



Understanding SME Policy Environment in ASEAN

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The Development Research Forum (DRF) of Cambodia, with financial support from the International Development Research Centre (IDRC) of Canada, is coordinated by the Cambodia Development Resource Institute (CDRI). In partnership with the Economic Research Institute for ASEAN and East Asia (ERIA), the DRF organised a seminar on “Understanding SME Policy Environment in ASEAN” in Phnom Penh, Cambodia, on 6 June 2014. The objectives of the seminar were: (1) to share existing knowledge on major issues and challenges facing SMEs in Cambodia especially in policy environment and support services; (2) to promote research and research collaboration on SMEs among institutions involved in the DRF and its research interest groups; and (3) to provoke academic and policy debate on best practices to support SME policy initiatives with a view to strengthening Cambodian SMEs’ engagement with regional economies. The following is a brief overview of the key issues arising from the discussion.

1. Main features of enterprises in Cambodia

- Micro, small and medium enterprises (MSMEs) account for 99.9 percent of all businesses (503,008). Most enterprises are concentrated in Phnom Penh and the most economically active provinces of Kampong Cham, Siem Reap, Battambang, Kandal and Takeo.
- Majority of enterprises are in the service sector (85.8 percent), followed by manufacturing (14.1 percent).
- The overwhelming majority of enterprises (98 percent) active within the service sector are

micro firms. The dominant subsectors are retail trade (60.2 percent), food and beverage service activities (15.4 percent) and wholesale and retail trade of motor vehicles and motorcycles (5.2 percent).¹

2. Challenges facing SMEs in Cambodia

- **Access to finance:** survey results and feedback from people working in microfinance suggest improvement in SME owner/managers access to finance. Official data from the Cambodia Microfinance Association (CMA) shows that interest rates on loans have fallen from 5-10 percent per month ten years ago to 1-2.5 percent per month now due to increased competition among microfinance institutions. Lending to SMEs is mainly based on the business owner’s business plan, cash flow and financial statements rather than on hard and soft collateral. Nonetheless, there are concerns that demand for collateral for secured loans may subdue small business lending.
- **Business associations:** a number of business associations and federations have been established aiming to provide necessary support services to SMEs. However, their roles and functions have been understudied, and the majority of SME owner/managers view them as ineffective and not of meaningful helps. Currently there is a renewed interest in revisiting and addressing bottlenecks among business associations. Newly established associations include the Young Entrepreneurs Association of

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1 Data taken from the Economic Census of Cambodia 2011.

Cambodia (YAEC), with objectives to promote entrepreneurial education and start-up support initiatives such as the SME Helpdesk and incubation centres, and the Cambodia Investor Club (CIC) focussing on financing SMEs and developing the capacity of entrepreneurs. YEAC and CIC are good initiatives to inculcate entrepreneurship culture among young Cambodians, but it still is too early to conclude its usefulness in overall business environment in general and SMEs in particular.

- **Support and facilitation from the government:** there was a shared view among participants that government policy and programme interventions to help SMEs are still limited and unsystematic. The main supporters are bilateral and multi-lateral organisations, but the majority of their initiatives are pilot projects with targeted SMEs. Specific strategies and areas of intervention are specified in SME Development Framework 2005-10, but follow-up actions and programmes are inadequate. In addition, the lack of a monitoring and evaluation mechanism makes it difficult to develop a deeper understanding of SMEs required to anticipate and address emerging issues and challenges SMEs face.
- **National and international market expansion:** increasing SMEs' share in domestic and international markets remains a problem. Factors such as low education level of SME owner/managers, lack of easily digestible market information, the use of conventional production approach, low rate of new technology adoption and limited access to long-term investment loans largely explain the status quo.
- **Relatively high cost of production compared to that in other ASEAN countries:** it is generally agreed that doing business in Cambodia is relatively costly, from starting to operating and closing a business. Ease of doing business is slow to improve. Electricity is among the most

expensive in ASEAN countries, putting Cambodia at a competitive disadvantage. SME owner/managers report that red tape and associated bribes continue to strangle small businesses.

- **Informality of MSMEs:** majority of micro firms operate informally, making it difficult for government to collect taxes and to design and implement targeted support policies and programmes to help MSMEs move up the value chain. Government must consider the implications of this issue for long-term growth.
- **Increased competition, yet unfair:** lack of compliance resulted from uneven and biased implementation and enforcement of rules and regulations is an issue. Importers who evade import duties and customs tax have a price advantage over business owners and domestic producers who fully comply. The tax system of an estimated tax regime and a real tax regime was reported to be one of the root causes of unfair competition.
- **Lack of knowledge on technology adoption:** majority of MSMEs stick to conventional production methods. Most owner/managers understand how new technology could help improve production and productivity, but their low educational level and the perception that new technology is costly and time-consuming prevents them from doing so. Thus, they are trapped in a vicious circle of using low-productivity and cost-ineffective older or obsolete technologies.

3. SME Policy Index

- ASEAN SME Policy Index 2014 is one of the latest publications by ERIA in collaboration with OECD.² It reviews, tracks and identifies

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² For information on the SME policy index scores of other ASEAN countries, see *ASEAN SME Policy Index 2014: Towards Competitive and Innovative ASEAN SMEs* by Economic Research Institute for ASEAN and East Asia (ERIA) SME Working Group.

SME policy development and implementation, and can be used by governments to compare policy experiences and analyse policy gaps at national and regional levels.

- The Index calculates scores for eight policy dimensions: institutional framework, access to support services, cheaper and faster start-up and better regulations, access to finance, technology and technology transfer, international market expansion, promotion of entrepreneurial education, and more effective representation of small enterprises' interests. The score ranks from 1 (lowest) to 6 (highest).
- Quality of institutions is strongly positively correlated with other policy performance indicators.
- ASEAN governments should enhance collateral-free debt and equity financing.
- Cambodia's scores on all policy dimensions are below regional averages and the lowest among ASEAN countries, informing policymakers and stakeholders that more needs to be done to overcome the barriers to SMEs' competitiveness and productivity given regional integration.
- There was scepticism about Cambodia's scores being lower than those of Laos and Myanmar as some participants had experienced more difficulty doing business in Laos than in Cambodia.
- The Cambodian government could use ASEAN regional integration as a platform for reforms, seizing opportunities to strengthen sectors and subsectors that have competitive advantages.

4. SME policy priorities

Workshop participants highlighted the following important areas for consideration:

- Harmonise the definition of SME across line ministries. Following a unified definition would lead to more effective implementation
- of standardised support policies and programmes.
- Set up a “one-stop-shop” system to avoid confusion among SME owner/managers about administrative and operating procedures.
 - Renew the SME Development Framework since it is quite dated.
 - Liberalise and streamline rules and regulation to make business start-ups fast and simple.
 - Consider establishing business clusters that could promote production and economies of scale.
 - Explore further the venture capitalist approach to bring in people who have ideas with those who have financial capital. However, this would need serious works in legal and administrative dimensions.
 - Start formalising MSMEs by tackling tax evasion and reforming the dual tax system.
 - Improve technology adoption among SMEs by exploring the opportunities for public-private or public-private-academic partnerships.
 - Improve SMEs statistics to allow systematic and scientific analyses and to develop a monitoring and evaluation mechanism that supports policy design and more effective implementation.

5. Key questions for SME research

- What benefits could production clusters provide to their members? How and where can clustering work effectively and efficiently?
- What is the role of venture capitalists in spurring innovation and entrepreneurial spirit in young Cambodian firms? What legal, regulatory and administrative requirements are necessary to make venture capital work effectively and efficiently?
- What are the roles of public, private and academic institutions in creating and delivering low-cost technology to SMEs? What cost-effective mechanism needs to be in place to achieve that?

- Should the government keep the tax system of real and estimate regimes? What are the pros and cons of eliminating the estimated tax regime?
- Are there opportunities to improve the business environment to help informal enterprises formalise their operations?
- What impacts will the AEC have on SMEs? Could domestic SMEs compete with the influx of goods and services from other ASEAN countries? Which subsectors and SMEs stand to be most affected by regional economic integration?

About the DRF

The Development Research Forum (DRF) of Cambodia was established following the All-Partners Forum organised by the International Development Research Centre (IDRC) of Canada in September 2007.

The DRF vision is of a high capacity, professional and vibrant Cambodian development research community. Its goal is to support and strengthen the capacity of the Cambodian development research community.

The DRF partnership involves the Cambodia Development Resource Institute (CDRI), Cambodian Economic Association (CEA), Learning Institute (LI), National Institute of Public Health (NIPH), Royal University of Agriculture (RUA), Royal University of Phnom Penh (RUPP), Supreme National Economic Council (SNEC) and the International Development Research Centre (IDRC) of Canada.

In DRF Phase II 2012-15, with financial support from IDRC, the partners intend to work together to build research culture and capacity and to share research knowledge through workshops, policy roundtables and symposiums as well as training and online discussion (www.drfcambodia.net) on six research themes: growth and inclusiveness, governance of natural resources, social policy on education, social policy on health, agricultural development, and Cambodia and its region.

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