



Analysis of the business environment in Least Developed Countries

Cambodia

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Cambodia

Region
Southeast Asia

Population (2021)
16 589 023

Demographic growth
1.2%

Average income (2020)
1,625 USD

Human Development Index:

With improvements in income, health and education, the country's HDI increased by 56.9% in 2022, reaching the medium human development category and putting Cambodia at 146 among 191 countries.

Regional economic community

Regional Comprehensive Economic Partnership, Cambodia-China Free Trade Agreement

Economic overview

Cambodia is an open market economy with excellent economic growth over the past decade. From 2014 to 2019 (excluding 2020 and the effects of Covid-19), Cambodia's GDP growth rate has been stable at 6.8 per cent to 7.5 per cent and is expected to continue at the same rate in 2022. The country, however, remains one of the poorest in Asia. Cambodia relies on foreign aid, with donor support totalling approximately 25 per cent of the government's budget. Despite the strong performance of the garment, tourism, construction, and real estate sectors, Cambodia remains an agrarian country.



Eighty per cent of Cambodia's population resides in rural areas, and around 37 per cent of the total workforce was directly engaged in the agriculture sector in 2017. As a matter of policy, the Cambodian government encourages investment in agriculture, diversification of agricultural products, and investment in improved irrigation and water control. The government's Industrial Development Policy 2015-2025, launched in 2015, included reducing logistics and electricity costs in food processing. The prospects for non-agricultural employment will depend upon greater investments in export upgrading and manufactured product diversification.

The rapid growth of the garment sector, which transformed the country's export basket in a relatively short period, has resulted in a high degree of product and market concentration. Rapid concentration

in garments is explained by the nature of the first Free Trade Agreements signed by Cambodia and its comparative advantage in low-wage assembly, and its openness to capital flows. Most of Cambodia's garment export items are targeted at the low-quality/low-price segment of the U.S. market, with negligible diversification within garments.

Cambodia's large-scale agricultural workforce makes it important to foster linkages between small landholders and large-scale agricultural farms or corporations to ensure the development of agro-processing industries, increase the amount of high-value-added exports, and accelerate agroindustry growth. However, the most critical source of job creation and long-term economic growth will come from Cambodia's industrialisation, with new industries and manufacturing breaking into new

markets with high-value-added products, including consumer products and production equipment. The industrial and services sectors are where most of Cambodia's jobs and better-quality jobs would likely be created. This, in turn, opens important public policy questions for Cambodia around cluster development within the national business environment.

The tourism industry in Cambodia has matured quickly over the past few years due to political and economic stability and a dramatic increase in the number of Chinese tourists to Cambodia. According to press reports, the number of foreign arrivals reached 6.2 million in 2018, bolstered by a significant increase in Chinese tourists. Most tourists are attracted to the historical/cultural complex of Angkor Wat, but an increasing number of tourists also visit the beaches in the southern town of Sihanoukville. In 2018, annual revenue generated from the sector was estimated to reach \$4 billion.

Challenges faced by the private sector

- **Limited access and high-energy costs:** Electricity prices in Cambodia are among the most expensive in the region due to a shortage of integrated high-voltage transmission systems and the high cost of imported diesel fuel. Power in provincial cities is more expensive and less reliable than the supply in Phnom Penh. In very remote rural areas, the only source of electricity may be a small portable generator. However, the government of Cambodia has set a goal of electrifying all villages and connecting at least 70 per cent of all households to grid-quality electricity by 2030.
- **Poor road infrastructure:** Transportation in Cambodia takes place predominantly by road, with significant urban-rural gaps in terms of road accessibility. About 75 per cent of the road network comprises rural roads, of which only 5 per cent are paved. Limited access to all-weather roads negatively affects food value chains and access to health, education, and other public services, a problem exacerbated by frequent flooding. Greater and more resilient road

connectivity is needed to support sustainable development.

- **Under-developed human capital:** Local companies experience the challenge of finding well-qualified employees, particularly for technical positions or those requiring vocational skills. The private sector report that the need for quality human resources far outstrips supply, and the lack of well-trained workers is one of the main barriers to business growth and competitiveness. According to the world bank, the fractions of the population with no schooling and primary education are projected to be 23 per cent and 49 per cent, respectively, by 2050. Technical and vocational education and training (TVET) enrolment as a percentage of secondary enrolment is just 2.3 per cent, and tertiary, gross enrolment rates are the lowest in ASEAN after Myanmar. A 2011 ILO survey indicated that 73 per cent of employers feel that Cambodia's university graduates do not have the right skills, and more than 62 per cent of employers also noted that vocational training graduates do not have the right skills¹.
- **Limited innovation and investment in research and development:** According to the Global Innovation Index (GII), Cambodia ranked 95th out of 128 countries in 2016. Limited ICT adoption and low tertiary education attainment are key constraints to innovating.
- **Large Informal sector:** Cambodia's private sector is dominated by small informal enterprises and only a few large, modern businesses. Burdensome formalisation processes may be one of the explanations for the 'missing middle' segment of businesses, which would be key to productivity improvements and job creation since many firms may opt to remain 'small'. **Some of the major difficulties in the business environment include the time, costs and procedures associated with starting a business which dissuades formalisation.**
- **Corruption impedes private sector development:** Informal gifts or informal fees are

¹ <https://documents1.worldbank.org/curated/en/620151496155751423/pdf/115189-replacement-PUBLIC-SCD-Cambodia-web.pdf>

common in public transactions, meetings with tax officials, construction permits, and electrical and water connection. Corrupt practices occur through the acceleration of approvals, licenses, and other paperwork required for investment. Lack of transparency in handling dealings between the public and private sectors is a source of frustration that hindered making existing markets more efficient and creating new markets. The consequence is the formation of inefficient systems and the passing down of higher costs to consumers.



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- **Limited access to finance is a significant constraint to MSMEs' growth and development.** A large proportion of MSMEs cannot access finance due to collateral burden, high cost of finance (interest rates) and inability to meet the legal requirements by financial institutions for accessing loans. Due to gaps in information and a lack of access to long-term bank loans or equity, ensuring investment and growth has been challenging for MSMEs. This eventually increases the cost of production and the ability to scale.
- **Challenges to diversifying and increasing value in tourism:** They include Insufficient infrastructure beyond the main tourism enclaves, limited human capital availability, and declining price competitiveness. The inadequate transport infrastructure and poor environmental services hold back sustainable and more inclusive tourism growth, as many secondary destinations are unable to attract private investment. This discourages visitors from venturing off the beaten track, driving the imbalanced growth around Siem Reap and Phnom Penh.

- Despite recent efforts toward higher value addition, productivity in Cambodia's garment sector is still lower than in most structural peers. While labour productivity for the median manufacturing firm in Cambodia is better than in most comparator countries (except for the Philippines and Viet Nam), Cambodia's relatively low labour productivity is a result of low capital intensity and the fact that investors in the garment industry use Cambodia mainly as an export platform for low-cost, low-productivity production.
- With the limited application of the Sanitary and Phyto-Sanitary measure, a significant number of Cambodian products continue to be excluded from export markets due to poor hygiene in handling or other contaminations.
- Limited enforcement of intellectual property rights sale of counterfeit and pirated products remains a challenge to a vibrant private sector. IPR infringement has led to the loss of business, revenue, reputation and competitive advantage.

Private sector policy recommendations

- The government should engage the private sector in developing initiatives aimed at strengthening the modern services sector as a way for Cambodia to move on from its current labour-intensive, low value-added (assembly) mode of global value chain (GVC) participation. Modern services such as finance, insurance, telecommunications, transport and logistics are critical inputs for manufacturing exports, and an efficient services market is essential to enhance a country's competitiveness. Since services areas like design, marketing, and retailing segment, where the majority of value added are captured within value chains, enhancing the competitiveness of the services sector should be a main priority for upgrading in GVCs.
- **Private sector collaboration with the government is needed to develop a national human capital development framework.** This will help build an informed human development

strategy involving targeted education policies, upskilling the current adult workforce and preparing youth to acquire 21st-century skills.

- Small business owners should be offered training programmes to accelerate skills acquisition by combining financing, formalisation, and training programmes for entrepreneurs.

- Incorporate digital literacy and 21st-century human skills into the school curriculum. Include information and communications technology (ICT) and computer education, including software development, web development and computer programming, as part of the school curriculum and government Technical and Vocational Education and Training (TVET) programmes.

- Companies with organisational capabilities should be directly involved in skill development through industrial placements, dual apprenticeships, and internships, with firms incentivised with rebate or grant models.

- Develop public-private partnerships (PPPs) in TVET to align skill training with labour market needs. Private education providers should be incentivised with targeted funds and partnerships involving levy rebates to restructure the education curriculum and training portfolio in TVET.

- Improve the quality and relevance of higher education and research, mainly in STEM and agriculture, at targeted higher education institutions, and improve sector governance.

Better education opportunities are needed to meet the requirements of employers as they move into higher value-added processes and products.



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- **Support a jobs-intensive, private-sector-led economic growth strategy by:**

- Evaluating and strengthening existing private-sector support programmes, such as the expedited arrears-clearance and VAT-refund efforts and targeted soft loans.

- Enhancing the quality, frequency, and scope of the public-private dialogue.

- Addressing administrative inefficiencies in private-sector regulation and streamlining licensing processes.

- Prioritising public investment in ready-to-invest infrastructure for the manufacturing and tourism sector.

- Boosting pro-poor and growth-enhancing public investment, including cash-for-work projects, while promoting labour-intensive sectors to generate jobs by taking advantage of the quick recovery of domestic demand for consumer goods.

- Facilitating domestic and foreign investment expansion arising from recent bilateral and regional free trade agreements, including the Cambodia-China Free Trade Agreement and Regional Comprehensive Economic Partnership.

- Monitor economic vulnerabilities arising from the prolonged construction and property boom.

- Provide more public support to entrepreneurship and innovation ecosystems.

- **Boost household enterprise productivity by enhancing access to markets.**

The government should engage the private sector in developing initiatives to connect small-scale farmers to lucrative food markets; this provides a powerful means to reduce rural poverty. It should ensure access to market information and provide training so that produce meets the quantity or quality of crops demanded by the market and that farmers can effectively process and market their produce.

- **Establish suitable risk-sharing and mitigation frameworks and long-term financing instruments:** Enhanced semi-formal external finance sources can achieve this by lowering entry costs for providers and users. Government should develop initiatives that support small business associations/incubators and strengthen existing associations to reduce fixed costs associated with training programmes, financing, and other services.



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- **The government should adopt measures to reduce reliance on imported inputs and materials.** This should include additional investments in manufacturing enterprises and government subsidies for machinery to enhance a strong industrial base in Cambodia. Efforts should be made to transition to local raw materials where possible and focus on local value addition, particularly in manufacturing, to reduce dependence on imported goods. The government should consider protecting SMEs by emphasising the use of local content in projects.

- The government should develop a policy that focuses on improving and rehabilitating critical road infrastructure across the country with climate-resilient measures. This will reduce disruption to market access caused by floods and heavy rains, improve road connectivity to tourist sites, and generate jobs for local communities during road construction and maintenance works.
- The government should engage the private sector in implementing priority activities such as the Rural Roads Accessibility Financing Strategy, road safety awareness activities, study on transportation services in rural areas and providing technical assistance for roadside assets preservation and gender mainstreaming actions, capacity building and project management support.
- The government should develop policies to reduce informality in the agricultural sector by providing access to land tenure security, agricultural and social services, and selected infrastructure to small farmers and communities mainly operating in the informal economy.

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