

**ISLAMIC MICROFINANCE IN CAMBODIA:
ECONOMIC IMPACT ON POVERTY ALLEVIATION
AMONG HOUSEHOLDS**

BY

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**A dissertation submitted in fulfilment of the requirement for
the degree of Doctor of Philosophy (Economics)**

**Kulliyyah of Economics and Management Sciences
International Islamic University Malaysia**

AUGUST 2021

ABSTRACT

Poverty remains a dire problem for many Cambodians. Several intervention programmes have been launched to eradicate poverty since the end of the civil war in 1990s. This research examines factors that influence households to become Islamic microfinance beneficiaries and assesses its impact on poverty alleviation in Cambodia. The survey questionnaire was personally administered to collect data, with a total sample size of 313 consisting of treatment group (203) and controlled group (110). Logistic regression and ordinary least square were used to determine factors influencing accessibility and assess the impact of Islamic microfinance on household economic performance in the form of income, expenditure, and durable assets. In addition, the poverty measurement was constructed using the Foster, Greer, and Thorbecke (FGT) approach. The result of the average marginal effect showed that household with good social networks are more likely to become Islamic microfinance beneficiaries by 21.6%. Similarly, owning a house increased the probability of becoming beneficiaries by 18.5 %, holding other variables constant. The explanatory variables such as occupation (fisherman), education (illiterate), gender (female), and age suggested a significant positive relationship with Islamic microfinance accessibility. The findings of the economic impact at household level showed that receiving Islamic microfinance facilities had a positive significant impact on household income (7.2%) and household expenditure (4.7%) but the coefficients were very small and did not suggest a significant relationship with household's durable assets. However, the poverty measurement indicated that Islamic microfinance as an intervention programme could reduce the ratio of headcount poverty, poverty gap, and poverty severity. The headcount ratio of beneficiaries reduced from 87% to 44% upon joining the Islamic microfinance programme. This pioneering study on Islamic microfinance in Cambodia offers important implications to several stakeholders including the Muslim community, academics, Islamic microfinance institutions, community leaders, and the government.

Keywords: *Islamic Microfinance, Impact Assessment, Poverty Alleviation, Cambodia*

خلاصة البحث

لا يزال الفقر يمثل مشكلة خطيرة بالنسبة لمعظم الكمبوديين. لقد تم إطلاق العديد من برامج التدخل للقضاء على الفقر منذ نهاية الحرب الأهلية في التسعينيات. تناقش هذه الأطروحة العوامل التي تؤثر على الأسر لتصبح مستفيدة من التمويل الأصغر الإسلامي وتقيم تأثيره على التخفيف من حدة الفقر في كمبوديا. إستخدمت الدراسة منهج البحث الكمي (استبيان) لجمع البيانات ، حيث بلغ حجم العينة 313 مشاركاً تتكون من مجموعة المعالج (203) ومجموعة التحكم (110). تم استخدام الانحدار اللوجستي والمربعات الصغرى العادية لتحديد العوامل التي تؤثر على إمكانية الوصول وتقييم تأثير التمويل الأصغر الإسلامي على الأداء الاقتصادي للأسرة في شكل الدخل والإنفاق والأصول الثابتة. بالإضافة إلى ذلك ، تم إنشاء مقياس الفقر باستخدام نهج فوستر وجرير وثوريك. أظهرت نتيجة متوسط التأثير الهامشي أن الأسر ذات العلاقات الاجتماعية الجيدة من المرجح أن تصبح مستفيدة من التمويل الأصغر الإسلامي بنسبة 21.6%. وبالمثل ، فإن امتلاك منزل زاد من احتمال أن يصبح مستفيداً بنسبة 18.5% ، مع الحفاظ على المتغيرات الأخرى ثابتة. تشير المتغيرات التفسيرية مثل المهنة (الصيد) والتعليم (أمي) والجنس (أنثى) والعمر إلى علاقة إيجابية كبيرة مع إمكانية الوصول إلى التمويل الأصغر الإسلامي. أظهرت نتائج الأثر الاقتصادي على مستوى الأسرة أن تلقي تسهيلات التمويل الأصغر الإسلامية كان له تأثير إيجابي كبير على دخل الأسرة (7.2%) وإنفاق الأسرة (4.7%) لكن المعاملات كانت صغيرة جداً ولم تشير إلى وجود علاقة كبيرة مع الأصول الثابتة للأسرة. ومع ذلك ، يشير قياس الفقر إلى أن التمويل الأصغر الإسلامي كبرنامج تدخل يمكن أن يقلل من نسبة الفقر ، وفجوة الفقر ، وشدة الفقر. انخفضت نسبة عدد المستفيدين من 87% إلى 44% عند الانضمام إلى برنامج التمويل الأصغر الإسلامي. تقدم هذه الدراسة الرائدة حول التمويل الأصغر الإسلامي في كمبوديا آثاراً مهمة على العديد من أصحاب المصلحة بما في ذلك المجتمع المسلم والأكاديميين ومؤسسات التمويل الأصغر الإسلامية وقادة المجتمع وممثلي الحكومة.

الكلمات الإفتتاحية: التمويل الأصغر الإسلامي ، تقييم الأثر ، تخفيف حدة الفقر ، كمبوديا

APPROVAL PAGE

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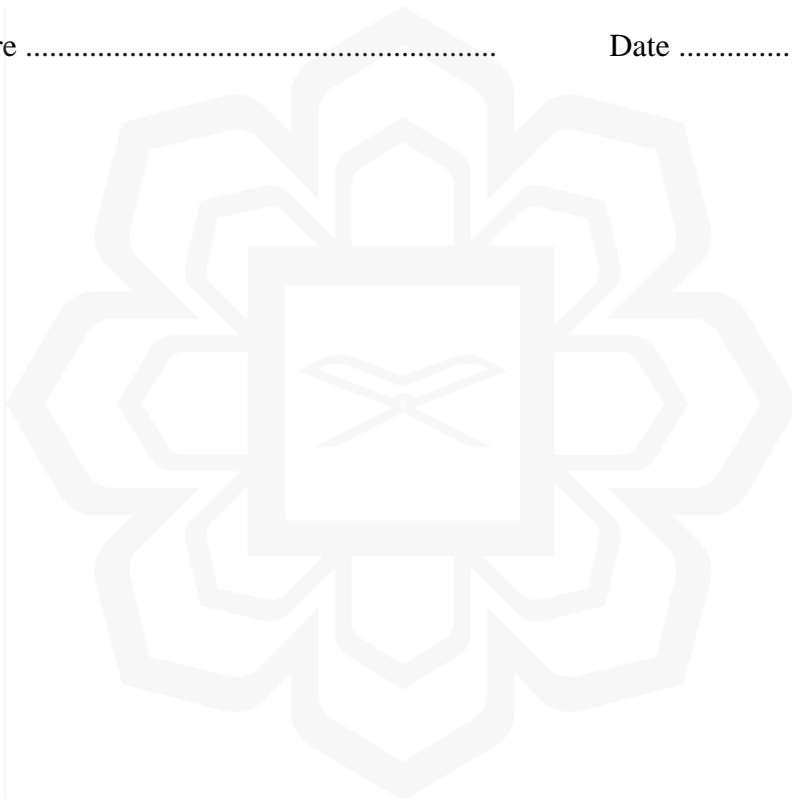
DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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ACKNOWLEDGEMENTS

All the praises and thanks be to Allah Almighty with Whose permission I have been able to complete this thesis.

Taking this opportunity, I am extending my utmost appreciation and gratitude to my main supervisor, Professor Dr. Mohamed Aslam Mohamed Haneef and co-supervisors, Professor Dr. Norma Md Saad and Associate Professor Dr. Mohd Nahar Mohd Arshad, for their valuable academic advice, guidance, and encouragement. Their professionalism, kindness, and humility have motivated me to complete this thesis

I wish to express my appreciation and thanks to the International Institute of Islamic Thought (IIIT) for providing me a scholarship to pursue a Ph.D. programme at IIUM. Without their financial and moral support, I might not have been able to further my study in this Garden of Knowledge and Virtue. I am particularly grateful to Dr. Ahmad Totonji, Professor Dr. Omar H.Kasule, Emeritus Professor Dato'Wira Dr. Jamil Osman, Dato'Haji Ahmad Azam Abdulrahman, Haji Mohd Kahliab, and Dr. Shahrar Kasim for their fatherly guidance, mentorship, and support extended to me. May Allah bless them all.

I would also like to acknowledge Mr. Khairul Hafiz, Country Director of Muslim Aid Cambodia Field Office, for his encouragement and valuable advice. I sincerely thank him for all the support he has extended to me. Further, I wish to express my sincere gratitude to all professors and lecturers at the Department of Economics who have taught me and guided me in the academic world. My sincere appreciation to all my friends for helping me during coursework and thesis writing. I am indeed indebted to brother Muhibullah, Ali Adam, Ahmad Khandar, and Rashid for their kindness and assistance and shall never forget the efforts as enumerators and survey respondents for contributing to the success of this thesis.

It is my pleasure to dedicate this work to my beloved parents, Haji Sles Zakariya and Hajah Mit Tichao, and my siblings who have always stood by me and offered me unceasing support. I thank my dear better half, Husna for their prayers, love, patience, and unwavering belief in my ability to accomplish this goal. Lastly I dedicate this work to my adorable children, Alfatih, Almuqri and Alfarabi. May Allah protect them all.

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LIST OF ABBREVIATION

ADB	Asian Development Bank
AIMS	Assessing the Impact of Microenterprise Services
AusAID	Australian Agency for International Development
CMA	Cambodia Microfinance Association
CGAP	Consultative Group Assist the Poor
DCM	Discrete Choice Model
DID	Difference in Difference
GDP	Gross Domestic Product
GNI	Gross National Income
HDI	Human Development Index
HEPM	Household Economic Portfolio Model
IA	Impact Assessment
IAIA	International Association for Impact Assessment
IFC	International Financial Corporation
IsMF	Islamic Microfinance
IsMFIs	Islamic Microfinance Institutions
MAC	Muslim Aid Cambodia
MDGs	Millennium Development Goals
MFI	Microfinance Finance Institutions
MLR	Multiple Linear Regression
NBC	National Bank of Cambodia
NGOs	Non-governmental organizations
OLS	Ordinary Least Squares
PSM	Propensity Score Matching
RGC	Royal Government of Cambodia
RUT	Random Utility Theory
UNDP	United Nations Development Programm

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Poverty remains a significant challenge for all nations and is widespread in many parts of the world, including developed and developing countries. Because of poverty, the poor are prevented from being productive, leading to unemployment, social exclusion, and high vulnerability. The poor are struggling to fulfil the most basic human needs such as food, clothing, shelter, health, education, clean water and sanitation.

An estimated 650 million people live in extreme poverty accounting for 11% of the world's population¹. In addition, more than 50% of the world's population live on a daily income of less than US\$ 7 a day, and more than 2.5 billion people earn less than US\$ 4 a day (Fanconi and Sheurle, 2017).

Table 1.1 World Extreme Poverty Estimate (1990-2015)

Year	Poverty rate(%)	Poverty gap(%)	Squared Poverty gap	Poor (millions)	Population (millions)
1990	35.9	12.7	6.1	1,894.8	5,284.9
1993	33.9	11.9	5.8	1,877.5	5,542.9
1996	29.4	9.8	4.7	1,703.2	5,792.6
1999	28.6	9.5	4.5	1,728.6	6,038.1
2002	25.6	8.3	3.9	1,609.9	6,276.8
2005	20.7	6.3	2.9	1,352.2	6,517.0
2008	18.1	5.4	2.4	1,223.2	6,763.7
2011	13.7	4.1	1.9	963.0	7,012.8
2013	11.2	3.4	1.6	804.2	7,182.9
2015	10.0	3.1	1.5	735.9	7,355.2

Source: Poverty and Shared Prosperity Report (2018)

¹ See the UNDP official website, retrieved dated 26 October 2018, Available at <http://www.undp.org/content/undp/en/home/sustainable-development-goals/goal-1-no-poverty.html>

Cambodia has a population of 15.5 million, and poverty is a leading development barrier. Some 13.5% of Cambodians are living under the poverty line of less than US\$ 1.90 per day. The Global Multidimensional Poverty Index (2018) reported that poor Cambodians constitute 35% of the population. The World Bank (2018) also reported that 32% of Cambodian children under five are stunted, 79% of Cambodians (some 12.3 million) do not have access to piped water supply, and 58% (9.3 million) people lack access to improved sanitation. While the country has made good strides in maternal health, early childhood development and primary education programmes in rural areas remain significant challenges². Cambodia's monetary poverty rate had fallen from 53.2% in 2004 to 13.5% in 2014. However, the World Bank (2018) found that the vast majority of the poor who have exited poverty have not gone far above the poverty line, and the probability of returning to poverty is relatively high. In other words, those who have graduated from poverty are still vulnerable when exposed to economic and other external shocks.

Like many other poor, Cambodian poor cannot access loans from formal financial institutions (un-bankable). The poor borrows money from relatives, friends and moneylenders that charge higher interest rate.

Coleman (1999) considers credit constraint among the poor as the main cause of poverty. Robinson (2011) in his most cited work on microfinance describes that 90% of people in developing countries lack access to financial services either for credit or for saving. Coleman (1999) calls this situation a "poverty trap", meaning that poverty continues as a cycle. The poor lack financial support, and without it, the poor produce at a small-scale level, which in turn is difficult to accumulate savings or other assets. When

² Khmer Times, released 22 March 2017, retrieved date 01 October 2018, Available at <https://www.khmertimeskh.com/news/36740/cambodia-improves-human-development-index/>

the poor accumulate small savings, they could not expand their businesses and invest in more productive resources. As a result, they could not access credit in formal financial institutions.

Diagne and Zeller (2001) criticise the financial institutions for perceiving the poor as bad credit risk due to their inability to fulfil the traditional borrowing requirements. Moreover, dealing with the poor incurs high operational costs and low return on investment for the bank. Therefore, the poor are excluded from financial institutions.

Quach, Mullineux, and Murinde (2005) note that the poor demand financial services. Evidence suggests that access to credit reduces household poverty (Morduch and Haley, 2002; Quach et al., 2005). Naceur and Zhang (2016) commission an empirical work to study the relationship between financial development and income inequality and poverty by employing 143 countries as a research sample. A wide range of literature that Naceur and Zhang (2016) reviewed, for example, Honohan (2004), Li et al. (1998), and Rajan and Zingales (2003), agreed that financial inclusion, specifically credit, can stimulate income growth and reduce income inequality for the poorest strata in society. The findings across countries showed that that the relationship between financial service and poverty is linear.

Milana and Ashta (2012) cited Arthur Lewis (1955), who suggested that there is a two-way relationship between finance and economic development. Economic growth is a consequence of well-managed and well-regulated financial intermediation. The poor need credit to develop their income-generating activities and exit the vicious cycle of poverty. Inaccessibility of credit decelerates the development of the economy.

For the past 39 years (1979-2018), the Royal Government of Cambodia (RGC) has taken pains and efforts to rebuild the nation by bringing back political stability, restoring physical infrastructure, develop human resources and economy. The RGC, with

support from development partners and international agencies, proposed and implemented many development schemes to eradicate poverty. Among others, microfinance registered a most valuable strategy in reducing poverty. Following the 2006 announcement as “a year of microfinance for Cambodia”, microfinance institutions (MFIs) have grown remarkably. This growth contributed significantly to economic development and poverty alleviation (Vada, 2010).

Bylander and Hamilton (2015) noted that microfinance came to Cambodia relatively late in comparison to other countries in the region and South Asia, but its growth has been rapid. The industry has been expanding, with Cambodia among the top five countries in terms of penetration rate (Bylander and Hamilton 2015). The number of borrowers increased significantly from 500,000 in the mid-1990s to 2.3 million in 2016. As of 2017, MFIs in Cambodia comprised seven deposit-taking microfinance institutions³, 69 microfinance institutions and 313 rural credit operators (NBC,2017).

Contemporary microfinance, a concept that emerged in the late 1970s, has become an essential component of national strategies used to eradicate poverty in many countries. Microfinance is an economic development tool providing financial services to low-income groups and entrepreneurs and social intermediation services such as group formation, training, and development of self-confidence to the poor and entrepreneur (Ledgerwood, 1999). The MFIs’ exponential growth has attracted public attention. The Global Outreach and Financial Performance Benchmark Report (2016) shows that MFIs credit product has reached 115 million borrowers with a total loan portfolio of US\$ 96.6 billion. The saving product attracted 98 million depositors resulting in US\$ 64 billion in

³ Deposit-Taking Microfinance institutions received license from the National Bank to take deposit. Other microfinance cannot take deposit from customers.

deposits. Such data were reported by 774 MFIs to the MIX Market⁴. The number of outreach and borrower may be more than this report because, according to Fanconi and Sheurle (2017), approximately 4000 MFIs are currently operating globally.

Table 1.2 Global Outreach of Microfinance

Region	FSP Count	Number of Active Borrowers '000	% of Total borrowers	Gross Loan Portfolio (GLP) (USD) m	% of Total Gross Loan Portfolio	Number of Depositors' 000	% of Total Number of Depositor	Deposit (USD)m
Africa	127	4,800.8	4%	8,118.3	8%	16,226.3	16%	9,023.4
EAP	90	17,578.2	15%	17,012.9	18%	12,707.4	13%	9,190.8
ECA	110	2,538.8	2%	6,090.5	6%	4,795.2	5%	4,872.6
LAC	251	22,338.4	19%	41,732.7	43%	24,470.2	25%	30,638.8
MENA	26	2,206.7	2%	1,226.5	1%	630.3	1%	256.6
South Asia	170	65,547.8	57%	22,492.7	23%	39,977.0	40%	10,069.5
Grand Total	774	115,010.6	100%	96,673.5	100%	98,806.4	100%	64,051.8

Source: *Global outreach and financial performance benchmark report (2016)*

The existing literature proves the positive impact of conventional microfinance on poverty alleviation. Thousands of poor people were reported to have exited poverty. However, most Muslims do not fully benefit from conventional microfinance, given that its products are not tailored in line with their faith. Muslim scholars agree that conventional microfinance has violated Islamic principles (Mirakhor and Iqbal 2007; Karim et al. 2008; Mansori et al. 2014). Muslims need to access financial provisions designed based on *Shariah* law. To this end, Islamic microfinance emerged.

⁴ The Mix Market is a data bank of microfinance industry. They provide the data, analytics. The Mix allows users to browse the directory of over 2,000 profiles of financial service providers, networks, funders, and investors around the world working towards financial inclusion. (For detail see: www.themix.org)

Islamic Microfinance Institutions (IsMFIs) are becoming a new market niche that offers financial services to the poor, particularly in the Muslim world. IsMFIs offer financial services to millions of low-income people. IsMFIs are now reaching 1.3 million customers, accounting for 1 percent of total microfinance outreach. An estimated 255 Islamic microfinance institutions are operating across the globe, with 92 percent concentrated in East Asia, and the Middle East and North Africa (MENA) (Mahmood et al., 2015).

Muslim Aid Cambodia (MAC), an international faith-based NGO, is the first institution that offers *Shariah*-compliant financing to poor and small entrepreneurs in Cambodia. The objective of offering this *Shariah* financial provision under the economic empowerment project is to help uplift the living standards of the Muslim community who are living under the poverty line with meagre education and poor health. Islamic microfinance was introduced in 2007 with only ten clients. The number of beneficiaries has increased to almost 1,000 within a few years.

MFIs and IsMFIs practitioners, donors, and governments have been interested in knowing the extent to which these programme interventions affect the lives of beneficiaries and how financial services can serve the poor effectively. Assessing microfinance's impact is gaining momentum in the last decade and remains an imperative field for researchers, policymakers, and development practitioners (Khan et al., 2014). Hume (2000) notes that knowledge about the impact of microfinance is partial and contested.

According to Hulme (2000), the objective of the impact assessment of microfinance is to improve the effectiveness and efficiency of microfinance programmes. The effectiveness of impact assessment enables major stakeholders - microfinance

institutions, donors and regulators to understand the current situation and adapt better policy measures for the microfinance industry in the future (Khan et al., 2014). Johnson and Rogaly (1997) suggest that microfinance impact assessment enables MFIs to remain steadfast to their mission to serve the poor and fight against poverty.

Barnes and Sebstad (2000) define impact assessment (IA) as “a study to identify changes that result from a programme by employing methods to establish a plausible association between changes experienced and participation in the programme”. The International Association for Impact Assessment (IAIA), a leading global professional network in impact assessment, defines impact assessment as a process to identify the future outcome of a current programme intervention by considering what would have happened to the individual if without the programme intervention (IAIA, 2009).

The World Bank, the United Nations, the Consultative Group Assist the Poor (CGAP), and other development agencies have used different methods to assess the impact of microfinance on the economic and social well-being of participants. A number of socio and economic measures such as food availability, family health service, children’s access to education, housing, women’s empowerment and women’s social status, per capita income and expenditure are considered (Brau, Hiatt and Woodworth, 2009). However, there is no single universal approach to measuring the impact of microfinance (Khan,et al. 2014).

Limited literature studied the impact of Islamic microfinance, with most studies focusing on conventional microfinance's impact on poverty alleviation. Nevertheless, the evidence of impact studies of microfinance and Islamic microfinance present varying and revealing results.

The impact assessment conducted by Rahman and Ahmad (2010) uses proper research methods and tools of analysis. The findings showed that Islamic microfinancing

has a significant impact on poverty alleviation. This result is supported by other studies such as Rohkman (2013), Aslam (2014), Gumel et al. (2014), Riwijanti (2013), and Mahmood et al. (2015). In contrast with the above studies, Morshid and Abdullah (2013) and Mulyangingshih et al. (2015) showed that Islamic microfinance has no impact on income. Meanwhile, Rulindo (2012) showed that Islamic microfinance impacts clients' income and poverty status but up to a certain level.

Determining a positive impact is crucial if microfinance or Islamic microfinance programmes are to be the way forward in developing countries where poverty remains rampant. This study assesses the impact of Islamic microfinance on the poverty alleviation of the Muslim community in Cambodia. A scientific methodology is employed to investigate the effect of Islamic microfinance on poverty alleviation.

1.2 PROBLEM STATEMENT

Microcredit in Cambodia first emerged in the 1990s after the Paris Peace Accord Agreement and the transformation of the economic system from a planned economy to a free-market economy. With funding and technical assistance from international development agencies⁵, and microfinance advocates, several organisations started experimenting with microfinance in the form of credit as NGO-style microfinance. Later, in 2000, microfinance in Cambodia transformed from NGO-style to commercial microfinance with a wide range of financial services offered such as credit, saving, money transfer, movable banking service, micro-insurance and ATM services.

⁵ For example, the UNDP allocated \$US 4.3 million grant which specifically designed to promote the welfare of demobilize soldiers. The projects attempted to include the vulnerable group to the society by providing the opportunity of employment and income generating activities (Bateman, 2017).

Despite being ranked as one of the world's best microfinance attributed to national economic growth, strong regulatory regime and limited outreach of commercial banks, there is no specific figure showing how many poor have exited poverty due to microfinance and the extent to which microfinance in Cambodia contributed to poverty alleviation. However, official reports show that the microfinance industry shared 25% of national Gross Domestic product (GDP).

Bylander (2015) is sceptical about the positive role of microfinance in Cambodia, and Bateman (2017) is saddened with the reverse role of microfinance which was expected to offer a major contribution to rebuilding the nation after decades of civil war. The work of Maningo et al. (2015), Zhuo (2015), and Oversen and Trankell (2015) exhibited concerns over the future of Cambodia's MFIs. Bateman (2017) found that microfinance caused over-indebtedness, land loss, saturated local market, and the draining of wealth from the poor community.

Bylander (2015) found three major disconnects between the rhetoric and reality of microfinance in Cambodia. Firstly, loans that were supposed to be used for and repaid via microenterprises are primarily used for various non-productive purposes. Secondly, microcredit is used alongside informal credit rather than substituting it. Informal microcredit charge high interest rates yet people use it to pay debt to formal microfinance. Lastly, in practice, borrowers often struggle to repay loans and debts, which can substantively heighten their vulnerabilities. Bylander (2015) argued that the use of microcredit in Cambodia is a coping strategy rather than a development strategy per se.

Researchers and industry experts, for example Bateman (2017), Maningo et al. (2015), Zhuo (2015), Oversen and Trankell (2015), blamed the increase of informal loans, multiple borrowing, over-indebtedness, mission-drift, and the intervention of

government on interest cap that contributed to the ambiguous future of Cambodia's MFIs. Seng (2017) called for rethinking microcredit to play a significant role in promoting the welfare and sustaining poverty reduction in the country.

Even though there are inconclusive empirical findings of the impact of microfinance on poverty alleviation in Cambodia, the Muslim community in Cambodia does not benefit from this programme. Like other MFIs in the world, MFIs in Cambodia are interest-based institutions, strictly prohibited in Islam.

The Islamic microfinance programme of Muslim Aid Cambodia (MAC) was launched in 2007 as an alternative to conventional microfinance. It is operated under the sustainable livelihood project. The goal of the programme is to provide financial and non-financial services to the poor to participate in income-generating activities and self-employment. Besides interest-free microcredit, the MAC provides entrepreneurial training to support small businesses and enhance the poor's capacity. The Islamic microfinance scheme has been operating in Cambodia for a decade, yet, to the best of the researcher's knowledge, there is no academic research empirically studying the impact of MAC's Islamic microfinance programme. Without impact assessment, we will not know the credibility and viability of Islamic microfinance in poverty alleviation, and we are unable to improve the existing programme. Moreover, it is important to know the degree of success of Islamic microfinance programmes to expand the system in Cambodia.

The systemic review of Islamic microfinance impact assessment literature from 1995 to 2015 shows that 22% of Islamic microfinance impact assessments are conducted in Bangladesh, followed by Malaysia, which accounted for 17%. Indonesia, Sri Lanka and Pakistan each accounted for 9%. The remainder of the papers gauged the impact of