers who have been affected financially.

## **V. Conclusion and Preliminary Recommendations**

Trend analysis suggests that there is observable impact of the pandemic on credit to consumer business, particularly in the first two quarters of 2020. However, the recovery seems to begin subsequently. Quarter-over-quarter change of credit enquiry to consumer business experienced significant drop (-29%) in the second quarter of 2020. The decline was seen across the main regions, except Plateau region where there was slight grow of 1%. Moreover, by institution level, the decline was seen only in MDIs (-15%). In terms of loan balance, credit to consumer business experienced slower growth, compared to same quarter in previous year.

As previously stated, there are limitations in the method used in this study. Given limited data of higher frequency for more sophisticated models and methodologies, this study used trend analysis on overall credit and credit to consumer business data. Trend analysis allows only observations, not the quantification. Future studies may benefit from adopting more advanced method to look at the relationship between credit variable and other potential dependent variables. Moreover, future study can extend to the study of SMEs' access to finance, concentrating on those that are not formally covered by financial institutions.

From the findings as well as the above review of existing initiatives and policy responses, this paper will conclude with preliminary recommendations. To survive the pandemic, SMEs, given smaller scale and more vulnerable state, need assistance from the government and stakeholders. As previously mentioned, Cambodian government has contributed to the survival journey of

the SMEs. However, assisting them to the right direction given opportunities and challenges posed would prepare SMEs well not only for survival but also for resilience in the market. This paper proposes three recommendations for SMEs access to finance. Firstly, during this unprecedented time, ability to have some spaces to breath financially, as the ability to request for restructured loan, for example, is undeniably important for SMEs. This is exactly what the NBC is already implementing. As the pandemic situation is still going on, to extend the restructured loan circulation as need to is what this paper is supporting. According to the NBC, restructured loan has surged to 4.2 billion USD which is equal to over 280 thousand borrowers across the country. Without the circulation, SMEs would struggle financially. Secondly, providing financial assistant focusing on prioritized sectors and growth opportunities for SMEs is key. CGCC's guarantee progress report (2021) shows that out of over 15 million USD loan amount guaranteed, approximately 60% were given to non-prioritized sectors. Thus, there is room for increasing the share to prioritized sectors such as industry, service and agriculture. Furthermore, although the pandemic has posed challenges to SMEs, there are opportunities they should embrace to adapt and to be resilient. For instance, SMEs may benefit from the increasing e-commerce transactions due to limited physical visits during the pandemic. If successful, this not only helps them survive from the pandemic but also prepare them well for the future business operation and reaching potential as well as targeted customers. Last but not least, enabling data analytics and harnessing alternative data for credit assessment, as well as promoting financial literacy would be particularly important for improving access to SME finance in the near future. If successfully adopted, data analytics and tapping on new data source for credit assessment will alleviate aforementioned challenges as to scale up the access to SME finance.

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