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Small and Medium Enterprises and Regulatory and Business Environments in Cambodia

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Abstract

Small and medium enterprises (SMEs) are an important driver for a rapid economic growth in Cambodia. SMEs are expanding in various economic sectors. Nevertheless, with progressive economic development, SMEs in Cambodia still face obstacles over regulatory frameworks and business conditions. This paper thus aims to study the challenges over regulatory frameworks and economic condition for SMEs in Cambodia. The paper would also provide some suggestion to the challenges on regulatory and business conditions for SMEs. The paper is based on information from documentary research and in-depth interview from experts in Cambodia. The paper is divided into four parts. The first part discusses overview of economic condition and SMEs in Cambodia. The second part focuses on current regulatory and business environments for SMEs. The third part explores potential regulatory and business challenges for SMEs in Cambodia. The last part provides conclusion and recommendation regarding to SMEs development in Cambodia.

Keywords: Small and Medium Enterprises; Regulation; Business Condition; Cambodia

1. Cambodia Economy and Small and Medium Enterprise (SME)

Cambodia is fast-growing countries in Southeast Asia. According to the World Bank, Cambodia's economic growth rate is at average of 6.9% in 2016–2017 (World Bank, 2017a). The Cambodia economy has been significantly developed during 1990–2016 with expansion from US\$ 2.53 billion in 1990 to US\$ 20.2 billion in 2016 (See Table 1). The growth rate is based on factors of the expansion of construction activity, increase of garment exports, the development on agriculture business, and enhancement of tourist (World Bank, 2017a). The expansion of construction project stimulates inflow of foreign direct investment (FDI) in Cambodia (World Bank, 2016). The FDI based on construction projects rises due to the government policy on the Cambodia special economic zone that supports industrial developments and facilitates export-import businesses in Cambodia (Council for the Development of Cambodia [CDC], 2016).

The Cambodia garment and textile sectors have been risen during 1990–2010 and the sectors remains vital export industry for Cambodia (ILO, 2015). Cambodia government also considers various policies which improve agricultural production through productivity enhancement and increase value addition of agriculture products (Food and Agriculture Organization [FAO], 2014). While Cambodia government does not provide direct price support to farmers, it provides value-added tax exemptions to all agricultural culture products (FAO, 2014). In addition, Cambodia tourism sector has a very high tourists-to-population ratio. It is estimated that about 4.8 million tourists arrived in Cambodia in 2015 and the trend of increase on tourists arrival is expected (Cambodia Government, 2016). What can be seen

is that Cambodia is at the important step toward economic development under government support. The support on economic development also continues basing on Cambodia Industrial Development Policy 2015–2025 which has principle purpose to build “*Market Orientation and Enabling Environment for Industrial Development.*” The policy is to make sure that Cambodia has economic direction toward the structural transformation of domestic economy and the changing regional and global economic architecture (Cambodia Government, 2015). The policy also links Cambodia economic development with regional liberalization frameworks of ASEAN. ADB forecasts that Cambodia gross domestic product will be the second top of ASEAN countries in 2017 and 2018 (See Table 2).

The economic development with the government policy on market orientation and liberalization is boon to proliferation of SMEs in Cambodia. The SMEs in Cambodia are mainly based on very small business or microbusiness, 97% of the 505,134 firms in Cambodia are microbusinesses (Thangavelu et al., 2017). The small business accounts as 2% of the share. The share of medium-sized and large firms is low, accounting for only 0.16% and 0.15% of total firms in Cambodia economy (Thangavelu et al., 2017). Thus, industry, trade, and service sectors in Cambodia are mainly based on micro and small businesses. The small businesses become a backbone for economic development in Cambodia (See Table 3).

According to the establishment of SME Sub-Committee by resolution No. 45 S.S.R in August 28, 2007, under the Minister of Industry, Mines and Energy, SMEs are defined according to full-time employees (Polsaram et al., 2011). In case that employee number is not appropriate indicator for defection, the size of total assets or a combination of the employees and asset will be an indicator for SMEs definition. Based on the definition indicators, businesses in Cambodia can be classified into

Table 1: Cambodia economy

Economic Indicator	1990	2000	2010	2016
GDP (current US\$) (billions)	2.53	3.65	11.24	20.02
GDP growth (annual %)		8.8	6	6.9
Inflation, GDP deflator (annual %)		-3.2	3.1	3.5
Agriculture, value added (% of GDP)	47	38	36	27
Industry, value added (% of GDP)	13	23	24	32
Services, etc., value added (% of GDP)	40	38	40	42
Exports of goods and services (% of GDP)	16	50	54	61
Imports of goods and services (% of GDP)	33	62	60	66

Sources: World Bank, 2017, Cambodia Country Profile, <http://data.worldbank.org/country/cambodia>. GDP: Gross domestic product

Table 2: Economic forecasts for Southeast Asian

Country	2017	2018
Brunei Darussalam	1.0	2.5
Cambodia	7.1	7.1
Indonesia	5.1	5.3
Lao People’s Dem. Rep.	6.9	7.0
Malaysia	4.4	4.6
Myanmar	7.7	8.0
Philippines	6.4	6.6
Singapore	2.2	2.3
Thailand	3.5	3.6
Vietnam	6.5	6.7

Sources: Asian development outlook, 2017 <<https://www.adb.org/countries/cambodia/economy>>

four categories of microbusiness, small business, medium business, and large business (Polsaram et al., 2011). The categories are according to Table 4.

The micro and small businesses are business having 11–50 employees and financial asset not more than US\$ 250,000. For the purpose of article, the definition of SME refers to any business with up to 100 employees.

2. Regulatory and Business Environments for SMEs

SMEs businesses in Cambodia continue to grow rapidly in size and numbers of operations. The SMEs growth is supported from favorable business, regulatory, and policy environments. According to the World Bank report on “*Doing Business 2017: Equal Opportunity for All*,” Cambodia has continued to improve business environment over the past year (World Bank, 2017b). The Cambodia Credit Bureau reforms credit scores to financial institutions and helps facilitate financial support to SMEs which have financial history (World Bank, 2017b). Cambodia government focuses to buildup an open and liberal market regime under pro-investor legal and policy frameworks (U.S. Department of State, 2015). The government also provides incentive for foreign investors by 100% foreign ownership of companies, corporate tax exemption up to 8 years, duty-free import of capital goods, and no restrictions on capital repatriation (U.S. Department of State, 2015). With the increase of investment in Cambodia market, business environment tends to be more market orient with less regulatory and business barriers. The improvement of market orientation in Cambodia leads to a healthy business environment is according to Table 5.

Table 3: Sizes of enterprises in Cambodia

Details of Enterprises	Total/ average	Micro (1–10)	Small (11–50)	Medium (51–100)	Large over (100)
# of enterprises	505.134	493.544	10.009	800	781
% share of total	100.0	97.7	2.0	0.2	0.1
# of persons engaged	1.673.390	975.980	191.792	53.879	451.739
% share of total	100.0	58.3	11.5	3.2	27.0
Total sales (million USD/month)	293	147	53.2	10	82.8
% share of total	100.0	50.2	18.2	3.4	28.3

Source: Vathana, 2014. p. 3

Table 4: Regulatory criteria for business size in Cambodia

Micro	Statistical employee number	Financial assets excluding land (USD)
Small	11–50	<50,000
Medium	51–100	50,000–250,000
Large	Over 100	250,000–500,000 Over 500,000

Source: (Polsaram et al., 2011). p. 3-2

Table 5: Advantage to business and investment in Cambodia

Openness to foreign investment	Favorable investment incentive and tax regime
Business-friendly government	Abundant of natural resources
Foreign-friendly population	World class tourist cites
Low levels of government red tape	Low cost, young, and energetic workforce
Widespread of use and acceptance of the US dollar	Easy access to larger economies nearby Thailand, Vietnam, and China

Source: (DFDL, 2013)

The increase of investment in Cambodia market facilitates SMEs development by SMEs investments in various economic sectors in Cambodia. In addition, basing on Cambodia Industrial Development Policy, government plans to support SMEs by institutional arrangement and incentives:

- “Encourage the preparation of medium-term plan to nurture the growth of SMEs by way of identifying enterprises with good export potentials, developing new products, linking to multinational corporations, connecting them to the value chain and regional production networks, and preparing concrete action framework to develop them;
- Strengthen the SME development framework and mechanism, focusing on the preparation of registration, and monitoring and tracking the progress of this sector. The objective is to encourage Cambodian enterprises to register in the formal tax regime, thus allowing the Royal Government to have accurate information about the sector so that it can initiate proper supporting policies to enable better access to credit information and other businesses advise to grow their business and investment;
- Strengthen the single-window mechanism for registering SMEs by way of using their registration and account ledgers as the basis for evaluating and determining criteria for providing incentives and receiving support from the Royal Government (Cambodia Government, 2015).”

The SMEs development was also based on the legal specification on market economy. The article 56 of the Cambodian Constitution 1993 stipulates that Cambodia must implement a market economy system. Furthermore, the article 61 of the constitution obligates government to promote economic development in all sectors, especially in agriculture, handicrafts, and industries. Furthermore, the SMEs in Cambodia have significant support from law reform in 2005. The Law on Commercial Enterprise was adopted by the National Assembly on April 26, 2005, took effect on May 19, 2005 (CDC, 2017). The Law on Commercial Enterprise becomes the primary and comprehensive enterprise law in Cambodia. This law governs the partnership entity, limited company, and public limited company. The law covers both local and foreign business. The Law on Commercial Enterprises is considered as a modernization of regulatory framework for business enterprises. The law contributes to the development on commercial regulation and registration. Trading and services businesses are under commercial regulation and registration (CDC, 2017). The regulation and registration become legal tools to standardize all business entities in Cambodia. Thus, government policy and regulatory framework in Cambodia are set up as to ensure SMEs development under open and liberalized economy.

3. Regulatory and Business Challenges for SMEs in Cambodia

In the previous part, the paper displays that SMEs development stems from favorable business environments and on favorable regulatory frameworks. However, in practical, the SMEs do find challenges from the regulatory framework and business environments. The challenges are based on finding from field study and in-depth interview in Cambodia. The field study and interview in Phnom Penh were conducted during June 22–24, 2016 and November 24–28, 2016. The information gathered from the field study and the in-depth interview shows that SMEs in Cambodia do find difficulty in doing businesses. The difficulty is from the lack of government support, shortage of financial support, and lack of clear regulation.

3.1. Lack of government support (Business Expert, 2016)

While there are various regulatory reforms as to support SMEs growth and to stimulate open market economy, Cambodia government lacks of practical support to SMEs. Basing on field study and in-depth interview in Phnom Penh, various SMEs feel that government does not support them to develop their business in market economy. SMEs mentioned that one of the reasons that government does not have practical support to SMEs is because government is lack of budget and knowledge in business development. SMEs have to survive in business without government support. The government, while aiming to expand SMEs in Cambodia economy, does not have solid mechanism or national

plan for SMEs. SMEs have to work on their own way and some have to face various difficulties for implementation of some government policy on business.

Government tends to pay attention to large businesses and industries that based on foreign investment. Start-up business or SMEs do not have much care from government. The example is that when the start-up business would like to acquire know how about business. Government does not provide any support on know how regarding to how to sustain in business. Even, SMEs aiming to develop their business, the SMEs still lack of plan and strategy for market challenge. The example is that the SMEs can obtain franchise business from overseas but with a lack of skill and know-how support, the SMEs are not able to run the franchise business. In contrast, the large business that does not require any development or know how from government seems to have significant favorable support from various government policies and implementations. Thus, SMEs are in lack of government support for developing their business in Cambodia economy.

3.2. Shortage of financial support (Business Expert, 2016)

By the field study and in-depth interview, Cambodia financial system primarily based on cash investments. All business sectors prefer to use cash as means for trade exchange. The US dollars generally used as means for investments while the government aims to increase the use and surplus of Cambodia Riel for investment. SMEs find advantage of cash system that they can earn cash from their daily trade. However, the SMEs do have to pay cash to their suppliers too. With the cash as a main means of investment, SMEs have to save a significant amount of money in case they need to expand their business. SMEs have to save their significant amount of cash to buy buildings or automobiles for their expanding business. The Cambodia government does not have budget to support short-term or long-term loan to SMEs. It is due to the fact that the government still relies on foreign aid and loan to sustain the government spending. Thus, SMEs do not have direct financial support from government. As to maintain in market, SMEs have to work on their own way to be efficient in cash and lack of financial support.

In addition, the SMEs do not easily acquire loan from banks in Cambodia. It is because SMEs are on cash system with no validated financial track record and SMEs do not have sufficient reliable collateral for loan agreement. SMEs when doing their business by cash on their trade and services do not have proof of their daily, monthly, or yearly financial statements that can display their ability to secure loan from banks in Cambodia. With no solid financial record, banks tend to refuse any request for business loan from SMEs. Furthermore, SMEs do not have reliable collaterals that banks have to consider before approving any loan agreement. It is SMEs that suffer from the lack of loan. When compared with large business decent financial records, SMEs tend to have less financial support from both banks and government.

3.3. Lack of clear regulation (Business Expert, 2016; Legal Expert, 2016)

Having the Law on Commercial Enterprises 2005 help modernized and formalized business enterprises in Cambodia. Some SMEs can gain regulatory benefit from the Law on Commercial Enterprises as they can be registered in the government market system. However, most of SMEs still do not legally register in government system. According to the interview information, the registration of business can be seen in two layers. The first layer is national registration system in which Cambodia government aims to use as a vital control system on all business (Commerce, 2017). The second layer is a registration through the registration/notification with local authorities (Srok/Krong/Khan). Nevertheless, there is legal gap of the registration. The gap is that there is no legal validity whether which national or local registration can be considered as a legal registration. The gap creates a possibility for authority to use authoritative power in a corrupt way. Government officers may make a check to any businesses for business registration. The officers may refer to either the national or local registration. This check contributes to unclear and difficult formality of SMEs in Cambodia. Basing on interview, officer would only see whether there is any registration of business or not.

If the SMEs can display the proof of any registration to the officers would be satisfied with the proof. However, in many cases, whether having any registration or not SMEs will choose to pay a

corruption money as to finish the check from the officers. Most of SMEs are not aware of registration and do their business without making registration. The SMEs then become an unregistered business and become opportunities for corrupt officers. In addition, according to interview from business person, even the SMEs would like to make a legal registration, the SMEs would have to facilitate the process by pay some money to officers. Alternatively, SMEs must have connection with officers to fasten the registration approval. The SMEs find difficulty to legally do businesses and they may have to conform with a corruption process with government officers. From interview information, SMEs are prone to officers' inspection from various government authorities. The officers come a check on business sites basing on their authoritative power. The officer check ends up by that SMEs have to pay the bribe to the officers.

Thus, the main challenge of regulatory and business environments is based on three main aspects of the lack of government support, shortage of financial support, and lack of clear regulation. Nevertheless, there are other challenges to SMEs in Cambodia including unfair competition in a fragmented market, poor infrastructure, and gaps in the financial infrastructure (Ung and Hay, 2010). With regard to all the mentioned challenges, SMEs may find difficulty to survive or to develop themselves in Cambodia growing economy.

4. Conclusion and Suggestion Regarding to SMEs Development in Cambodia

The paper displays that Cambodia is a fast-growing country with a development of economic condition toward open and liberalization for investments. The paper shows also that there are favorable regulatory frameworks and business environments that help stimulate prosperity of SMEs in Cambodia. Cambodia government has set up policies which support the SMEs and has reform regulation as to ensure open condition to businesses. Nevertheless, in reality, the paper points out that SMEs have to face with major challenges on lack of government support, shortage of financial support, and lack of unclear regulation. The challenges thus create a potential difficulty to SMEs in Cambodia economy. Therefore, the paper recommends that there must be a reform on aspects:

- Government law and policy providing specific support to SMEs: It is important that Cambodian government should establish solid policy and implementation that can especially support SMEs growth. The example is that there must be an adoption of SMEs promotion law and policy that can be vital government mechanism for promoting SMEs. The example is from Malaysia and Thailand that have their specific law and policy that enables the governments to directly support SMEs. In Malaysia, government set up SMEs promotion policy by establishment of SME Corporation Malaysia (SME Corp. Malaysia) as the agency under the Ministry of International Trade and Industry Malaysia (SME Corp. Malaysia, 2017). The SME Corp. Malaysia has an important duty to formulate overall policies and strategies for SMEs and to coordinate the implementation of SME development programmers across all business sectors (SME Corp. Malaysia, 2017). In Thailand, specific SMEs Promotion Act, B.E. 2543 (2000) has been adopted as to institute SMEs Promotion Commission and the office of SMEs Promotion Commission. The commission and office then become a cohort agency for set-up regulations and policies as to support SMEs in Thailand. Basing on the work of SMEs promotion by the regulation of SMEs Promotion Act, the SMEs in Thailand have been expanded and improved rapidly. Thus, when considering to SMEs in Cambodia, the government should make sure that it has in place law specific law and policy supporting SMEs.
- Financial suitability and support to SMEs: There should also be a development and reform on financial sector that ensures the benefit to SMEs. As mentioned that SMEs are primarily rely on cash investments, the financial suitability should be adopted to promote SMEs in Cambodia. For instance, Thailand has established the Thai SMEs bank which specifically supports SMEs finance (SMEs Bank of Thailand, 2017). SMEs can rely on financial help and products from the Thai SMEs banks. Thai SMEs become a key financial supporter to SMEs expansion and developments in all business sectors (SMEs Bank of Thailand, 2017). Thus, there should be an establishment of financial institution that can provide specific help to SMEs in Cambodia. The institution should also rethink about financial products that serve the direct SMEs' financial needs in Cambodia. The

financial institution should make sure that it can serve the increase of SMEs' cash investment and expansion in Cambodia.

- Clearer regulation for SMEs: Any unclear regulation and legal burdens to SMEs in Cambodia should be reformed and streamlined (Baily, 2008). The registration system whether national or provincial systems should be harmonized as to create unifies registration system for SMEs. The unified registration system would provide clearer regulatory framework for SMEs as well as tackle with corruption problems. Moreover, any authoritative power of officers that may hamper SMEs business should be scrutinized and reformed. For instance, any authoritative exercise from officers toward SMEs should be checked. SMEs should be able to request for clearer explanation as well as able to appeal to officers' decision. Thus, the reform and remove of unclear regulation would create a business confidence for SMEs in Cambodia.

All in all, the paper points out that there is a bright future of SMEs development in Cambodia. However, there must be a move forward as to dealing with those major challenges. Furthermore, the deep down research on the main challenges is needed. The deeper research would provide better understanding on the challenges and give better solution for the challenges.

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