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Private Sector in Cambodia – Glimpses from Case Studies

This article aims to examine the growth and success of the private sector in Cambodia, with a view to determine impediments to and opportunities for growth, as seen from an entrepreneurial perspective. *

The findings are based on case studies conducted with enterprises to gather information on their establishment, growth, problems faced and coping strategies of individual enterprises. The problems themselves suggest a need for public policy.

A commercial farmer began with only 0.5 hectares of land in 2000, and in a year, was able to sell 4.7 million riels (about US$ 1,200) worth of vegetables.

The Data

Ten case studies were prepared on relatively successful entrepreneurs. The enterprises were selected from the primary, secondary and tertiary sectors. Small and large-scale enterprises were interviewed, and traditional as well as modern business units found place in the study. Efforts were made to seek representation of business units located outside Phnom Penh as well. The sample consists of a banker, a hotel owner, a diversified construction/ trade/ plantation company (C-T-P in short), a brick manufacturer, a fish-sauce maker, a plastics-manufacturer, a bakery, a handicrafts maker, a poultry farmer and a commercial vegetable farmer. The interviews were detailed, which helped to obtain a historical profile of the growth of business through the 1980s/1990s and beyond.

Origins of the Business Community

In Cambodia, historically, people migrating from outside came to control trade since the early times, with the help of technology and by monopolising transportation. Initially many were travelling merchants but gradually a small community settled locally, and created a new community of Sino-Khmer.[1] The Sino-Khmers possess knowledge about business and commerce that has been passed down from one generation to another. Additionally, being a progressive minority, they are a closely-knit community and community bonds are helpful in furthering business and commercial interests.[2] Most respondents admitted that they maintain their kinship network and invest time and resources nurturing it. As a result, they have become influential in the non-agricultural sectors. All 10 in this sample are of Sino-Khmer origin.

Growth of Business

Nine out of 10 businesspeople from the case studies began from relatively humble origins. All the entrepreneurs learnt the skills of doing business on the job and grew as the economy grew – some grew more rapidly than others.

The bank selected for the study grew rapidly from an asset base of about US$8 million in 1993 to over US

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$124 million in 2001. It opened several branches in provinces as well. Two main factors led to success: first, it mobilised money from the expatriate Khmer/Sino-Khmer community, and second, it created a niche for lending money among a wide base of Cambodian middle and upper-middle class businessmen who otherwise would not have found institutional finance. Similarly, the hotel grew rapidly from a small 27-room establishment (in 1993) to one that has 157 rooms of varied facilities (in 2002), in addition to a new semi-luxury category hotel in another city. The business currently has an annual turnover of over one million US dollars. This multi-fold rise in the assets/income has been the latest in a series of successful ventures by the owner and his family (in trading) before they came into the hotel business. Initially he earned money because UNTAC and its staff wanted all the possible space in Phnom Penh. Later, with considerable and consistent efforts lobbying international NGOs, medium budget officials and tourists, the hotel created a niche among certain types of foreign visitors. The C-T-P group, a tightly knit conglomerate of seven companies, also grew out of virtually nothing to over US$30 million in assets now. This group's story goes back to the 1980s, when the export of plantation products was among the few options in the country. Having earned some handsome profits from exporting plantation products, the owner began to diversify into construction, and finally moved into the vertical integration of plantation sector activities.

Among the relatively small companies and businesses, the one that showed a ten-fold increase in capital, from US$10,000 to US $100,000 between 1994 and 2001, was the poultry farm. Quality assurance and the creation of niche markets were the key elements to the farm's success. The bakery began operations much earlier, in 1979. In the earlier days their products were marketed mainly in localised neighbourhoods but after 1994, the company climbed on to a high growth trajectory. The commercial farmer began with only 0.5 hectares of land in 2000, and in a year, was able to sell 4.7 million riels (about US$ 1,200) worth of vegetables. The fish sauce manufacturer, who began operations in 1986, has also experienced rapid growth. The handicraft enterprise began as a very small unit in 1997, but was able to sell more than US$20,000 worth of products in 2001. Problems of unequal trade conditions with neighbouring countries and acute competition have, however, disturbed the growth of the brick making unit (started 1991). The plastics-company, which started in 1993, has faced shutdown in the face of cheap imports on more than one occasion. It has not performed in the same fashion as the others in this sample.[3]

In short, many enterprises captured markets early enough in key areas where there was demand. They then grew as the markets expanded. International competition is low in these areas. Business success has been higher in the primary or tertiary sector.

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Technology and Management

The bank began in 1993 as a family business with 19 people (mainly relatives) employed. Employment has now grown to over 250; most are skilled. The owners are aware that ownership and management are separate concepts and that the roles of each should be clearly defined. The bank has acquired technology through strategic alliances with international groups like *Swift* (money transfers), *MasterCard,* and *Visa* (credit cards), and *Cirrus* (automatic teller machines). Modern technology is not cheap, but the productivity gains compensate for the expenses incurred. The hotelier family learnt the trade the hard way. Some learnt the business from other hotels in Cambodia and Thailand; others learnt information technology, while still others acquainted themselves with accounting, etc. Every mistake was consciously rectified and the lessons learnt. The owner and his wife alone are formally the 'owners' while the offspring are 'salaried employees'. Despite this, they have not really tried to separate ownership from control; this may constrain further growth in the future. Until now, however, the concentration of skills and management within the family has guaranteed huge savings, no leak of funds and ensured each member works hard.

The C-T-P group, in contrast, has leaned on the technologies and management styles of multinational companies with whom it has collaborated. It has also engaged highly trained expatriate staff. In terms of management practices, initially cousins and uncles were relied upon but this practice is slowly giving way to hiring professional staff. However, tension between family control and professionalism does exist. The poultry farmer gets his technological expertise through a partnership with a Thai company. A relative of the present owner, who introduced him into the business, sent him to work in a well-established poultry enterprise in Thailand to learn the business and its technical details. The owner obtains his stock of poultry from the Thai company; he maintains that the fowl are more scientifically reared in Thailand. Birdfeed, too, is obtained from the Thai company. The farm has acquired skills to create optimal mixes of bird and animal feed to obtain the best results. The owner earlier tried to adapt locally available technology but did not succeed. The dependence on his Thai partner therefore continues.

The handicraft entrepreneur has not invested in developing or acquiring technology for either stone cutting or polishing. There is therefore wastage of stone in both carving and chiselling. This increases the costs of input as well as transport. The owner expresses his inability to do much about it: he has no resources to get better quality machines or trained manpower in his province. He finds it more profitable to contract skilled workers on a job-basis. He maintains that there are people who have artistic skills, and it requires no special effort to keep these alive. The owner's belief that artistry, rather than modern technology holds the ultimate advantage, could be problematic in the long run. The owner of the bakery knew the trade from earlier than 1979, and therefore had the advantage of being among the first. All the machinery and equipment are of Chinese origin. Packaging material comes from China and Thailand, a cause of regular delays and high costs due to poor transport facilities and informal payments. Efforts at contracting local firms to supply packaging material have not been successful; both for want of quality and cost. The vegetable farmer, who obtained his earlier training from an NGO, is aware of the benefits of modern technology in increasing yields but feels financially constrained, and tends to make small, selective investments. The brick maker employs traditional methods for brick manufacture - his principal fuel is rice husk He is not undertaking modernisation for want of inputs and technologies. In the short-term modern equipment will raise costs, resulting in reduced competitiveness. In any case, coke is not available on an industrial scale in Cambodia, which limits the possibilities for development in this industry.

For fish-sauce, local materials including equipment are adequate. One of the factors inhibiting expansion is the bottling capacity. This manufacturer is therefore unable to penetrate the upper segments of the market. The plastics-factory acquired equipment in 1991 through a Taiwanese dealer. His technology is obsolete. While the owner thinks less of technical issues compared to commercial and market-oriented ones, the reality is that the technology, scale, and up-keep are all too expensive, making his unit less competitive. Earlier he imported raw plastic from Singapore and Korea; later he began to recycle used plastic waste. This cut costs, though his product quality deteriorated. He has now reduced the number of employees, and pays them on piece-rate. This has further cut costs and kept him in business.

In short, those who opted for modern technology have gained more than those who have not. Those who use old methods are not even aware that they are losing out. There is little in the form of locally available modern technology or an institutional means to access it from elsewhere. Many entrepreneurs have cut on labour costs to remain competitive rather than reap the benefits of modern technology. Earnings of workers are low in such cases. Almost every business studied here has had tight family control over the management. While in the initial stages this was both necessary and advantageous, this family-oriented approach may not be the most optimal choice as the sizes of operations grow.

Finance

In the context of the bank, it is meaningful to discuss the uses and circulation of money rather than source of money *per se*. This bank has obtained all its initial capital from overseas Cambodians, through a diversified investment corporation. The bank is one of these downstream companies. The bank now receives deposits from local business as well as private citizens. It lends to local small, medium as well as large organisations. Part of the risk that the bank takes is cushioned by ethnic and kinship factors. The Sino-Khmer community is tightly knit and the pressure on borrowers not to default is high. There is, though, virtually no transaction between banks and financial institutions in the country - this limits banking operations. The hotel, despite its present size, has been exclusively dependent on its own funds. In the 1980s, the owner first earned handsome profits from the bullion trade. Once the hotel was established in the early/mid-1990s, placement of family members in many key positions has reduced costs and ensured no financial leaks, and hence earned the owner yet more profits. The vertical integration of activities – having one's own power generator, in-house laundry, a fleet of guest pick-up vehicles, ticketing arrangements, are some examples – also keep costs low. Part of the profits was used for working capital, and part, for accumulation and business expansion.

The C-T-P group has developed strategic associations with influential officials to obtain trading rights in some primary products, the original money-spinning activity. The cash was then used to lever more capital from the market, banks and overseas corporations. This is the only business, other than the bank, which seems to resemble modern practices in mobilising capital. The poultry farm earlier (in 1997) got 50 percent of its capital by contracting a loan from a bank at an annual interest rate of 24 percent. This is the only institutional finance that this business has obtained; all subsequent requirements for both fixed and working capital have been obtained from its own sources, or through arrangements with the partnering Thai company. The handicraft firm is located outside Phnom Penh and facilities for institutional finance outside the capital city are few, if any. The owner thus uses his own resources and savings, including borrowing from relatives. The bakery owner gets bulk orders, and payments are made only after the merchandise is delivered. For working capital, he is frequently 'forced to borrow money' from a bank at an annual rate of 22 percent.[4] Borrowing raises costs, and cheap products from Thailand begin to compete with his products, a phenomenon becoming worse with the dollarisation of the Cambodian economy. A similar attitude was expressed by the commercial vegetable farmer, who maintained that fixed capital needs should be met from one's own resources while for working capital only occasional borrowing is acceptable, at low interest rates. The fish-sauce maker relies on his own savings and family sources (up to 70 percent) and on loans from a moneylender (30 percent, at an annual interest rate of 24 percent) for setting up and expanding his business. For working capital, internal funds are ploughed back in. He had tried once for a bank loan but the procedures, delays and unofficial fees thwarted his efforts. The brick maker had a similar story to narrate – that relatives and friends are the only reliable sources. He once underwent training at a micro-credit bank, but was unable to get a loan, as its loan ceilings were lower than his needs. The plastics-company owner got into partnership with a relative to raise money for fixed assets. The working capital needs are met from internal revenues.

In short, institutional finance is virtually absent in Cambodian business. In the process the leverage that institutional and market finance can provide for business to grow is absent. The problem is of inadequate supply, high costs and inadequate tenurial rights, and the consequent attitude of potential borrowers towards loans. This attitude also prevails because of very high interest rates. Most institutional finance agencies are rigid, offering very limited services. Ineffective legal and financial governance systems are often quoted as reasons. The institutional credit supply problem is higher outside the capital city.

Marketing Strategies and Problems

The bank offers loans to segments of business that are not served by others. It has also come out with innovative schemes for small and medium enterprise (SME) start-ups: loans of up to 90 percent of the value of the fixed assets of SMEs, along with profit-sharing arrangements and business advice. Many analysts think that the bank has 'spread too thinly' and is subject to risks. However, the owners feel that returns on capital are high – this is why people regularly pay such high interest in the open market – and therefore it is worth going for the spread, particularly when the loans are hedged by sufficient collateral. The bank also attracts customers because it takes very little time to process loan applications, offers credit card and ATM services, and encourages middle class depositors.

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The hotel has created a market for itself among international NGOs and middle-budget tourists through a number of measures. These include continental food, credit card payments, hot and cold running water, etc. The strategic location of the hotel, where many international NGOs also have their offices, has helped. However, the owners see that the going may not be easy forever. There are many competitors emerging with attractive packages. The initial marketing strategy of C-T-P was to become the monopoly exporter, thus guaranteeing a safe market. As the business diversified, a number of approaches like strategic tie-ups with international partners, and diversifying in primary products and services where there is not much international competition, were adopted.

The poultry farmer supplies up to 80 percent of his products – chicken, eggs etc. – to large restaurants, hotels and supermarkets in Phnom Penh. In the egg market, one of the reasons why his product fetches a better price compared to many others is the larger size of the eggs, thanks to the transfer of quality technology from abroad. The market, though, is price sensitive, and there is stiff competition from local as well as cheap foreign products. While fair competition is welcome, illegal dumping/smuggling of eggs and other poultry products from both Thailand and Vietnam have been reported. Recent attempts by the government to crackdown on smuggling have been welcomed, but poor implementation, however, is a cause for concern. Next, wholesale merchants control the prices and can drive the buying price very low. There was once an attempt to form an association of poultry farmers to stabilise the prices, but lack of knowledge and experience thwarted this attempt. The weakening of the Thai baht and Vietnamese dong has also adversely affected profits.

The handicraft market is highly quality-conscious. Also, there is competition from Thailand. This entrepreneur keeps out of the competitive tourist market. He has so far sold his products to local art collectors, elites and overseas Cambodians, mainly against orders. Being near stone quarries helps to keep transport costs low, though they could be lower. He does not see easy times ahead. For one, he has no machinery that would ensure product standardisation and quality. Next, his workers are not skilled enough to meet international quality standards. Thirdly, being located outside Phnom Penh is a handicap. Lastly, marketing is expensive and requires a different expertise.

The baker had faced fluctuations in sales of 30-50 percent due to the 1997 crisis, as well as the Asian Financial Crisis. Part of his clientele, expatriate Cambodians, visit less frequently now. He also repeated the exchange-rate argument. Again, like earlier, smuggling of cheap products from across the border cut into his market. The owner also complained that Cambodia has become a high cost economy owing to expensive electricity, high transport costs and informal payments. An additional problem with regard to the market is defaults and delays in payment by many dealers.

The commercial farmer sells his produce both through dealers and through direct marketing. In the dry-season, he faces price fluctuations. To overcome this problem he ferments and/or dries his vegetables to sell them later. He said that maintaining good relations with dealers as well as moto-drivers is critical to marketing his products. He complains that at times he has to pay informal fees to get his merchandise to the market. The fish-sauce maker has markets in Phnom Penh-based restaurants as well as those in at least three other provinces. Targeting the produce at middle-class Khmer restaurants and pricing the output competitively are key factors to his marketing success. He has no illusions about growing and diversifying beyond his present scale, he would have to target the higher segments in the market (bigger restaurants, larger hotels, international tastes), in which there are a number of imported products to compete with. Advertising is out of the question because of high costs and uncertain impact.

The brick maker has segmented the market according to the order of importance: schools, warehouses, and finally small retailers. Of late other local manufacturers have begun to crowd the market, which has affected his sales. Being outside Phnom Penh is another huge drawback. Next, while he is able to sell his products in Cambodia (three provinces), efforts to export bricks to Thailand despite a 1:3 price advantage, have not materialised. Both quality and trade barriers are responsible for this. Added to his problem are the defaults and delays in payments from his buyers. The plastics-manufacturer repeated what the others said: that repeated shocks in the economy; devaluation of currencies in neighbouring countries; smuggling of cheap plastic products from across porous borders; and high costs, particularly of electricity; have all but killed a nascent and fledging plastics industry. Additionally, small-scale producers of low quality products illegally fake the labels of well-known companies (like his) to obtain a market for themselves, which further affects genuine manufacturers.

In short, some entrepreneurs have created a monopoly-like position or a strong market niche. Macroeconomic factors like dollarisation and external shocks have been harmful; obsolete/ rudimentary technology, poorly endowed workers and a 'high cost, low productivity' infrastructure, have all kept Cambodian industry less competitive; a very open market has not permitted local entrepreneurs to grow in the tradable segments of the market; and lack of effective governance – porous borders, high informal fees, inability to give or get credit guarantees – has been an inhibiting factor.

Entrepreneurship

The *first-movers* had/have obtained near-monopolies or important places for themselves, and some have made tremendous strides. They have taken calculated risks at the right times and cashed-in on these. Some diversified while others entered new fields and yet others expanded on their existing activities. The better the business sense exercised – both with respect to the choice of the product and the market – the more the business grew.

It has paid to create and maintain strategic alliances. Besides the kinship links, there are business alliances reached with international companies and even contacts developed with influential figures that have helped further business goals. One may be tempted not to consider some of these modes of operation as ethical or fair business practices, but Cambodia in the 1980s and 1990s was not a classical market. It had emerged from ashes: law and rules had to be made, business systems had to be established, capacities had to be built, governance processes had to be put in place, people's confidence had to be won, etc. It is only rational that a few chose to take the route of finding favours with the powerful.

People who weathered the earlier years nurtured a vision. They halted at the right intervals to take stock of their progress and also undertook mid-course corrections and/or changes in direction. The entrepreneurs worked very hard – often seven days a week, round the year. They also deployed their family members and relatives for unforgiving numbers of hours each week, for endless weeks. Such an approach cut costs and kept them in competition. Many now are sending their offspring to business schools so that the next generation is able to do business using modern methods.

Why did some entrepreneurs grab early opportunities while others waited for better times? There is no unique answer; there are a number of conjectures, though, that are only partly supported by data. There is a typology of at least two types of businesspersons. First, there are those who are 'risk-taking entrepreneurs with foresight'. They had other choices, probably outside the country, but foresaw better times ahead here and risked their resources to become the first movers. Next, there were the 'no choice survivalists', who did what they did because they did not have many choices. Most business owners expressed that they had faith in the 'future of the society' and considered it a duty to work for its betterment.

In sum, entrepreneurship emerged in the form of taking risks at the right moment and using all possible approaches and means to further the business. It began as a fight for survival, which transformed into a triumph. Hard work and unfailing dedication paid.

Concluding Remarks

This paper finds the following: First, being an open market with porous borders, the nascent industry is unable to compete with imported products. Second, being a very shallow economy - unit value added per activity is low - there are few comparative advantages that this economy has. It can deploy very cheap labour, but this does not take an economy too far. Third, lack of finance, technology and marketing, all throttle private industry. Fourth, unavailable or overly expensive infrastructure, increase costs. Fifth, institutions necessary for modern business practises- rating agencies, audits, consultancy firms, to name but a few - are just not available. Fifth, the macroeconomics is not always to the advantage of the local business. Lastly, informal payments add to costs and therefore are a major disincentive.

In terms of solutions, the paper essentially proposes measures that would supplement or strengthen policies that the government and/or donor agencies are already contemplating - in macroeconomics, finance, infrastructure, and business development services. It additionally finds a role for private sector associations and commune councils for furthering the private sector.

Endnotes

1. Such communities have sprung up all over Southeast Asia.
2. There is nothing unique in this behaviour. Jewish communities in Europe and America and the Marwadi and Parsi communities in South Asia also exhibit similar patterns.
3. The reasons for success for each business in food related activities was/is identification of niche markets for non-rice food items in a period when urbanisation was on the rise and demand for non-rice and processed food products was rapidly growing.
4. This attitude towards credit is certainly archaic in today's world, and reflects that the opportunity cost of one's own resources is zero.