Capacity Leads, Capital Follows: Donors and Investors Match Instruments to ACLEDA’s Stage of Development

by Heather Clark

This case study highlights the role of donor staff (including staff of ILO, UNDP, KfW, SIDA, USAID, and IFC) who enabled a business development project to grow into the largest retail bank network in Cambodia. At each major transition in the development of ACLEDA, key donor staff met the needs of this rapidly growing financial services institution, overcoming internal institutional constraints.

Overview

ACLEDA began in 1992 as a small business development project in post-conflict Cambodia. Initially created as a 2½ year project by the International Labour Organization (ILO) and the United Nations Development Programme (UNDP), with funding from the government of the Netherlands, ACLEDA has since become the largest retail bank network in Cambodia. As of April 2004, ACLEDA Bank, Plc., owned by seven national and international shareholders, served over 130,000 customers through 111 branches, 96 of which were located in small towns and rural areas.

In four major transitions from 1992 to 2003, ACLEDA successively operated as a business development project, a multi-sectoral non-governmental organization (NGO), a dedicated microfinance institution (MFI-NGO), and a specialized microfinance bank. In 2003 ACLEDA Bank, Plc., was licensed as a full service commercial bank. Convinced of ACLEDA’s potential to provide financial services to large numbers of poor and low-income people, different donors provided critical support to build capacity and then provide capital. During each transformation, donors shared a trust in ACLEDA’s management and staff as they strived to match their resources to ACLEDA’s stage of growth.

Today, ACLEDA Bank, Plc., has a gross loan portfolio of US $47.7 million, voluntary deposits of US $17.8 million, and a portfolio-at-risk ratio (PAR) more than 30 days of 0.76 percent. There are over 82,000 micro-loan clients (see Box 1 on page 4) with an average outstanding balance of US $116, or 41% of GDP. The bank’s principal products—small and micro loans—are complemented by an array of financial services, including international and domestic transfers, payroll services, company overdrafts and a variety of deposit account options. Firms of all sizes, international institutions that conduct transactions in multiple foreign currencies, and rice growers in distant villages who make deposits in badly worn Cambodian riel, avail themselves of the bank’s services.

Setting the Stage

In 1992, inflation in Cambodia was over 150 percent. The human and physical infrastructure of the country had been shattered by 30 years of war. As Cambodia recovered from a regime that outlawed currency, blew up the Central Bank, and caused the death of almost one-fourth of the population, more than 530,000 refugees and internally displaced people began to resettle their country. No commercial bank operated outside the capital city of Phnom Penh, and none provided financial services to the vast majority of the poor population.

In 2000, the National Bank of Cambodia (NBC) issued a set of regulations that enabled NGOs to transform into licensed financial intermediaries. By then ACLEDA, led by In Channy and a team of talented and skilled managers and staff, was in a position to attract international institutional investors, maintain the high standards that had been hard won over the previous six years, and take the next step to transform into a bank—a step anchored by three years of preparation.

How Donors Found the Winning Instrument at Each Stage of ACLEDA’s Development


The “ground breakers” built ACLEDA’s institutional capacity as a platform for future growth; they did not follow a “quick impact” strategy. In the devastated post-conflict environment of Cambodia, many donors supported “quick impact projects.” Such projects often
trade perceived impact against permanent institutional capacity. Building a local organization is often difficult, time-consuming, resource-intensive; implies responsibility over the long term; and requires the patience to wait for an institution’s learning curve to accelerate. The rewards and benefits to clients, however, are much greater, and the learning curve is often not as steep as a donor anticipates.

ACLEDA benefited from the leadership of ILO’s chief technical advisor, who supported the local staff’s desire for national ownership. Under his tenure, the ILO/UNDP project followed a reverse strategy than the one laid out in their project document. It concentrated on building a local organization from the outset and hiring local staff who would lay the foundation, rather than pushing out cash. They searched for people who were entrepreneurial, open to new ideas, willing to learn, honest, and had a desire to contribute to Cambodia’s development. They found teachers, planners, and accountants in refugee camps and government agencies. ILO technical assistance and the ACLEDA staff’s ability to manage the budding operation proved to be more important than the project’s US $600,000 revolving fund, which was not fully utilized until 1995, when ACLEDA’s skills, products, and systems allowed portfolio growth.

The views of ACLEDA staff fundamentally changed during this period; they became convinced that customers, not donors, were the future of their organization. Following this first step toward commercial microfinance, products were made more attractive by designing them to meet customer preferences. The mandatory savings requirement for loans was removed, the time between loan application and disbursement was reduced, business training courses were shortened, and a professional relationship between staff and customers was established. The rapid growth in capacity outpaced the availability of capital, constraining lending operations until three creative donors stepped in.

The Swedish International Development Cooperation Agency (Sida) made a notable contribution by extending the first large (US $2million) non-designated grant to ACLEDA, which built equity, instead of targeting new branches or beneficiaries. Kreditstalt für Weideraufbau (KfW) took a major risk by lending to an NGO. KfW had just opened an office in Cambodia and was looking for an investment opportunity, but could not find an institution with the capacity to manage significant funding until it evaluated ACLEDA. The initial KfW loan (US $2.8 million) allowed ACLEDA to leverage its equity for the first time (see Box 2 on page 4).

“[ACLEDA] was a diamond in a desert of stones. I could not understand why others didn’t realize that earlier as it was very obvious. There was an attitude of transparency, external audits, a strong management team, and a robust market apparent in the waiting list of customers that ACLEDA could not [serve]....You can always ask for more figures, statistics, and projections, but at a certain point, you have to believe.”

Dr. Joachim Trede, Project Manager, KfW

The U.S. Agency for International Development (USAID) overcame its preference for funding NGOs in Cambodia via their US partners and provided a small direct grant (US $235,000) to ACLEDA to ease its liquidity crisis. USAID in Cambodia saw ACLEDA’s enormous potential for the future and resolved to provide the institution the kind of assistance it needed despite the additional management burden for USAID.

“[It was clear there would be no value added for ACLEDA through [existing] arrangements...but there would be hoops to jump through—a pre-award audit, an opinion on registration with USAID, procedures to establish pre-eminent capacity....Our main thinking at the time was that this would be good for Cambodia; not why we couldn’t do it.”

Toni Ferrara, Project Officer, USAID Cambodia

ACLEDA became an appealing lender in a market starved for capital. Provincial branches that served an average of 390 customers in 1994 were serving 2,100 customers by the end of 1996 due to an expansion of rural and district offices within each provincial branch.

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The “risk-takers” eased the capital constraints of ACLEDA during a fast growth period, using a mix of instruments. ACLEDA, now a multisectoral NGO offering business and vocational training as well as credit, focused on building institutional capacity. Standard operating manuals, as well as systems and policies, training for credit, cash management, customer service, and internal control were developed, enabling decentralized decision making and more efficient rollout of new branches. Loan-officer productivity increased seven-fold and administrative costs fell.

The "right thing" had definitely been the exception for quite a while. In your life you don’t have the chance to do the right thing very often. It’s good to get the chance to do [it] once.”

Roel Hakemulder, Chief Technical Advisor, ILO

The "right thing" had definitely been the exception for quite a while.
The institution’s efficiency climbed; it cost US $1.07 to lend US $1 in 1993, but only US$ 0.17 in 1997. Within SIDA, KfW, and USAID, skilled staff overcame established and risk-adverse policies to provide the type of funding most needed. Their determination to provide this young microfinance provider with the right support—their commitment to sustainable microfinance coupled with a dedicated ILO/UNDP technical advisory team, were crucial to ACLEDA’s subsequent development.

Movers and Shakers: National Bank of Cambodia (NBC) and the UNDP/USAID/IFC Transformation Project: 1998–2000. The “movers and shakers” provided a legal framework and technical assistance for ACLEDA's transformation to a licensed financial institution, thereby paving the way for commercial investors. In 2000, the National Bank of Cambodia (NBC) issued a set of regulations as part of the new Banking and Financial Institutions Law of 1999 that enabled NGOs to transform into licensed financial intermediaries. The new law incorporated a tiered licensing and regulatory framework for microfinance, including a specialized bank license allowing MFIs to provide services other than credit, such as deposits and transfers. ACLEDA was now ready to undertake its third organizational transformation to attract international institutional investors, while maintaining the high standards that it had worked so hard to achieve.

“The purpose of the new framework was to enable MFIs to become sustainable over the long term as part of the formal financial system.”

Tal Nay Im, Director General, National Bank of Cambodia

The transformation project funded by USAID, UNDP, and the IFC’s Mekong Project Development Facility (MPDF), with valuable support from the Ministry of Finance, enabled ACLEDA to redesign its systems to comply with international commercial banking standards. Legal status, organizational structure, owner-ship, governance, taxes, labor policies, reporting, information technology and the management information system—just about everything the institution had in place except its micro and small loans—had to change.

Supporting an NGO transformation was initially a barrier for IFC. Companies generally came to the IFC already prepared for expansion. At the time, the IFC did not have a microfinance division and doubted the feasibility of microfinance as a commercially viable business model within a donor-supported NGO. However, the strength of ACLEDA’s management and performance track record convinced IFC’s MPDF to champion a small grant (US $60,000) to complement the technical assistance package, an important step in overcoming IFC’s initial reservations about equity participation.

“Over time, people visited ACLEDA and saw how in such a poor country, microfinance could have a large development impact in a very commercial way. IFC was uniquely positioned to become a founding shareholder. It was the strength of ACLEDA itself that changed attitudes; the hard part initially was getting an audience.”

Morgan Landy, IFC/Mekong Project Development Facility

Perhaps most importantly, the donor consortium concentrated on attracting commercial capital—not undermining it—by supporting the technical assistance ACLEDA requested.

The Deal Makers: DEG, Triodos-Doen, FMO, and IFC, 2000?2004. The “deal makers” formed a consortium of investors for the transition to a bank. ACLEDA was licensed as a specialized bank in late 2000, and as a commercial bank in December 2003. Its shareholders included ACLEDA NGO, the ACLEDA Staff Association (ASA), IFC, and several international socially responsible investors—Deutsche Investitions und Entwicklungsgesellschaft (DEG), Triodos-Doen, and the Netherlands Development Finance Company (FMO). In preparation for the transition, ACLEDA continued building staff capacity in five key areas: operational risk, asset management, liability management, internal controls and audits, and information technology. During 2002 alone, 327 courses were delivered to 856 staff members, or 99 percent of the staff.

The investors in the new bank formed a like-minded consortium reducing the exposure of individual institutions. The participation of each investor was important to attract the others. Each relied on the expertise and backing within the consortium.

Cambodia’s heavy-risk weighting in international finance markets was the key risk for international investors. Yet, each investor weighed country risk against other factors. For DEG, the development impact overruled the country risk. Triodos-Doen, one of the first private international investors in microfinance—and one of the first interested in ACLEDA—had expertise in NGO transformations. Their aim to bridge the gap between donor funding and capital markets brought private banking experience to governance and equity to the table. Although the IFC perceived its initial participation small compared to other investments globally, it weighed its investment as
valuable support to a financial institution that provided otherwise unavailable services, and a contribution to Cambodia’s developing financial sector.

“...There were a lot of factors that mitigated the risk in Cambodia. ...The reputation and actions that supported transparency within the institution were attractive, the presence of a former Standard Chartered Banker was attractive, the continuity of expert technical assistance who knew the institution was attractive, the IFC with access to policy levels through the World Bank was attractive, the consortium of investors was attractive.”

Emile Groot, Netherlands Development Finance Company (FMO)

In 2000, each of ACLEDA’s international investors perceived similar risks for their original capital subscriptions, and in 2003, each investor increased its capital to meet the requirements for the commercial bank license, paving the way for private domestic capital.(see Box 2). They believed the returns outweighed the risks.

Conclusion

From the “ground breakers” to the “deal makers,” each highlighted donor, investor, and many others, recognized ACLEDA had the potential to play a leading role in the financial sector of Cambodia. Institutionally, ACLEDA was sound: it had solid management and skilled staff, a commitment to transparency, and a vision for the future. At each stage of its growth, donors and investors recognized ACLEDA’s potential and bet on committed staff and leadership. They concurred with what ACLEDA’s management knew from the very beginning: capacity leads, capital follows.

“...With the granting of a commercial bank license, the foundations have been firmly laid to build ACLEDA Bank into the leading micro, retail and commercial bank in the country....I have often been asked whether the move into commercial banking signifies a change in our strategic direction away from microfinance. Microfinance and small scale credit is and will remain our core business. This is compatible with our aim to become Cambodia’s leading bank for the people and our new products will complement and provide depth to our traditional business....We have grown with our customers....Everyone has to learn, to improve all the time. Our learning never stops.”

In Channy, General Manager, ACLEDA Bank, Plc.

References


Boxes 1 and 2


Website

ACLEDA website: www.acledabank.com.kh

Heather Clark, a former board member of ACLEDA NGO, is currently writing a book on ACLEDA.