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Policy Paper on Cross-border Investment in Agriculture & the Role of Finance



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Executive Summary

The following policy paper is a derivation of the research report into cross-border agricultural investments in Cambodia. The paper aims to provide content for a discussion on future reform regarding the Cambodian financial sector, specifically the promotion of sustainable finance. Through our desk research, we emphasised the increasing relevance of sustainable finance as an innovative concept of international development, including in Cambodia.

The recommendations, some of which advocate for tighter legal requirements and for the creation of training sessions for financial practitioners, are articulated over three areas: the enhancement of human capital through capacity-building initiatives, regulatory reform, and pro-transparency requirements. The content of the recommendations followed the nature of the findings from the research report, which identified three critical gaps in the current sustainability of the Cambodian financial sector.

These gaps included a lack of awareness among practitioners in the financial sector regarding the concept and implications of sustainable finance, relatively weak enforcement of the regulatory framework, and a lack of common requirements for FIs regarding their disclosure of information on sustainable initiatives.

By adopting the recommendations, gaps in these three areas may be filled. We predict that the Cambodian financial sector will reap several benefits, including increased levels of trust among stakeholders and greater capacity among FIs to switch their operations to more sustainable practices.

1 Background

Despite enjoying steady rates of economic growth, the process of Cambodian development has not always been smooth. In the agricultural sector, which is characterised by the presence of vast Economic Land Concessions and substantial foreign investment, allegations in recent years have targeted the operations of agribusiness companies, particularly foreign investors, regarding their respect of local communities and land tenure.

In a well-publicised case, a Vietnamese agribusiness firm operating in Cambodia, Hoang Anh Gia Lai, was involved in controversial land clearing, which drew the ire of local communities. Complaints by these communities were taken on several occasions to higher authorities, including the ombudsman of an international development organisation, the International Finance Corporation (IFC). Such complaints focused not only on the disregard of land and tenure rights by the operating firm, but also on the involvement of the IFC itself in providing loans to said firm via intermediary banks. Such involvement would raise questions over the IFC's stated commitment to promote sustainable investment practices.

This case raises the issue of the relations in Cambodia between the role of finance and the promotion of sustainable practices in the agricultural sector. Given the key role of finance in driving investment in agriculture, it is undeniable that the guarantee of fair practices in the Cambodian financial sector would provide a huge boost to the successful resolution of conflicts between agribusiness firms and local communities.

2 Methodology

The methodology for the policy paper and the research report involved a combination of desk review and primary data collection.

Desk review was conducted initially to identify the main stakeholders in the Cambodian financial stakeholder. The stakeholders were mapped according to their presumed levels of knowledge of financial practices in agriculture and their willingness to share relevant information during an eventual interview. This assessment was based on the assumption – borne out of prior working experience by the research team – that some stakeholders, especially banks, would be reluctant to share what they consider as sensitive information regarding their lending and other financial operations. This risk constituted one of the working limitations identified by the research team in the inception report.

The assessment produced a small set of stakeholders identified for the interviews. Questions were then drafted for the data collection phase. Some of the knowledge gained from the desk review, such as that regarding Cambodia's sustainable finance initiative and the driving role of the Association of Banks of Cambodia (ABC) in promoting sustainable finance in the country, was used to inform the drafting of the questions. Given the time limitations, the questions were designed in such a way that answers would be a way to crosscheck the desk review findings and gain new qualitative data.

In particular, the expectation for the interviews was to understand more about the financial sector's own perception of the sustainable finance initiative and approximate timelines for future stages of reform. Unfortunately, some of the expected work limitations emerged during the interviews, as interviewed stakeholders were unwilling to share many details regarding the lending activities of Cambodian FIs. Despite these limitations, enough qualitative data was gathered to produce an innovative and useful research report.

3 Key Findings and Analysis

3.1 Issue description

Our key finding was that there are current weaknesses in the ability of the Cambodian financial sector to ensure its activities are sustainable. Sustainable in the sense that activities do not directly or indirectly cause

negative environmental, social or governance (ESG) issues. These weaknesses are evident across three dimensions.

Firstly, financial practitioners and other stakeholders lack awareness and knowledge of the concept and implications of sustainable finance. In particular, staff working at Cambodian banks and other FIs are not very aware that sustainable finance is gaining ground globally as an innovative and profitable development solution. The emphasis is on the relation between sustainable development and business profitability: there are plenty of illustrated cases in the literature of international banks that profited in several ways by mainstreaming sustainability into their operations and strategies. Some local initiatives in Cambodia have been promoted and adopted by FIs, mainly through the work of the main sectoral association. However, the general picture is that sustainable finance is still in the introductory phase in the country.

On the regulatory side, there appear to be few legal incentives for Cambodian FIs to become more sustainable. Any achievements in this regard so far have been possible thanks to the pioneering work of the ABC. The association has allowed willing members of their network of banks to comply with a certain degree of sustainability measures aimed towards the Cambodian financial sector. Adoption of such measures, most importantly, is voluntary. There is therefore much space open for banks not to comply and suffer little consequence. There are talks of future reform to the legal framework, but at this stage relevant legislation is still being drafted and its exact content and impact on the financial sector is the purely a matter of speculation.

Finally, Cambodian FIs have little requirements to adopt pro-transparency measures, such as disclosing relevant information on their governance structure, operational exposure to E&S risk, and adoption of sustainability strategies and/or policies. Some FIs in the country, as mentioned, have followed the trend set by the *Cambodia Sustainable Finance Initiative*, and have started publishing online reports detailing their sustainability policies and efforts to help local communities, including quantitative data. With sustainable finance in its introductory phase, this is a promising and notable trend. However, these efforts are not standardised, with some reports being much more detailed than others, and some appearing as broad vision statements. It is also unclear how these efforts reflect a sector-wide approach to the problem, rather than individual initiatives.

3.2 Scope of the recommendations

Having identified the problem, we therefore make recommendations over three areas: capacity-building, regulatory and pro-transparency measures. The aim of the recommendations is to provide a practical tool for discussion with relevant stakeholders, particularly the Royal Government of Cambodia. Hopefully, the discussion can provide an impetus for the promulgation of reform in this field, by contributing to consultations among affected stakeholders in Cambodia. Intended as a collective tool, these recommendations are not only

aimed at the Cambodian government, but also at other relevant stakeholders that can contribute their efforts to reform the financial sector. These actors include Cambodian FIs, regulators, sectoral associations, development partners, and the general public.

4 Recommendations

4.1 Capacity building

4.1.1 Introduction

The aim of capacity-building recommendations is to fill the current gap regarding knowledge of sustainable finance among Cambodian financial stakeholders. As mentioned earlier, current knowledge could be improved. The recommendations are primarily targeted to the workforce of Cambodian FIs. The range includes all levels of staff, from frontline clerks to senior management. They are also addressed to the government, regulators of the financial sector, development partners and representatives from sectoral associations (such as the ABC) and consumer associations.

Impact on Cambodia

Successful implementation of these recommendations would increase knowledge and awareness of sustainable finance at several levels of Cambodian society.

Most importantly, Cambodian banks and other FIs would be in a much better position to actively contribute to the spreading of financial good practices in the country. In practice, this would mean, for example, frontline staff being trained to better recognise the Environmental and Social risks when handling transactions with clients, or senior managers spearheading the creation of new and more detailed environmental sustainability strategies for their companies.

It is not only workers in the finance staff that would benefit from this development, however. The Cambodian government and financial regulators would be more aware of good practices from financial regulators in other countries, helping them make more informed decisions when conducting relevant policy reform in Cambodia.

Finally, the wider public, represented by customers of FIs in Cambodia, would be more aware of sustainability corporate and sectoral initiatives carried out by actors in Cambodia, and would therefore be able to make more informed consumer choices. By rewarding sustainability-conscious banks, for example, Cambodian borrowers encourage more banks to move in the same direction.

4.1.2 Training sessions and informative campaigns

The two recommendations are to (1) arrange training sessions and (2) carry out informative campaigns on aspects of sustainable finance. Both these initiatives entail the creation of informative curricula, tailored according to the different requirements of the stakeholder they are aimed for.

Due to the scope of work, FI staff members and financial regulators are obviously more involved in sustainable finance than other stakeholders, such as consumer associations. Therefore, training and dissemination materials designed for the financial private sector and regulators would be more in depth and cover more technical aspects of sustainable finance than those for other actors. Introductory information could include, among others, explanations on key definitions and concepts, and an overview of international best practices. Key topics would be making the business case for sustainability and giving examples of regulatory frameworks set in place by governments and regulators worldwide. As the main drivers of change in sustainable finance, it is essential that the private sector grasps the potential benefits of “going green”, and the informative material should provide plenty of practical examples of such benefits gained by FIs, such as an enhanced brand reputation and access to low-interest rate loans.

On the other hand, materials designed for other stakeholders would be somewhat lighter and less technical, possibly focusing more on explaining how non-financial stakeholders can contribute to making the sector more sustainable, such as by designing multi-stakeholder engagement platforms and agreeing on concerted action plans.

As mentioned in the research report, there is a vast amount of literature detailing financial best practices, to draw from when designing the training and informative curricula.

4.2 Regulatory

4.2.1 Introduction

The aim of regulatory recommendations is to provide a space for continuous sustainable finance reform, thus strengthening the role of government and other regulators in the promotion of financial best practices. Although the Cambodian government has supported the *Cambodia Sustainable Finance Initiative* by having it endorsed by the Ministry of Environment, the current financial regulatory framework in Cambodia does not appear to be very stringent in requiring FIs to integrate sustainability in their strategy and operations.

Thus far, the main impetus for change has been provided by the autonomous initiative of Cambodia’s main sectoral association, the ABC. The promotion of sustainable finance currently relies mostly on the voluntary participation of FIs, with relatively little legal incentive for non-participating FIs to comply. The regulatory framework could thus be strengthened, by introducing requirements for all FIs regarding sustainability and establishing an overarching sectoral strategy with clear roles and requirements assigned to every stakeholder

in Cambodia, from FIs to sectoral associations and national regulators. As a collective effort, these recommendations are meant primarily for Cambodian FIs, the government, and sectoral associations.

Impact on Cambodia

A more stringent financial regulatory framework is expected to increase compliance by FIs regarding the integration of sustainability into corporate strategy and operations.

Moreover, the establishment of a sector-wide national strategy is expected to increase the participation of all major stakeholders in promoting sustainable finance in Cambodia.

Components of the strategy could be the creation and formalisation of a multi-stakeholder platform for dialogue and engagement across all relevant sectors of Cambodian society. This platform could provide a venue for more disaffected Cambodian actors – such as members from civil-society organisations – to offer their advice on how to mitigate some of the environmental and social risks that come from current financial practices in the country. Cross-sectoral engagement and dialogue, if conducted constructively, is expected to build trust and communication venues between various interest groups.

4.2.2 Establish a sectoral strategy and engagement platform

The first step to clarify the Cambodian regulatory framework is to establish a nationwide sectoral strategy, which allocates clear roles and tasks for each stakeholder of the financial sector. The content of the strategy can be discussed in a future venue, but it would include a vision statement, a stakeholder map, and roadmap with a comprehensive timeline of activities.

The process could involve a series of multi-stakeholder consultations and the assistance of sector experts, who would illustrate some of the international best practices in this regard and help guide the formulation of the strategy.

The consultations could be formalised into a national dialogue and engagement platform, which could meet regularly to provide ongoing discussion on aspects regarding the implementation of sustainable finance in Cambodia.

Preliminary guidelines could help steer the consultation process. These could include, possibly: defining the private sector as the main driver of sustainable finance promotion in Cambodia, identifying the ABC as a primary coordinator of sustainable finance initiatives, assigning a supervisory role to the National Central Bank and a regulatory role to the relevant line ministries, and laying the foundations for more “grassroots” participation channels from the wider public, including Civil Society Organisations and consumer associations. These guidelines could be published in a document and circulated among stakeholders prior to the consultations.

4.2.3 Create tools to manage non-compliance and stakeholder dialogue

Two tools could be set in place to improve the effectiveness of regulatory changes: establishing a system of penalties for non-compliers and a mechanism to address grievances from Cambodian society.

The former could include various levels of penalties, based on the severity of the offence. For instance, lighter offenders could be included as examples in third-party monitoring reports or be issued with a warning, whilst heavier offenders might be threatened with suspension from the ABC or any other relevant sectoral body they belong to.

The latter is a monitoring mechanism to address grievances from Cambodian society regarding the implementation of financial practices in the country. Hearing and attempting to solve such grievances would go a long way in building trust on the part of the more disaffected parts of Cambodian society. The exact structure of the mechanism is still to be defined. However, like in any other cases, there are vast quantities of informative material on similar mechanisms already existing worldwide, such as civil ombudsmen.

4.3 Monitoring and disclosure

4.3.1 Introduction

The aim of the final set of recommendations is to bridge the current transparency gap that exists regarding the disclosure of sustainable activities, including the adoption of corporate sustainability strategies and ongoing initiatives, by Cambodian FIs.

At present, as mentioned earlier, the regulatory framework is not stringent regarding requirements for FIs in implementing sustainable practices. Some of the areas with few or no regulatory requirements include FIs' own disclosure of their sustainable activities and strategies, E&S policy and governance structure, and operational exposure to E&S risks. In this context, Cambodian FIs have little legal incentive to provide information to the public, for instance by publishing freely available sustainability reports on their website. Whenever such material is disclosed, the process relies on the voluntary adherence to transparent information-sharing practices by institutions in the country.

Since a key component of sustainable development - and sustainable finance specifically – is to include a wider range of stakeholders in the monitoring of company activities – it would help in this regard to provide a stronger incentive for Cambodian FIs to disclose relevant information to the public.

Impact on Cambodia

The implementation of monitoring and disclosure recommendations is expected to reduce the mentioned transparency gap significantly, guaranteeing wide-ranging benefits to Cambodian society. These benefits include the building of trust among financial stakeholders and an increased capacity for affected stakeholders

- such as government, CSOs and consumer associations – to effectively monitor operations by FIs and identifying weak points in the corporate implementation of sustainable practices.

By making information clearly available to anyone interested to view it, FIs can show their goodwill towards the Cambodian public, especially towards interest groups that currently see themselves as marginalised in the decision-making process. In return, complying FIs can expect to gain significant returns, in terms of their reputation towards the Cambodian public and the international development community.

The information displayed can help those interested in monitoring corporate compliance with sustainability requirements by providing them with a more detailed knowledge of efforts by individual institutions in the field. This data can then be elaborated into measurement tools, such as stakeholder mapping, corporate benchmarking and performance indicators.

The resulting higher levels of trust among stakeholders is guaranteed to build further momentum for reform in the field, by breaking down obstacles to effective stakeholder cooperation and accelerating the convergence of interests. This process will ensure a long-lasting positive impact that goes beyond the immediate regulatory landscape, positioning sustainable finance reform as a key component of future Cambodian development.

4.3.2 FIs report on sustainability strategies

The first recommendation is to make it a requirement for FIs in Cambodia to disclose information on their sustainability strategies, operational exposure to E&S risk and any other corporate area – such as their governance structure – that would be of interest to the public for monitoring purposes. Although some companies in Cambodia are already active in sharing this information, as we mentioned, this commitment is entirely voluntary.

The introduction of a legal requirement in this regard would, similarly to the requirement for FIs to adopt a sustainability strategy, increase compliance among Cambodian FIs. In the same way, a tiered system of penalties could be introduced for non-compliers, ranging from warnings to sanctions. At the same time, compliant companies could be rewarded through increased reputation, and recognition from the competent regulators.

4.3.3 Provide common templates for reporting

The second recommendation is to provide FIs with common templates for their reporting requirements mentioned above. The templates would be circulated among FIs and other financial stakeholders, and their adoption could be the subject of a training session provided to complying Cambodian FIs.

The standardisation of reporting material would help reduce operative costs for compliers – the FIs – and those in charge of monitoring these reports. In the first case, FIs would reduce time and costs dedicated to the

writing of such reports, by having clear guidelines and being shown exactly what type of information is required of them beforehand. In the second case, monitoring stakeholders can use these standardized reports to make more informed decisions and even provide a sort of benchmarking regarding levels of compliance by FIs.

There is a vast amount of material regarding the adoption of common templates by international financial stakeholders, some of which was detailed in the research report. This material can help inform the choice of such templates for the Cambodian financial sector.