



## Improving the Business Environment in Cambodia

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### **Policy recommendations:**

- Increased government investment in telecommunications in rural areas would bring more businesses online and increase productivity.
- Further regulatory and legislative reforms are required to lessen commercial bottlenecks and speed up procedures relating to public works.
- The government should raise public understanding of the intellectual property rights (IPR) while improving IPR-related law enforcement.
- Access to finance and inclusive financing need further expansion especially for SMEs that lack collateral to access credits.

### **Introduction**

In 2020, Cambodia experienced a negative growth rate for the first time in two decades. As a country susceptible to small changes in the global economy, it grew increasingly obvious that Cambodian businesses need a more solid foundation in order to grow and diversify. The majority of businesses in Cambodia are small and medium enterprises (SMEs) but they significantly contribute to the country's employment, domestic economy and poverty reduction. However, SMEs are encountering several major challenges including informality

of operation, limited access to finance, inadequate human resources, and limited technology and innovation capabilities.

This policy brief outlines the major challenges that Cambodian firms are facing in light of the COVID-19 pandemic before making policy suggestions. Our recommendations pertain to government policy on infrastructure, business regulation and legislation, business networks and access to finance. The analysis is based on CDRI's survey of 361 businesses in industry and service sectors conducted between July and August 2022.

## Key Findings

***Almost 70 percent of firms say poor telecommunications is an obstacle to their businesses.***

In the age of Internet of Things and digitalisation, access to reliable and speedy internet is key to business success. More and more Cambodian businesses are selling their products and services online and accepting e-payment methods. However, majority of them (almost 70 percent of surveyed firms) view access to internet as an obstacle to their business operations, preventing them from further expanding their customer bases and growing e-commerce transaction.

***Some firms still perceive that business regulations are less favourable and transparent.***

These statistics pertain to government policy, specifically legal reforms and regulations, and their impact on businesses. While the survey results show more than 60 percent of firms find the current legal frameworks and regulations favourable, about 12 percent find them unfavourable. While 80 percent of firms agree that regulation is transparent, about 10 percent found them not transparent. In Phnom Penh, this number increases to 13 percent, while in the provinces it decreases to 9 percent.

***More than one-third of firms have to pay informal payments to officials to get things done.***

Almost 90 percent of firm report it is essential to have a good relationship with government officials in order to run successfully. Although a majority of firms perceive the current legal frameworks and regulations to be favourable and transparent in general, there is a concern about informal payments paid to officials. Thirty-nine percent of firms report paying informal fees to officials. This is more common in Phnom Penh than in the provinces. This may become an additional financial burden or barrier to doing business. It may also imply that if firms do not pay officials informally, they cannot get things done smoothly, reflecting a form of corruption amongst officials dealing with business.

***Almost half believe the infringement of intellectual property rights is an obstacle to their operations and performance.***

Intellectual property rights' protection is relatively nascent, but important for doing business in Cambodia. About 48 percent of firms perceive the infringement of their intellectual property rights is a significant obstacle to their business operations and performance. In particular, more firms in Phnom Penh perceive infringement of

IPR is a major obstacle than in the rest of the country. More business owners, especially in the service sector, are concerned about intellectual property of products and/or services being developed and offered in both domestic and foreign markets. Specifically, medium firms in the service sector are the highest proportion concerned about IPR infringement, while the medium-sized firms in the industry sector are the least concerned. Overall, more than half of small firms perceive the infringement of IPR to be an obstacle to their business.

***Less than one third of firms are members of a business network, reflecting limited inter-firm and industrial connections within both sectors.***

Business associations play a very important role in the private sector to establish linkages for production, innovation and technology while also providing their members with guidance on government legislation and policy. Contradictory to the promising gains of being a business association member found in literature, about 30 percent of the surveyed firms are members of a business network(s), generally illustrating the lack of inter-firm and industrial linkages in both industry and services. Usually, firms that are part of associations gain advantages, such as information about legislation, collectively

solving common problems and receiving training or technical support. Among the firms within the business networks, firms, and particularly large firms, in the industrial sector have more extensive business networks than firms operating in services, while the majority of small and medium-sized firms are not part of the business networks. Geographically, firms in Phnom Penh seem to be more likely to establish links and use their networks to exchange information and work collectively to solve bottlenecks than firms in other provinces.

***Few firms rely on financial institutions for loans.***

Only 28 percent of firms have a loan from a bank or financial institution. More firms in provinces (32 percent) take loans than firms based in Phnom Penh (25 percent). Medium firms have the highest percentage of taking loans (48 percent).

Over half of firms report difficulties in borrowing money from financial institutions. Large firms (48 percent), medium firms (68 percent) and small firms (52 percent) report cumbersome lending procedures. Furthermore, similar proportions of firms of all sizes think credit conditions are unfavourable to their businesses. When there is no access to finance from banks or financial

institutions, more than 40 percent of firms choose to take loans from their relatives and friends.

Even in the nation's capital, half of firms that do not borrow money from institutions will borrow from friends. Besides taking loans from relatives and/or friends, firms in the service sector in other provinces are also likely to sell their assets. Taking loans from informal lenders is among the top three choices for firms of all sizes; a small proportion of firms would sell assets and seek shareholders to increase their capital.

### **Conclusion and policy recommendations**

The findings outlined above indicate businesses are moderately dissatisfied with multiple aspects of Cambodia's business environment. The issues that require urgent action from policy makers and stakeholders include telecommunications, business regulation and legal framework, lending terms from financial institutions and comradery among businesses and firms.

With changes to these external factors, businesses will be able to improve their presence in Cambodia's digital economy, contribute more to its GDP, gain easier access to financing from accredited institutions without hindering friends

and family's corporate prospects, and collectively solve problems and share information more easily. More stringent implementation of Cambodia's intellectual property right laws will also encourage creativity and improvement within the country's service and corporate industries. Additionally, public awareness against product counterfeiting and strengthening intellectual property right-related laws and regulations and aligning them with international standards are both essential.

Further effort to reduce informal payment is needed while it also requires to increase transparency in business-related procedures. This will encourage less formal and financially successful business to proceed with registration processes more quickly. The inclusion of more informal economies will also contribute to Cambodia's GDP.

In a country with a high rate of informal and easily disrupted economies, businesses with support networks are less vulnerable to global instability. Strengthening and creating industry and territorial actors – such as regional development agencies, industry associations and intermediary brokers like technology transfer offices – are paramount to encourage firms to engage with each other and to generate positive results.