



**KINGDOM OF CAMBODIA
NATION RELIGION KING**

Small and Medium Enterprise Development Framework

**Royal Government of Cambodia
Sub-committee on Small & Medium Enterprises**

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SME DEVELOPMENT FRAMEWORK

Prepared by the

SME Secretariat

On behalf of

SME SUB-COMMITTEE

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ABBREVIATIONS

ABC	–	Association of Banks in Cambodia
ADB	–	Asian Development Bank
BDS	–	business development services
CED	–	Customs and Excise Department
CR	–	credit registry
GDP	–	gross domestic product
IAS	–	international accounting standard
IFC	–	International Finance Corporation
JICA	–	Japan International Cooperation Agency
MEF	–	Ministry of Economy and Finance
MIME	–	Ministry of Industry, Mines, and Energy
MOC	–	Ministry of Commerce
MOJ	–	Ministry of Justice
MOU	–	Memorandum of Understanding
MPDF	–	Mekong Private Sector Development Facility
NAC	–	National Accounting Council
NBC	–	National Bank of Cambodia
NBFI	–	non-bank financial institution
NGO	–	non-government organization
NPRS	–	National Poverty Reduction Strategy
OECD	–	Organization of Economic Cooperation and Development
PPP	–	public private partnership
PPTA	–	Project Preparatory Technical Assistance
SEDP II	–	Second Five Year Socioeconomic Development Plan
SME	–	small and medium enterprises
SNEC	–	Supreme National Economic Council
TCAP	–	Technical Cooperation and Assistance Program
UNDP	–	United Nations Development Program
UNIDO	–	United Nations Industrial Development Organization
USAID	–	United States Agency for International Development
VAT	–	value added tax
WTO	–	World Trade Organization

FOREWORD

The Royal Government of Cambodia clearly recognizes that the creation of an enabling environment for private sector development is a precondition for promoting economic growth, creating employment, reducing poverty, and sustaining economic development. Moreover, in order to assure that Cambodia is able to achieve its goal in developing long-term economic growth, we should not overlook the importance of establishing an appropriate environment so that the private sector can play its role as the **Engine for Growth** through resource mobilization and to create new business models and technologies. It is in this sense that The Royal Government of Cambodia gives high priority to the national rehabilitation and development of infrastructure, both in terms of hardware and software, and continues to strengthen the legal and regulatory framework and enhance institutional capacity to facilitate private business, trade, and investment activities. In Cambodia, this spirit is clearly reflected in the **Rectangular Strategy for Growth, Employment, Equity, and Efficiency** in which small and medium enterprise (SME) development is a very important angle of the Rectangular Strategy governing private sector development and job creation.

On this basis the SME Sub-Committee has been created to formulate the SME Development Framework, which serves as the strategy and comprehensive implementation plan of The Royal Government of Cambodia until 2010. The main objective of this framework is to promote SME development through: (i) improvement of the legal and regulatory framework, (ii) facilitation of SME access to finance, and (iii) coordination of SME support activities linking them with the work and tasks of a number of ministries/institutions. At the same time, the SME Development Framework will play a crucial role in providing the necessary institutional and facilitation mechanism for ministries/institutions via the SME Sub-Committee.

The Royal Government of Cambodia will certainly use the mechanism of the SME Development Framework as a tool for inter-ministerial communication in order to address any obstacles that impede SME development and to improve coordination with donor agencies involved in this sector.

I believe that this is the most effective strategy to address the issues impacting the economy and society. Within this spirit, The Royal Government of Cambodia will make efforts to promote SME development through the improvement of the investment environment and to undertake support activities to build capacity of those enterprises to meet the requirements of increasing market competition.

I would like to thank the Asian Development Bank for its support in the preparation of SME Development Framework and the commitment to provide support for its implementation through the SME Development Program in Cambodia. In fact, this Program is very important in helping The Royal Government of Cambodia to undertake the necessary legal and regulatory reform process to improve the business environment and to increase access of SMEs to long-term finance at reasonable interest rates. I would also like to express my thanks to the other development partners who participated in the preparation of this document and look forward to their future cooperation in supporting further the development of SMEs.

Undoubtedly, we will face challenges on the path toward achieving effective implementation of this strategy and action plan. Despite this The Royal Government of Cambodia takes the position of ownership for implementation of the reform program specified in this SME Development Framework.

Phnom Penh, July 29, 2005

Prime Minister

Signed by **Hun Sen**

PREFACE

The private sector is the key to the development of Cambodia and is the main reason for the rapid economic growth experienced in recent years. In particular, industrial sector growth has fueled economic development and now accounts for almost 30% of total GDP, twice the ratio it accounted for in 1995. While much of this growth is accounted for by the rapid expansion of the garment industry, an important aspect has also been the development of small and medium enterprises (SMEs), which make up approximately 99 percent of all enterprises and almost half of all employment.

The Royal Government of Cambodia has emphasized the important role SMEs play in economic growth and poverty reduction in its Second Socio-Economic Development Plan and National Poverty Reduction Strategy. The Prime Minister has also emphasized the importance of SMEs as part of the Government's 'Rectangular Strategy' for economic development. This strategy emphasizes the importance of improving SME access to medium and long-term finance, streamlining licensing and registration procedures to reduce bureaucratic red tape, improving market access for SMEs through better trade facilitation, the reduction of smuggling and support for building linkages between SMEs and larger enterprises. Other strategies include support for building capacity of SMEs through training and other measures to enhance productivity and improve quality of production.

A key factor in strengthening the SME sector is to reduce the cost of doing business. Cambodia is facing tough competition from neighboring countries, which have lower cost business environments as a result of better infrastructure, a better trained labor force and lower costs related to bureaucratic red tape. As Cambodia becomes more integrated with international markets through accession to the World Trade Organization, it will be vital for SMEs to become more competitive and to better integrate into both national and international markets.

The SME Development Framework is an important tool to address these issues through its emphasis on the establishment of an enabling environment for SMEs through legal and regulatory reforms, which reduce the risks and uncertainties that cause high transactions costs. To achieve this task, the Prime Minister established the inter-Ministerial SME Sub-committee to take the lead for implementing the SME Development Framework. As the Chairman of this inter-Ministerial Sub-committee, I will do my best to make this an effective body for addressing issues affecting the business environment for SMEs. The SME Sub-committee has established a secretariat to provide an inter-Ministerial coordinating mechanism to implement the SME Development Framework and its 'road map' for promoting SME development.

As part of its responsibilities, the SME Sub-committee will take the lead in establishing a regulatory review process to evaluate the impact of regulations on SMEs and to make recommendations for streamlining licensing and inspection procedures and potentially removing unnecessary or duplicative licenses. The SME Sub-committee will also take the lead in establishing a mechanism for the private sector to appeal decisions made by relevant agencies concerning licensing and inspection. The SME Sub-committee will play an important role in improving the business environment by helping to reduce the cost of doing business.

The Sub-committee will also prepare recommendations for legal and governance reforms to enhance the competitiveness of SMEs by reducing regulatory burdens. This is important for creating an enabling environment to allow SMEs to grow. The Government will use the SME strategy as a means for reducing regulatory burdens on SMEs caused by excessive licensing

and inspection requirements and to assist them to enter the formal sector through simplified registration processes.

The SME Sub-committee has also prepared a set of recommendations related to enabling SME access to finance. SMEs need help to present themselves to banks by improving accounting practices. Improvement of SME financial reporting practices through the provision of guidelines and the effective dissemination of those guidelines will strengthen the ability of SMEs to approach banks and will assist them in strengthening their own management. Recommendations have also been made to establish a credit information sharing system to assist banks in assessing credit risks by making past information about borrowers available to all banks. This will help creditworthy SMEs improve access to finance at a more reasonable cost. The preparation of an enabling legal and regulatory framework necessary to promote leasing as a new financial product in Cambodia is also recommended to improve SME access to medium and long-term finance.

We would like to express our deep gratitude to the Asian Development Bank for its technical assistance to support the preparation of this SME Development Framework, through TA 4179-CAM: Preparing the Cambodia SME Development Program, and for its continuing support through the SME Development Program Loan. The program will help to support implementation of the strategies laid out in this document by addressing reforms and policies to support SMEs through the coordinated efforts of all concerned Ministries as well as through the assistance of the donor community.

Although the implementation of the SME Development Framework poses great challenges for Government policy makers and will require the concerted efforts of several implementing agencies, the Government has made a commitment through this SME Development Framework to take ownership of the reform process and to work with donors and the private sector to achieve the vision set out in the document.

Signed by Keat Chhon
Senior Minister
Ministry of Economy and Finance
Chairman of Steering Committee
on Private Sector Development

Signed by Suy Sem
Minister
Ministry of Industry, Mines and Energy
Chairman of the SME Sub-committee

EXECUTIVE SUMMARY

The Government has embarked on an ambitious program of development and reform to meet the needs of its people. A primary goal is reducing the incidence of poverty. In the fight against poverty, the Government recognizes that small and medium enterprises (SMEs) play a significant role in promoting economic development and creating sustainable employment and incomes. Therefore, the SME Development Framework has been developed to improve and coordinate the Government's efforts in promoting SME activity in a market economy. In doing so, it incorporates and elaborates the Government's key SME policies including those set out in the July 2004 'Rectangular Strategy.'

The SME Development Framework is intended to serve the Government as a road map for the development of the SME sector. In doing so it should be seen as a 'living document' which will be amended as conditions faced by SMEs and capacity in the Government to deliver services changes. The Framework also provides a focal point around which government and donor discussions and activities can be coordinated.

The SME Development Framework is divided into five interrelated Chapters and one Appendix. Chapters one and two provide background information and identify the major issues faced by SMEs. Chapter three provides the policy context and institutional structure for the SME Development Framework. Chapters four and five set out a strategy for dealing with each of the major issues identified. It divides the strategy into two phases and by issues. The Appendix provides a summary road map of actions needed to be taken.

Despite the lack of information, it is possible to recognize that Cambodia is dominated by SMEs and the largest numbers of these are found in the rural sector. Moreover, the lack of a formal definition for SMEs has hampered policy development and data collection. Therefore, a formal definition based on employment is proposed.

An analysis of the SME sector shows that the major obstacles for its development relate first, to an inadequate legal and regulatory framework. Thus, many of the necessary institutions, laws and regulations needed for an efficient private sector are currently missing or being developed. Furthermore, some of the existing institutions and regulations need reforming to improve the enabling environment for businesses. Second, there is limited access to finance. The primary cause for poor access to finance relates to the lack of suitable collateral, uncertain land titles, the lack of a comprehensive legal framework and poor contract enforcement, as well as, to a lack of diversity in financial institutions. Third, there is a lack of support services in the form of private sector business development services (BDS) or the provision of public goods and services.

Given these constraints, the Framework sets out a vision for the SME Sub-Committee that promotes a conducive business environment, which will lead to a competitive SME sector, contribute to the creation of quality employment and improve the range of goods and services available to the people of Cambodia. The vision is to be implemented through market based solutions that draw on the experience of other countries, particularly those in the region facing similar problems.

In order to give effect to the vision and the strategy, an inter-Ministerial SME Sub-Committee with private sector representation has been established. The SME Sub-Committee has a secretariat located in MIME to support its functions and coordinate activities. The implementation of the road map will also require the government to coordinate with donors as well as support the development of, and coordinate with, business associations.

In order to implement the Government's 'Rectangular Strategy' and achieve a conducive business environment, the SME Development Framework focuses on three key areas (i) regulatory and legal framework, (ii) access to finance, and (iii) SME support activities. Several issues are identified and discussed within each of these three key areas. The discussion includes background information and the constraints and objectives faced by SMEs. For each sub-topic, the discussion then shifts to actions to be taken in two phases (Phase I: 2005-07 and Phase II: 2008-10).

In regard to the regulatory and legal framework, a significant issue is the need for streamlining and reducing the cost of company registration. Currently, it represents one of the highest cost and time consumption in the region. A second priority is establishing a regulatory review process and recourse mechanism. This would focus on the numerous and overlapping number of licenses issued by most Ministries and imposing a severe burden on SMEs. Third, the need for establishing a commercial legal framework is highlighted as an important part of the strategy. In mid 2005 the commercial legal framework still remains incomplete.

The second key area in the strategy is improving access to finance. Access to finance is a critical issue for all businesses and remains a particular problem for SMEs. Among the issues the strategy addresses are: (i) collateral and land titling; (ii) leasing; (iii) credit information sharing; (iv) simplified accounting for SMEs; and (v) non-bank financial institutions. Addressing these issues is seen as critical for improving SMEs access to credit.

Finally, the third key area is improving support activities for SMEs. In the delivery of support services, there is a role for the Government to play in addition to that played by the private sector. Where public goods and services are involved or there is market failure, the Government should take the initiative, either by itself or in partnership with the private sector. Where BDS markets do not exist there is a role for the SME Sub-Committee to work with donors and business associations to stimulate demand and develop private sector supply. In particular, support activities should focus on improving access to markets, upgrading of technology and human resources and on developing linkages.

The SME Development Framework will require significant effort by the SME Sub-Committee and its secretariat. It will also require the cooperation and coordination of donors, business associations and other stakeholders. Moreover, the SME Development Framework should be periodically reviewed and revised to reflect changing conditions and priorities for Cambodian SMEs.

I. INTRODUCTION

1. The small and medium enterprise (SME) sector (which includes micro-enterprises in rural areas) dominates Cambodia's economy in terms of the number of firms (99%) and employment (45%). Despite the size and significance of the SME sector, Cambodia's small scale entrepreneurs continue to face many problems. These problems have already been well documented in many reports, including both the World Bank's Investment Climate Assessment and Asian Development Bank's (ADB) Private Sector Assessment. The ADB and World Bank reports identified a similar set of constraints facing the private sector and SMEs, including poor governance, rule of law and regulation. Other constraints identified include poorly developed markets, low productivity and limited access to finance.

2. Whilst recognizing that the SME sector remains one of the core engines of economic growth, the Government has until recently been unable to establish a framework for its development. The Government's July 2004 'Rectangular Strategy' has identified thirteen 'policies' for the development of SMEs, but these have not been operationalised or incorporated into actions. As a consequence, various agencies and line ministries are developing their own SME programs, which are at times redundant and even contradictory. There is a danger that the absence of an SME development framework may lead various agencies and line Ministries to implement distorting policies for SMEs.

3. Thus, this document, guided by the thirteen SME 'policies' listed in the 'Rectangular Strategy', sets out a national SME Development Framework for Cambodia. It identifies issues critical for SMEs and sets priorities. It also identifies cross-ministerial and institutional issues to be addressed. The SME Development Framework will allow a coordinated effort to be made in enhancing the business environment for SMEs. The Framework addresses an identified need and builds on the Prime Minister's establishment of an SME Sub-Committee and responds to need of the Government for an SME development strategy. The SME Development Framework provides direction and a set of priorities for the SME Sub-Committee and Ministries, as well as for private public partnerships (PPP) and donor interventions.

4. The SME strategy developed here is a medium-term strategy with two phases. In the first phase (from 2005 to 2007) the emphasis is on establishing a framework for an enabling environment for SME development. Once this has been achieved, the second phase (from 2008 to 2010) will enhance and expand the framework for an enabling environment. Further items are identified for future consideration and aimed at fostering greater competitiveness of SMEs through better integration into the global economy.

5. Issues outside the scope of the SME Sub-Committee's agenda are not covered in the SME Development Framework. Such issues as infrastructure, telecommunication, basic education and issues related to macroeconomic policy, to name but a few, while crucial for a vibrant SME sector and the economy as a whole, fall outside the scope of this framework. While mention is made of these broader and crucial topics, it is assumed that these are being addressed by the Government through its poverty reduction strategy and socioeconomic development plan, as well as through the World Trade Organization (WTO) accession plan. The SME Development Framework is primarily intended as a working document for the Government.

6. The SME Development Framework is organized into five Chapters and one Appendix. Chapter two provides background information and identifies the major issues faced by SMEs. Particular importance is given in this Chapter to the need for policy coordination across Ministries. Chapter three follows with a discussion of the overall vision for the strategy, the broader policy context and institutional arrangement for implementation.

7. Chapter four represents the detailed SME strategy of the SME Development Framework. Here, a two-phase action strategy is discussed for the previously identified issues. The strategy covers the three broad themes of regulatory/legal framework, access to finance and support services. The implementation of the strategy is the responsibility of the SME Sub-Committee. Chapter five covers several important implementation matters, including the need for a regular review, donor coordination and capacity building and funding for the strategy.

8. Finally, the objectives and actions to be taken are summarized in a table format in Appendix 1, creating a "road map" which allows the reader to see at a glance the broad categories, objectives and proposed actions to be taken. Together, the five Chapters and Appendix form the Government's SME Development Framework.

II. ISSUES AND CHALLENGES

9. Cambodia is at the crossroads of economic development. Development is taking place in an increasingly competitive regional and international marketplace, making it imperative that SME issues and challenges are successfully identified and addressed. Given that the economy is dominated by SMEs (including micro enterprises), the future development strategy of the country must take into account the SME sector so that its rapid growth and transformation will result in increased productive employment and reductions in poverty. This chapter provides a brief background to the sector and identifies the issues and challenges facing the country's SME sector.

A. DESCRIPTION OF THE SME SECTOR

10. Cambodia has over five million people, or 36 percent of the population, living below the poverty line, with 90 percent of these found in the rural sector. Over 80 percent of the population lives in rural areas with agriculture accounting for over 70 percent of all employment.¹ In all sectors economic activity is dominated by SMEs. Despite rapid economic growth over the last decade, GDP per capita remains low at \$297. On the United Nations Development Program (UNDP) Human Development Index, Cambodia ranks 130th out of 173 countries.² By most measures, Cambodia remains a poor rural-based economy. Therefore, developing the SME sector should be a fundamental part of any strategy to improve the lives of people in a sustainable manner.

11. Small-scale enterprises dominate economic activity and account for a substantial part of employment.³ The sector is made up mostly of unregistered farmers and agricultural enterprises. Women constitute 52% of the economically active population of which approximately 45% are self-employed, primarily in the informal sector. In 2002, the Ministry of Industry, Mines and Energy (MIME), through its annual survey of industrial enterprises, determined that there were 26,920 small industrial establishments with fewer than 50 employees (see Table 1).⁴ This represents an approximate 11 percent growth in the number of operating establishments since 1999. Food, beverage and tobacco manufacturers represent the largest number of small industrial establishments.

12. It is difficult to estimate the exact number of small enterprises, because there are so many unlicensed industrial establishments. According to MIME data there are a total of 18,639 small rice-milling enterprises of which almost 10,000 have not obtained operating permits and are operating informally. These small rice milling enterprises account for 69 percent of all small industrial establishments and employ over 41,000 people. Food processors account for 80 percent (or 21,568 in number) of all small enterprises. Over 11,000 of them do not have operating permits. There are 1,417 small textile and garment enterprises of which over 90 percent do not have operating permits. These are mostly weaving enterprises and producers of textiles for the handicraft industry.

13. To encourage further growth, the Government's industrial policy is focused on diversifying production away from reliance on a few key sectors, increasing its range of exports and improving productivity. It intends to do this by focusing on: (i) developing labor-intensive industries, such as garment, toys and footwear; (ii) promoting the development of

¹ Statistical Year Book 2003, National Institute of Statistics, Ministry of Planning, Cambodia.

² UNDP Human Development Report 2003, Oxford University Press, New York.

³ Accurate figures are not available. The dominance by small-scale enterprises incorporates economic activity in all three sectors - agriculture, industry and services, and includes household and micro-enterprises.

⁴ Data on small industrial establishments is provided by the Ministry of Industry, Mines and Energy. The Ministry, through its municipal-provincial departments, gathers information on small industrial establishments nationwide, including the number of establishments, capital investment, labor, permit status and output.

agribusiness by strengthening, first, the legal framework for longer-term land management, and second, to provide tax incentives for establishing factories to process agricultural products, such as cotton, jute, sugar, palm oil, cashew nuts, rubber, cassava and fruits; and (iii) developing industries based on processing existing natural resources such as fish, meat, cement production, brick and tile. As part of the industrial strategy, the Government also intends to promote SMEs, micro-enterprises, and handicrafts.

Table 1: Small Industrial Establishments by ISIC, 2002

ISIC Code	ISIC	Number	Total Labor	Average size by labor	Licensed	% Licensed
31	Food, beverages and tobacco	21,568	51,885	2.4	11,069	51.32
32	Textile and wearing apparel and leather industries	1,417	5,463	3.9	132	09.32
33	Wood & wood products	13	29	2.2	9	69.23
34	Paper products, printing & publishing	15	207	13.8	15	100.00
35	Chemicals	275	1,077	3.9	117	42.55
36	Non-metallic mineral products except products of petroleum & coal	757	8,963	11.8	596	78.73
38	Fabricated metal products, machinery and equipment	1,899	5,627	3.0	1,537	80.94
39	Other manufacturing industries	976	3,117	3.2	514	52.66
Total Manufacturing		26,920	76,368	2.8	13,989	51.97

Note: Figures for ISIC 36 licensed establishments were adjusted to compensate for computational errors.
Source: Ministry of Industry, Mines and Energy

14. Over the last decade the macroeconomic performance of the Cambodian economy has been one of strong growth but highly vulnerable to external shocks. This can be explained by Cambodia's relatively small and emerging market economy, which is characterized by a lack of: (i) diversification in economic activity; (ii) functioning institutional structures required for economic activity; and (iii) small fragmented markets.

15. Special mention should be made of the agriculture sector, since it is the largest sector by GDP and employment. In 2002, agriculture accounted for 27.6 percent of GDP share and for over 70 percent of employment.⁵ In order to maximize the benefits from this sector, productivity will need to increase significantly. Currently, agriculture accounts for three-fourths of all employment, yet agro-industry provides less than 1 percent of total employment and accounts for only 3.2 percent of GDP. Thus, there is significant potential in agro-industry for job creation and poverty reduction by increasing the value added to products.

16. The value added per worker in the agro-industry sector is 2.6 times lower than for the dominant export sector - garments.⁶ In comparison to other rural-based economies, it is also lower. For example, Cambodia's value added per agro-industry worker is 4 times lower than Bangladesh and 7 times lower in comparison to Pakistan. These differences indicate possibilities for efficiency gains and growth in agro-industry exports. In addition, the Early Harvest program with China offers SMEs the potential to export nearly 300 products tariff free.

⁵ Cambodia Statistical Year Book 2003 and the Cambodian Development Resource Institute. Service share of GDP excludes 'Taxes on products' and employment figures are for 2001.

⁶ Cambodia: Seizing the Global Opportunity: Investment Climate Assessment & Reform Strategy, World Bank, August 2004.

17. Several studies have been carried out to diagnose and identify other major issues facing Cambodian SMEs.⁷ In discussions held between the government, private sector representatives and donor community, several issues and constraints were identified. Key issues are grouped and analyzed in more detail under the four broad categories of:

- Regulatory and legal framework;
- Access to finance;
- SME support activities; and
- Policy coordination.

18. Before beginning the analysis of the major constraints, mention should be made of the inclusive nature of the SME Development Framework. While reference is primarily made to SMEs, this is not intended to exclude other enterprises that fall outside of a narrow definition. It is recognized that Cambodia is dominated by micro and small enterprises, particularly in the agro-industry sector. The SME Development Framework laid out here is meant to incorporate these enterprises. The primary intention of the Framework is to develop an enabling environment for businesses – all businesses.

B. REGULATORY AND LEGAL FRAMEWORK

19. Several essential elements necessary to allow businesses to function efficiently remain absent from the Cambodian economy. For example, the legal framework has missing key legislation dealing with contracts, bankruptcy and mechanisms for dispute resolution. Legislation for dealing with secured transactions or sharing credit information amongst banks is either inadequate or does not exist. Such missing components raise the cost of doing business. An example of the increased cost in doing business is bank interest rates. Banks charge higher interest rates to cover the greater uncertainty of not having recourse to mechanisms such as a commercial court to enforce contracts.

20. The overall result is that SMEs in Cambodia face a high cost and uncertain business environment. SMEs face a business environment that lacks transparency, is unpredictable and induces high transaction costs. Part of the explanation for this lies in the fact that the country began to move to a market economy in the mid 1980s and only then began to implement major economic reform. Many essential components for an efficient market economy are still missing or are in the process of being implemented.

21. The existing legal framework for supporting SME activity remains weak with many necessary laws still in the drafting process or awaiting approval by the Council of Ministers and parliament. Currently, eight major commercial laws are being considered by the Government, including commercial enterprise, contracts, insolvency, secured transactions, commercial arbitration and commercial court laws. The passage and implementation of these laws will provide further building blocks for the establishment of an enabling business environment for SMEs.

22. A recent World Bank study showed that all enterprises, including SMEs, faced a significant array of barriers to doing business. The study estimated it took 94 days to start a business in Cambodia compared to 2 days in Australia and 52 days in Vietnam.⁸ Under these circumstances many small businesses make an economically rational decision to remain in the informal sector.

⁷ The SME Development Framework has been assisted by ADB TA No. 4030 – CAM: Preparing the Private Sector Assessment for the Kingdom of Cambodia, and PPTA No. 4179 – CAM: Preparing the SME Sector Development Program.

⁸ The figure for starting a business varies somewhat from study to study. For example, the World Bank study Doing Business 2004, has a lower number of days. However, it is generally accepted inside and outside Cambodia that it takes an unnecessarily long time to start a business.

23. Medium-sized enterprises able to access export markets face further bureaucratic hurdles that result in long delays and high levels of uncertainty. On average, an exporter is subject to 16 inspections per year. This is higher than China and equal with Pakistan. Such delays are particularly damaging to an economy reliant on developing a growing and diversified export market to meet the needs of its people.

C. ACCESS TO FINANCE

24. A number of surveys have highlighted the fact that SMEs have very limited access to finance. Local commercial banks provide only 1 percent of working capital and 1.7 percent of investment capital overall. Where lending is provided to SMEs, banks will lend only on the basis of a mortgage over land and buildings, because there is no enabling framework to lend on other forms of collateral and because of the low capacity of banks to assess SME lending. Even though banks have first mortgages over land and buildings, the high-risk lending environment is exacerbated by a very weak court system that makes acting on collateral difficult and in practice continues to make this form of lending very risky. This has resulted in Cambodia having one of the lowest levels of bank intermediation in the region.

25. Cambodia's financial sector is currently under reform. The Government is implementing a Financial Sector Blueprint for 2001 – 2010 to develop the financial sector. As part of the Blueprint and as a requirement for accession to the WTO, the Ministry of Commerce (MOC) has drafted a secured transactions law. The government has also drafted a number of other laws to create an appropriate commercial-legal infrastructure. Over time, the development of both the financial and legal infrastructures will improve SMEs' access to finance.

26. In addition to the initiatives referred to above, a number of gaps in the financial sector infrastructure will need to be addressed to develop a more sustainable system for improving SMEs' access to finance.

D. SME SUPPORT ACTIVITIES

27. Unlicensed and licensed SMEs alike generally have low productivity. Furthermore, in comparison to its key competitors in the international market place, Cambodia has significantly lower rates of productivity. As mentioned, workers and enterprises in Cambodia are less productive than those in China, Pakistan, India and Bangladesh. It has been shown that total factor productivity is 18 percent lower in Cambodia than in India and 24 percent below China. This is primarily due to low labor productivity, which is 65 percent below India and 62 percent behind China.⁹ The data tends to point to the need to raise productivity in the agricultural sector so as to improve its export potential and increase employment potential further up the agro-industry value chain.

28. Training to improve productivity is not readily available to the micro and small enterprise sector, especially training in business management. The experience of the Micro-Enterprise Center at Prey Veng illustrates the difficulties faced by SMEs. Established in 1995, the core of the Center's activities is the provision of short-course skills training in technical (rather than management) skills, with a particular view to establishing graduates in self-employment. After 3 years in operation, however, the percentage of graduates engaged in employment related to their training was 48 percent, and the percentage unemployed was 38 percent. The underlying problem appears to be the relative poverty of the province and the low level of rural economic activity along with the lack of a systematic approach towards identification of enterprise development opportunities.

⁹ Data is drawn from World Bank Investment Climate Surveys for the respective countries.

29. An additional problem is the presence of fragmented markets for goods and services outside the key urban centers. Poor infrastructure and telecommunication result in fragmented markets and poor information about opportunities and market conditions. Despite significant recent investment, the road network remains poor and subject to seasonal conditions, making it difficult for rural based enterprises to export. Similarly, electricity and telecommunication services in Cambodia are expensive compared with its neighbors. For example, line rental for SMEs in Cambodia is seven times more expensive compared to Lao PDR and four times more expensive than Vietnam and Thailand.

30. Relatively few government or private sector support services are available to overcome these problems. A small number of donors work in developing Cambodia's business development service (BDS) market. Some SME programs have been implemented by the donor community, including initiatives by Japan International Cooperation Agency's (JICA), Japan Center for training business managers and entrepreneurs, and the Mekong Private Sector Development Facility's (MPDF) company advisory assistance and SME support services programs, which deliver services to SMEs in the areas of business planning, marketing, quality control and support for e-commerce. However, donor activity in BDS cannot replace the lack of a dynamic support service market for SMEs. Financial and capacity limitations have prevented the Government from assisting SMEs to improve access to markets.

E. POLICY COORDINATION

31. As illustrated above, issues related to SMEs are pervasive and cut across nearly all Government Ministries. All of the more than 25 Government Ministries have policies related to SMEs. Of these policies, some are specifically designed to impact on SMEs while others indirectly affect them. None of the Ministries formally coordinate their SME activities with each other, nor do they take a common approach to dealing with SMEs.

32. The individual mandates of different Ministries dictate their focus and approach. For example, the Ministry of Environment, Ministry of Women Affairs and MOC all have significant numbers of policies that directly impact on SMEs, but each Ministry approaches the issue from their primary concern. Thus, a small-scale garment producer headed by a female entrepreneur faces regulations and policy initiatives from three Ministries (as well as many others), each trying to achieve different outcomes. In the best-case scenario these policy initiatives and regulations will complement each other and have a common approach. However, in a worst-case scenario, it is possible that the three sets of regulations will contradict each other in approach and outcomes. Currently, there is no guarantee the first scenario will be achieved.

33. To ensure SME policy initiatives and regulations by various Ministries take a common approach and complement each other, it is necessary to systematically share information and coordinate policy initiatives across Ministries. Systematic coordination of policy and agreement on a common approach for developing SMEs, will ensure greater efficiency and reduce waste. By establishing the SME Sub-Committee the Government has taken the first step in implementing mechanisms for SME policy coordination. Further steps will be required to ensure SME policy coordination.

III. A VISION FOR THE SME DEVELOPMENT FRAMEWORK

34. The SME Development Framework needs to have a broad vision, which conveys the SME Sub-Committee's overall approach to developing the SME sector, and is based on and guided by the Government's overall policy direction. The Government's overall policy direction is to reduce poverty and achieve sustainable economic growth. Among the documents identifying these policies are the Second Five-Year Socioeconomic development Plan (SEDP II), the National Poverty Reduction Strategy (NPRS), the Financial Sector Blueprint, the Industrial Development Action Plan and the 'Rectangular Strategy'. Therefore, the vision takes as its starting point these policy guidelines, all of which identify the private sector, SMEs and good governance as key elements. Once the vision has been defined, it is operationalised through the 'Rectangular Strategy' and implemented by the SME Sub-Committee. Finally, this section of the SME Development Framework concludes by providing a workable definition for SMEs.

A. THE VISION

35. The vision is for the SME Sub-Committee to create a conducive business environment, which will lead to a competitive SME sector contributing to the creation of quality employment and improve the range of goods and services available to the people of Cambodia.

36. In a small open economy like Cambodia it is vital that enterprises are able to function in an environment that has low transaction costs. Among other things, transaction costs are lowered by having robust institutional structures, an efficient regulatory environment, and efficient and appropriate PPPs.

37. In an ideal market situation SMEs can overcome their fundamental weakness of poor economies of scale. In a competitive environment cooperation and the use of flexible networks and clustering create advantages for SMEs and help to overcome limits to economies of scale. This can be in terms of sharing production processes, supply or distribution networks. A key requirement for this to happen is the existence of a business environment and regulatory framework that promotes competition and cooperation.

38. The Government is primarily responsible for developing and maintaining a business environment and regulatory framework that is conducive to business. Because of their size and in comparison to large corporations, SMEs have less bargaining power when it comes to negotiating their regulatory environment. Moreover, the regulatory burden often impacts more heavily on SMEs because of the indivisibility¹⁰ of government fees, levies and time taken to comply. Unnecessary regulations and costs can significantly raise the transaction cost of doing business. In general, the regulatory environment needs to be transparent, predictable, stable, consistent and timely in implementation. Overall, the economic environment, comprising policies, regulations and institutions needs to engender a climate of trust in which businesses can compete and cooperate.

39. The vision of creating a conducive business environment for SMEs translates into several specific objectives. Implementing the objectives will require the SME Sub-Committee to work closely with the private sector in coordinating, information sharing and problem solving. The four main objectives are:

- (i) Increase entry of SMEs into the formal sector;
- (ii) Implement governance reforms for SMEs;

¹⁰ 'Indivisibility' means that fees are the same whether the enterprise is large or small, so that the impact on small firms is greater.

- (iii) Develop public and government institutions required for an efficient SME sector; and
- (iv) Create mechanisms to foster PPPs.

B. RECTANGULAR STRATEGY

40. In July 2004, at the first cabinet meeting of the new Government's third term in office, the new Rectangular Strategy for Growth, Employment, Equity and Efficiency was announced. The strategy sets the policy agenda for the Government and the National Assembly for the next three years. It emphasizes:

- (i) Promotion of economic growth;
- (ii) Generation of employment for all Cambodian workers;
- (iii) Implementation of the Governance Action Plan; and
- (iv) Enhancing efficiency and effectiveness in order to reduce poverty and achieve sustainable development.

41. The Government's intention is for the 'Rectangular Strategy' to build on and further enhance the implementation of SEDP II (2001-2005) and NPRS. The Council of Ministers will issue a National Strategic Development Plan 2006-2010 for implementing the Government's development vision articulated in the 'rectangular strategy.' All these policies and strategies have as their primary goal the reduction of poverty and the promotion of sustainable development.

42. At the core of the 'Rectangular Strategy' is good governance. Within this framework one of the four strategic 'sides' is identified as private sector development and employment generation. This in turn is broken down into four components of: (i) strengthening the private sector and attracting investment; (ii) creating jobs and improved working conditions; (iii) promoting SMEs; and (iv) ensuring the existence of social safety nets.

43. In the 'Rectangular Strategy' the component for promoting SMEs is further delineated into thirteen 'policies'. The SME Development Framework takes the thirteen SME development policies mentioned in the 'Rectangular Strategy' as its starting point and provides details on how these can be implemented. The strategy outlined in the SME Development Framework focuses on implementation and operationalising these 13 SME development policies of the 'Rectangular Strategy' and in doing so, providing a guide for the SME Sub-Committee. Table 2 below sets out some, though not all, of the specific policies recommended to operationalise the 'Rectangular Strategy'.

Table 2: RECTANGULAR STRATEGY: THIRTEEN POLICIES FOR PROMOTING SMEs

- (i) **Encourage the development of SMEs, especially through the provision of medium and long-term finance.**
 - Establish effective collateral system and land titling.
 - Develop leasing as a financial product and develop credit information sharing for banks to reduce risk.
 - Develop a simplified accounting and taxation system for SMEs to improve financial information.
- (ii) **Suppress smuggling.**
 - Strengthen the capacity of the anti-smuggling task force headed by CED.
 - Rationalize the number of agencies involved at border checkpoints.
 - Extend the Single Window concept to border checkpoints.
- (iii) **Reduce registration procedures and start-up processes for companies.**
 - Reduce administrative and cost barriers in registration by implementing proposed reform plan.
 - Develop on-line registration system and decentralize company registration.
 - Link MOC business registration with MEF tax and VAT registration and merge into one procedure.
- (iv) **Facilitate export-import activities by simplifying procedures such as licensing and letters of permission.**
 - Review all related licenses and introduce a Single Administrative Document for customs.
 - Replace current system with a Single Window process at the ports and introduce a risk management strategy.
 - Enact the Law on Customs and develop implementing regulations.
- (v) **Support for newly established industries for an appropriate period.**
 - Foster private sector led incubator systems for developing new industries and enterprises.
 - Develop a comprehensive program for one-stop window for all relevant business licenses.
- (vi) **Promote linkages between SMEs and large enterprises.**
 - Encourage linkages between local clusters and international organizations.
 - Assist SMEs in clusters to become integrated in global value chains.
- (vii) **Assist SMEs to enhance their productivity and reduce production costs.**
 - Training institutions and donors to develop toolkit packages for training and capacity building in SMEs.
 - Develop an action plan to meet current technology and training needs.
- (viii) **Ensure the quality of domestic products to meet regional and international standards.**
 - Encourage quality standards in SMEs through ISO 9000 certification process.
 - Encourage linkages between training and research institutions and SMEs.
- (ix) **Establish national laboratories to test for quality and criteria of products.**
 - Use existing public research institutions to enhance the capacity for applied research & product quality testing.
 - Strengthen the capacity of research institutions.
 - Foster linkages between the private sector and research institutions.
- (x) **Strengthen mechanism for the protection of industrial intellectual property rights.**
 - Implement the specific institutional arrangement for effective implementation of intellectual property rights.
- (xi) **Promote vocational/skills training, both domestic and overseas.**
 - Promote learning networks, joint international marketing.
 - Coordinate with providers of vocational training to identify needs and develop links with SMEs.
- (xii) **Expand and accelerate the “one village, one product” program.**
 - Carry out a stock taking of clusters, including identifying number, size, product produced and location.
 - In cooperation with donors and associations, develop common service provisions and support for clusters.
- (xiii) **Strengthen the legal framework by creating laws.**
 - Enact draft laws on commercial enterprises, insolvency, secured transactions and contracts.
 - Enact legal framework necessary to create specialized court to resolve commercial disputes.
 - Engage in extensive capacity-building program for the commercial court system.

C. IMPLEMENTATION PROCESS

44. The SME Development Framework draws on recognized best practice in order to create an enabling environment and reduce impediments to doing business. It also provides a 'game plan' and mechanism for coordinating donor activity in the sector. See Part 1 of the Road Map, attached as Appendix 1 to the SME Development Framework.

45. The SME Sub-Committee will develop a small professional secretariat to carry out its role. The secretariat will be situated in the Ministry of Industry, Mines and Energy.

46. The Government, through a Prime Minister Decision (Decision No. 46 SSR dated 11 August 2004) has set up a SME Sub-Committee. The Prime Minister's decision includes the establishment of three Sub-Committees for the development of the private sector. The SME Sub-Committee's membership is as follows:

1. Minister, Ministry of Industry Mines and Energy	Chairman
2. Secretary of State, Ministry of Commerce	Vice-Chairman
3. Secretary of State, Ministry of Agriculture, Forestry and Fisheries	Member
4. Secretary of State, Ministry of Economy and Finance	Member
5. Secretary of State, Ministry of Tourism	Member
6. Secretary of State, Ministry of Women Affairs	Member
7. Secretary of State, Ministry of Labor	Member
8. Secretary of State, Ministry of Rural Development	Member
9. Deputy Secretary General, Council for Development of Cambodia	Member
10. Secretary General, Phnom Penh Chamber of Commerce	Member
11. Director of Small and Medium Industry Department, MIME	Secretary

47. The institutional framework comprises an inter-ministerial SME Sub-Committee with private sector representation and responsibility for implementing the SME Development Framework. The SME Sub-Committee has high-level representation from key Ministries with significant interest related to SMEs. The Sub-Committee also has private sector representation and can, as necessary, invite other ministries or institutions to participate (Article 3).

48. The Prime Minister's Decision establishing the SME Sub-Committee sets out a number of general functions, including:

- (i) Set up necessary measures within the framework of their responsibility in order to implement the policy program and 'Rectangular Strategy' of the Royal Government of Cambodia, particularly on elements related to private sector development.
- (ii) Strengthen implementation of "good governance" for all related areas of work responsibility and private investment.
- (iii) Discuss and exchange ideas with development partners, including donors, investors and business leaders in order to set up an action plan for each area and seek funding sources for encouraging effective implementation and realization of those action plans.
- (iv) Coordinate a discussion in order to determine policy and set up implementation measures within the framework of the three Sub-Committees for Private Sector Development.
- (v) Work in cooperation with sectoral Working Groups of Government Private Sector Forum on related areas.

49. The Prime Minister's Decision also identifies a number of specific functions, including:

- (i) Set up an incentive policy for manufacturing industry for domestic markets or manufacturing industry to substitute the imports in order to respond to the required strategy of establishing more production bases in the country, especially in the era of regionalization and globalization.
- (ii) Set up incentive policy and support for SMEs.
- (iii) Prepare a strategy to increase competitiveness capacity for SMEs.
- (iv) Prepare an action plan, promote and support SMEs as well as follow up and review the implementation.
- (v) Promote the preparation of regulations on the management of SMEs.
- (vi) Implement other roles related to the promotion and support of SMEs.

50. The SME Sub-Committee will have a permanent secretariat that supports it and takes actions on its behalf. The secretariat will consist of a few well qualified and experienced people. It is expected that extensive travel to the provinces will be required by members of the secretariat to consult with regional stakeholders.

51. In addition to the above roles identified for the SME Sub-Committee and its secretariat, there are several other roles it needs to perform that should be highlighted. Among the most important of these functions is to make sure that the SME Development Framework remains up to date. Events change rapidly and the SME Framework needs to reflect the reality faced by SMEs. Thus, there should be a review mechanism put in place to at least bi-annually review and update the road map for SME development.

52. A further significant function that should be highlighted here is the need for the SME Sub-Committee to produce an annual report. The SME Sub-Committee needs to take stock of its achievements and the performance of other agencies in implementing SME policies, evaluate the main issues facing SMEs and identify priority areas for the next 12 months. Such a report will also help to improve transparency in the functioning of the SME Sub-Committee and advertise its role and function to SMEs. Thus, the SME Sub-Committee should submit an annual report on the State of the SME Sector to the Royal Government of Cambodia.

53. The SME Sub-Committee should also encourage participation and dialogue with a wide range of stakeholders, which can help inform it and prioritize issues. It may consider implementing a mechanism for formal and informal consultation to take place with significant groups and institutions. Among the most important bodies with which the SME Sub-Committee should maintain close contact include:

- (i) SME and private sector associations and representative groups;
- (ii) Other Ministries not represented on the SME Sub-Committee; and
- (iii) Women's groups (particularly those representing female entrepreneurs).

54. Finally, the SME Development Framework will need to be implemented through an action plan that sets out priorities and identifies agencies charged with the responsibility to carry out actions. Furthermore, based on the Development Framework, the SME Sub-Committee should coordinate activities with donors.

D. A WORKABLE DEFINITION OF SMEs¹¹

55. Cambodia does not yet have a legal definition of what constitutes an SME. SMEs have been variously defined in terms of either value of fixed assets, size of employment or a combination of the two. While some statistical data has been collected for SMEs, there is

¹¹ There is no single definition of what constitutes an SME in Cambodia. Government ministries and the private sector use various definitions. While there is a scarcity of reliable data, an overview of the sector is possible from using various data sources.

generally a lack of accurate information available. The limited statistical data, compounded by the lack of a definition for SMEs, has led to uncertainty and confusion as to what is an SME. A definition of SMEs is important for collecting statistics, as well as for policy development and implementation purposes.

56. The problem with defining a small industry on the basis of the size of capital is that the cut-off point needs to be revised over time in order to allow for inflation. However, because not all firms revalue their capital in a uniform manner, inconsistencies can also arise. Defining SMEs by the number of employees has also been widely used. This method is usually straightforward, but can also face some problems. Part-time workers and family workers, who function both as manager and worker, create some definitional problems.

57. An additional problem with defining SMEs is that any definition must serve several purposes. At one level, it must define an SME as being conceptually different from large or other sizes. That is, SMEs are assumed to have characteristics (other than their size) that identify them as being different from large enterprises. It is on the basis of having different characteristics and, therefore, different requirements, that a specific SME policy is advocated and can be justified.

58. At a practical level, a definition must be easy to implement in terms of gathering accurate and useful data. At the sectoral level, financial institutions often need different data than national surveys or what is required by government institutions. Such diversity in needs, however, can be overcome by first redefining conceptual differences into notional demarcation between sizes. Further flexibility can be built into the definitions by adopting an official SME definition with an alternative that can be used when necessary. One definition could be based on employment and the other on the size of capital in real terms. A system of using more than one definition is found in many countries, including Thailand, Indonesia and the Philippines. Table 3 sets out the proposed definition for SMEs in Cambodia.

Table 3: A Definition for SMEs

Statistical		
Micro	Less than	10 employees
Small	Between	11-50 employees
Medium	Between	51-100 employees
Large	Over	100 employees
Financial		
Determined by Assets, excluding land		
Micro	Less than	US\$50,000
Small	Between	US\$50-250,000
Medium	Between	US\$250-500,000
Large	Over	US\$500,000

59. For statistical purposes and policy development and implementation, the definition is based on equivalent full-time employees. For other purposes, where the number of employees is not suitable, an alternative financial definition should be used, based on total assets, excluding land (see Table 3 above).

IV. THE DEVELOPMENT FRAMEWORK

60. The Development Framework is described in detail in this part of the report. It draws on the previously described vision and is guided by the 13 policies of the 'Rectangular Strategy'. For each major issue identified, background information is provided before identifying the Government's objective and outlining the actions to be taken during Phase I (2005-2007) and Phase II (2008-2010). Actions for future consideration are also identified.

A. REGULATORY AND LEGAL FRAMEWORK

61. Countries with an effective legal and regulatory framework tend to be more successful in encouraging entrepreneurs to start businesses and are more likely to have vibrant SME sectors, which are flexible enough to respond to the market and are innovative. Such flexibility and innovation require a predictable business environment that allows for simple and low cost market entry and the ability to change direction according to market signals. As such the legal and regulatory environment should encourage entrepreneurs to take risks by minimizing government intervention, which often creates high barriers to entry through overly burdensome regulation. An effective legal and regulatory system should ensure the quality of public and private goods while at the same time minimizing the costs resulting from excessive intervention in SME business operations and the negative impacts of bureaucratic red tape and corruption.

62. In side two of the Government's 'Rectangular Strategy' there are 13 SME 'policies', of which reducing registration procedures and start-up processes for companies is number three (see Table 2). To promote SME development in Cambodia it will be necessary to focus on legal and regulatory reforms to improve the business environment. Many constraints affecting the operations of enterprises are the result of having several ministries involved in licensing and regulatory oversight. SMEs face many inspections from several ministries some of which have overlapping functions. For garment exporters the multiple inspections involved with export processing are of particular concern with as many as three different ministries involved in processing each shipment.

63. The Government has been very active in updating its commercial law framework in large part in response to requirements for accession to the WTO. These reforms focus on putting in place basic elements of the legal framework to support the development of a vibrant market economy and the promotion of trade and investment. To accomplish this task the Government recognizes the importance of developing laws pertaining to commercial enterprises, secured transactions, bankruptcy and contracts and commercial court. The passage of necessary sub-decrees and prakas will provide detailed guidance for implementation. Wide dissemination of information concerning legal and regulatory reforms is needed so that both the public and private sector are well informed of new requirements. Training of government officials is required to assure proper implementation of the legal reforms. Finally, without judicial reform to assure proper enforcement of these laws and regulations, effective implementation of legal reforms will remain a problem. While the Government's efforts to reform the legal framework for the private sector should be applauded, much work remains to assure the reforms achieve their intended result, which is to facilitate private sector development and create an enabling environment for business.

(i) Company Registration

Background

64. Studies by the Asian Development Bank¹² and the World Bank¹³ have shown that the costs of registering a company in Cambodia are amongst the highest in the world. As a result, many firms choose to remain informal since the cost of incorporating outweighs the benefits. Businesses that do choose to register find it necessary to pay for the services of ‘facilitators’ to guide them through the complicated process. A simple and low-cost system is necessary to bring more SMEs into the formal sector and facilitate growth and investment.

65. There is now general agreement by policy makers and development economists that the company registration process should not represent a major barrier to doing business. An ideal situation is where businesses can register quickly and at minimum cost, without needing external assistance. Eventually, registration should be possible through the internet.

66. The enactment of the new draft Law on Commercial Enterprises will have a significant impact on the registration process by establishing clear requirements for minimum capital and for company articles of incorporation, which must be filed with the MOC.¹⁴ The law gives companies the option to adopt separate bylaws conferring particular powers on the company or its directors, which do not have to be filed with the MOC.

Objectives

67. The main purposes of company registration should be to facilitate tax collection and support policymakers with statistical information. Governments can also utilize information obtained from the registration process to create business directories and other mechanisms for the purpose of matching buyers and suppliers. The registration process should not be a barrier to market entry or used by governments to screen applicants to determine the viability or sustainability of the business. Registration must be treated as a right for all entrepreneurs and not as a privilege for a few.

68. Incorporation is beneficial for businesses since it establishes a legal entity that is allowed to pool the resources of shareholders to establish company’s capital. Establishment of a company also provides for limited liability of shareholders, which reduces the risks of doing business so that investors are free to innovate without large negative consequences associated with failure. Registered companies often outlive their founders and have better access to services provided by the court system and commercial banks which are often unavailable to unregistered firms. Registration is important for reducing risk to businesses and improving the likelihood for success.

69. Reforming the registration process will reduce the time and money needed for a business to incorporate and will make the benefits of registering outweigh the costs. Streamlining documentation requirements will lower the number of points of contact with government officials. A simple and transparent system will minimize the need for facilitators and will reduce this major barrier to market entry. Once registered, companies will have better access to markets, financing and investment incentives and will protect businesses from petty graft and corruption. The removal of the minimum capital requirement would also remove a significant barrier to market entry.

¹² Private Sector Assessment of the Kingdom of Cambodia, Ministry of Industry, Mines and Energy and the Asian Development Bank, December 2003.

¹³ Toward a Private Sector Development Strategy: Investment Climate Assessment, World Bank, 2004.

¹⁴ Currently, the company registration process is governed by the Law on Commercial Rules and Registration and Instructional Circular No. 360 on Registration at the MOC, which provides the detailed requirements for registration.

Actions to be taken: Phase I

70. The first phase for strengthening business registration involves reforming the process and upgrading the business registry. The second phase should focus on the implementation of a decentralized registration system, including web-based registration. After the successful completion of the first two phases, items for future consideration may include expansion of registration and the removal of remaining barriers.

71. The registration process should be improved and made more transparent so as to make it easier for entrepreneurs to incorporate their businesses without the need for hiring high cost facilitators. To assist in disseminating information to the public about the procedures and costs involved the MOC will publish a manual on the process and distribute it through various means, including branch offices and on its website. The MOC will reduce registration fees and ensure that information on the costs of registration is made widely available to the public.

72. To reduce red tape and streamline the process, MOC will remove documentation requirements that are not required by the laws governing registration. Pending its passage at the National Assembly, MOC will issue a prakas to implement the Law on Commercial Enterprise and clearly outline the registration process. To simplify documentation requirements, MOC will draft and provide at minimal cost simplified model articles of incorporation. To remove the barrier for small and start-up company registration the MOC should also reduce the minimum capital requirement.

73. Decentralization of the registration to local authorities would significantly lower the cost of registration at the provincial level by removing the need carry out the process in Phnom Penh. MOC should develop procedures for decentralizing registration and establish a pilot program to allow registration at selected local authorities. MOC should develop information and communication infrastructure to guarantee that an accurate national business registry can be maintained.

74. A computerized business registry will create an up-to-date database of enterprises, which will benefit the commercial and financial sector in Cambodia. MOC should develop a computerized database for the business registry and make information accessible through its website. MOC will implement a plan to ensure that companies regularly update their information in the registry through an annual declaration process.

Actions to be taken: Phase II

75. In Phase II the decentralization process will be expanded by widening its pilot decentralization program to more local authorities. MOC will also expand its national database to include sole-proprietors licensed at the provincial level.

76. MOC should begin development of an on-line registration system by establishing the necessary legal and regulatory framework and the detailed operating procedures. On-line registration should speed up the process of registration, reduce the administrative costs for both the government and businesses and ensure transparency in the process by significantly reducing human intervention. After adopting the necessary procedures, MOC should develop information and communication technologies to facilitate on-line registration. MOC should then implement an on-line registration system.

For future consideration

77. Issues for the Government's future consideration may include expanding registration to a wider segment of the economy. Following the example of Singapore, Thailand and other neighboring countries, clear registration requirements should be established to include a broad segment of the economy by setting clear thresholds for firms to register either as sole proprietors or companies. In Singapore there are two laws covering registration, the Company Act and the Enterprise Act. The Company Act governs all companies while the Enterprise Act governs sole proprietors. The definitions of each are very clear and the requirements for registration for each category are outlined in the law. In Thailand the Commercial Registration Act of 1952 requires all companies and entrepreneurs to register while clearly identifying businesses exempt from registration.

78. To streamline inter-ministerial registration and licensing, the MOC should link the registration process to other ministries by automatically registering the company for the tax license and value-added tax (VAT) using the same process and by harmonizing the tax identification number with the registration number. Eventually registration as a new legal entity and tax registration could be merged into one procedure. A single identification number would help to facilitate registration and licensing and facilitate government wide data management.

(ii) Regulatory Review and Recourse Mechanism

Background

79. Government regulations deliver important benefits to the wider community through the achievement of various social and economic objectives. These objectives include protecting the environment from excessive pollution, protecting the public from unsafe buildings, managing risks in the workplace, reducing risks from contaminated food and drugs, controlling the use of natural resources and improving the quality of products and services. The efficiency of enforcement activities also influences the benefits and costs of regulations. However, if regulatory requirements are not managed effectively, the private sector is overburdened resulting in high compliance costs, which hinder business competitiveness and increase costs to consumers. An effective regulatory regime needs to strike a balance between protecting the population and limiting the administrative burden on enterprises.

80. In Cambodia, line ministries are responsible for issuing operating licenses for firms under their jurisdiction and to regulate the quality of goods, sanitation, environment and safety issues. Due to the large number of ministries and jurisdictions involved in the licensing and inspection process, it is important for the Government to achieve a balance between effective regulation and limited burden on enterprises. An inter-ministerial regulatory review process is an important first step in assuring this balance is achieved in a transparent manner.

Objectives

81. Government regulation should be designed to protect public goods and competition, while limiting the economic impacts on the private sector. While it is important to regulate businesses through licensing and inspection, the issuance of licenses and permits should be transparent and unnecessary red tape and unofficial fees should be avoided. By clarifying the roles and responsibilities of Ministries and local government bodies and removing overlapping authorities and responsibilities, enterprises will spend less time and money to obtain licenses and will be better able to comply with regulations. Inter-Ministerial efforts to remove duplication and overlapping responsibilities should simplify licensing requirements and reduce the cost of compliance for the private sector. Improving dissemination of

licensing requirements and procedures would remove some of the uncertainty entrepreneurs face in starting up a new business.

82. Clear guidelines should be developed for government inspections involving written requirements to improve the transparency of inspections and strengthen the rights of business owners. This would remove discretionary decision-making on the part of government officials and would standardize requirements. Improvement of licensing and inspection procedures would also encourage entrepreneurs to invest by reducing uncertainties related to government intervention. An inter-Ministerial regulatory review process focused on reducing the burdens imposed by excessive licensing and inspection requirements will assist in guarding against the tendency for business regulation to increase over time as issues are considered in isolation or without systematic reference to their impact on business costs. Finally, the establishment of a regulatory review process and recourse mechanism for administrative decisions would assist in reducing the burden of regulation on SMEs.

Actions to be taken: Phase I

83. An effective regulatory review process benefits the private sector by providing a systematic and consistent framework to assess the potential impacts arising from government action. The regulatory review process also contributes to greater transparency of Government decision-making and is designed to inform the public and other parts of the Government (as well as the agency conducting the analysis) of the effects of alternative actions. Regulatory analysis will help to determine whether or not a proposed action is misguided or implemented ineffectively. Such analysis can also demonstrate that well-conceived actions are reasonable and justified.

84. The SME Sub-Committee has compiled a comprehensive list of licenses and will select a representative sample to be reviewed by the relevant Ministry in charge through a regulatory impact assessment. The SME Sub-Committee, together with Supreme National Economic Council (SNEC), should review the regulatory impact assessments and make recommendations for ways to streamline paperwork and other requirements as a means for simplifying procedures, improving transparency and reducing costs. In some cases the assessments may recommend the elimination of a license.

85. A licensing review process should also include the establishment of a means of recourse for companies to file grievances regarding disputes resulting from licensing and inspection and to have decisions reviewed. Such a mechanism involves establishing a method of reporting grievances to the government and provides an administrative appeals mechanism through an independent tribunal.

86. To further streamline the licensing process the SME Sub-Committee should prepare a feasibility study for a pilot program to establish a one-stop shop for SMEs to obtain all necessary licenses from relevant Ministries. The Government should implement the pilot program and evaluate the performance of the one-stop shop.

Actions to be taken: Phase II

87. Based on recommendations of the licensing review program, the SME Sub-Committee should lead the effort to streamline redundant licenses, which burden SMEs. The SME Sub-Committee should also carry out a process to simplify procedures for obtaining licenses and create guidelines for inspections. The SME Sub-Committee should also develop rules for ensuring the rights of businesses in the inspection process and implement a recourse mechanism at the ministerial level. This recourse mechanism should include the formation of an independent tribunal to assist in dispute resolution.

88. The Government should expand the one-stop shops in selected provincial capitals for the purpose of assisting SMEs to obtain necessary operating licenses from various relevant ministries. The Government should also consider expanding the program to more provincial capitals and should begin to implement one-stop shops at the district level. To achieve the objective of improving service delivery to SMEs, the Government will need to establish rules and regulations for the operation of the one-stop shops.

(iii) Commercial Legal Framework

Background

89. At present, Cambodia's commercial legal framework is still in the process of development. Enforcement of contracts is hampered by the lack of a strong commercial legal framework and a weak judiciary for enforcing contracts. To remedy this, the Government has committed to the development of a legal framework for contracts and their enforcement as part of its accession to the World Trade Organization and in its recent 'Rectangular Strategy' in which there are thirteen SME 'policies', of which the last concerns the strengthening of the legal framework (see Table 2).

90. Cambodia's Contract Law (Decree 38D), dating back to 1988, covers both contracts between natural persons and between legal entities. The law does not provide a comprehensive basis for commercial transactions. A special judicial mechanism to enable commercial disputes to be efficiently resolved through a commercial court or an arbitration tribunal is also lacking. To strengthen the enforcement of contracts, the MOC is currently drafting a Commercial Contract Law and a Law on the Establishment of a Commercial Court. A Law on Commercial Arbitration has been approved by the Council of Ministers and is currently at the National Assembly.

91. Cambodia lacks a commercial enterprise law to provide a legal framework for the operations of limited companies. A commercial enterprise law has been prepared by the MOC and was submitted to the national assembly in June 2002. In the absence of such a law, company matters such as registration and corporate governance are stipulated under the 1995 Law on Commercial Rules and Registration and under other regulations of the MOC. The draft Law on Commercial Enterprises also establishes an enabling legal framework for partnerships.

92. There is also no legal framework for dealing with insolvent enterprises. An Insolvency Law has been drafted and is currently before the Council of Ministers. It is comprehensive and deals with the insolvency of natural and legal persons. It is noted that the order of priorities for distribution awards first priority to secured claims, but thereafter does not provide any priority for the Tax Department. Furthermore, protection for employees is weak allowing a maximum of only 1.2 million riel (\$300) for back wages. Back wages could easily exceed this limit. There are no provisions for other employee claims such as medical, leave or redundancy allowances.

93. A civil code is required to establish a legal framework for the capacity of persons, juristic persons, ownership rights, contracts, special kinds of contracts and personal relationships. The Ministry of Justice (MOJ), with the support of JICA, submitted to the Council of Ministers a draft civil code of Cambodia in June 2003. A civil proceedings code has also been prepared. The civil code's chapters include provisions dealing with natural persons, juristic persons, partnerships, ownership, general principles of contract, assignment of claims, and a range of specific contracts, including contracts of sale, lease, employment, loans and security. To assure clarity in the commercial legal framework, it is necessary to harmonize the provisions of the various commercial laws with the civil code and the code of

civil procedures to remove any contradictions that would impede effective enforcement of the laws. Where different laws deal with the same subject, ambiguity is created leading to a less predictable environment.

Objectives

94. To underpin SME development a basic legal infrastructure needs to be in place to establish the operational framework for companies and partnerships, establish an insolvency regime to protect creditors' rights, employees and the Government and create a consistent and transparent legal framework for commercial transactions. Legal and judicial reforms would assist in strengthening enforcement of contracts and would facilitate SME access to financing by improving the ability of banks to pledge and seize collateral necessary to secure loans. A comprehensive civil code, civil proceedings code and commercial contract law will strengthen the business environment as will the adoption of an anti-corruption law.

95. Strengthening the rule of law in Cambodia will have a significant impact on private sector development by creating a more predictable business environment. Reducing the need for long and expensive court proceedings to resolve commercial disputes is an effective means for improving enforcement of contracts. Implementation of the Law on Commercial Arbitration would facilitate the impartial and prompt resolution of economic disputes while at the same time safeguarding the legal rights and interests of the parties involved. The establishment of a commercial court would create a specialized chamber allowing for intensive training of a small group of judges in commercial law and enabling capacity building within the judiciary to move more quickly and efficiently. Cambodian judges require intensive, comprehensive training not only to strengthen their basic skills in legal reasoning, drafting, and research but also to address key areas of law, for example, related to contracts or secured transactions. Improved salaries for judges would help remove incentives for corrupt behavior.

Actions to be taken: Phase I

96. The SME Sub-Committee should work with the MOJ and appropriate government authorities to remove inconsistencies between laws that comprise the commercial legal framework, improve the laws where necessary, and enact the laws with implementing regulations. In addition, MOC and MOJ should create an awareness of the enabling legal framework amongst interested persons, such as SMEs, banks, lawyers, accountants and business associations. Strengthening the capacity of the judicial system is another important step. The Government also needs to address corruption, which significantly weakens the enforcement of laws.

97. Enactment of the draft laws required to establish the commercial legal framework is necessary to meet the requirements under WTO accession. During this phase the SME Sub-Committee should work with the MOC to ensure enactment of the major commercial laws and prepare necessary implementing regulations that are consistent with the provisions of the laws. The SME Sub-Committee should assist the government in developing a mechanism to determine inconsistencies and conflicts within the various draft laws, especially with the draft civil code and code of civil procedures. Once these have been determined, conflicts should be harmonized by making necessary changes to the relevant draft laws. The Government should only adopt the civil code and code of civil procedures after all efforts have been made to avoid conflicts with other commercial laws.

98. The Government should adopt the draft enterprise law to provide a clear legal framework for the operations of companies and partnerships. The Government should also adopt draft laws on secured transactions and insolvency. Before adopting the draft

insolvency law, changes should be considered to meet international practices concerning the priority of claims.

99. The Government should enact the draft Law on Commercial Contracts to establish the necessary framework for contracts and contract enforcement. This will provide increased clarity for contracts between merchants. As a means for avoiding lengthy court cases related to commercial disputes, it is necessary to create a commercial arbitration process by enacting the Law on Commercial Arbitration. The law will determine the forms of arbitration agreements, composition and jurisdiction of arbitration panels, the conduct of the arbitration proceedings and how awards are made and enforced. Commercial arbitration will help to reduce the cost and time needed to resolve disputes.

100. The Government should enact legislation to establish a specialized commercial court to resolve commercial disputes. Passage of the Law on Judicial Organizations will also be necessary to establish specialized courts. By creating greater specialization in the judicial system, commercial and economic disputes can be resolved more effectively, while enforcement of decisions will be more certain. To enhance the effectiveness of the commercial court, judges will be required to undergo specialized training in business and commercial law. The Government should adopt anti-corruption legislation to enhance the effectiveness of the commercial court and to better ensure transparency and fairness in the system. The judiciary should also adopt of a code of ethics to help build the integrity of judges.

101. All the best intentions of policymakers are meaningless if laws and regulations are not enforced properly. Improving transparency so that everyone knows what the rules are is an important first step in strengthening enforcement. The first step toward improving enforcement of the legal framework is to make sure that the laws and regulations are well known by the public. The Government should widely distribute a regular legal gazette, which includes all laws, sub-decrees and regulations affecting the private sector. To further improve the dissemination of legal information, the Government should establish a website dedicated to providing laws, sub-decrees and regulations so that all information is located in one place and that one agency is responsible for the content.

Actions to be taken: Phase II

102. Strengthening legal education at the Faculty of Law and other institutions is crucial to increasing the future supply of well-trained lawyers. Given the current levels of education among judges and prosecutors, long-term legal training is needed to improve the performance of the judiciary. Judges will need targeted, intensive training in commercial and business-related law, particularly as more complex commercial laws on enterprises, bankruptcy, secured transactions, leasing and others are enacted.

103. Strategies should be developed and implemented to properly remunerate judges and court officials to reduce incentives for corruption. Initially, this can be introduced into the governance structure of the commercial court. An extensive capacity building program should be implemented to strengthen the commercial court. It will be necessary for the SME Sub-Committee to consult with stakeholders and review the progress of legal reforms.

For future consideration

104. As the commercial legal framework develops and the judiciary strengthens it will be possible to develop further specialization in the court system to improve contract enforcement for SMEs. To enhance and simplify SME access to the courts and strengthen contract enforcement the Government should consider establishing a small claims court.

(iv) Smuggling

Background

105. In the Government's 'Rectangular Strategy' there are thirteen SME 'policies'; of these suppressing smuggling is identified as number two. Related to this is 'policy' number four, which mentions facilitating export-import activities by simplifying procedures such as licensing and other letters of permission.

106. Several studies, most recently the World Bank's investment climate assessment, have highlighted the high costs of corruption and long delays for customs clearance.¹⁵ The WTO has also identified many obstacles to trade in the form of both tariff and non-tariff barriers.¹⁶ The Government has committed, through its accession to the WTO, to carry out reforms to improve trade facilitation through customs reforms and other measures to streamline bureaucratic red tape involved in importing and exporting. These reforms should benefit SMEs by improving their access to inputs as well as to improve their access to markets. They should also reduce the incentive for smuggling.

Objectives

107. As Cambodia becomes more integrated in the global economy through accession to the WTO, access to international markets for Cambodian SMEs should improve. However, to fully benefit from WTO accession the high cost of importing equipment and raw materials and exporting domestic production should be addressed. Cambodian manufacturers import a high percentage of raw materials and equipment for production. Thus, low cost and efficient trade facilitation is important for domestic manufacturers to compete with foreign producers. Low cost trade facilitation is also important for exporters to compete in international markets. Reductions in the trade facilitation costs would help Cambodia to diversify its export base and reduce its dependency on the garment sector, which accounts for over three-fourths of all exports. Improved trade facilitation would also reduce the incentive for smuggling, which is major problem for domestic SME manufacturers, who find it difficult to compete with goods imported illegally.

Actions to be taken: Phase I

108. It is important for the Government to reduce the cost of trade facilitation to reduce costs and simplify procedures. The Government should review all licenses, procedures and documents to remove overlaps and unnecessary approvals. To streamline the process the Government should introduce a Single Administrative Document as a means toward automating customs processing.

109. Customs procedures at both land boundaries and at the Sihanoukville Port should also be streamlined to reduce the overlapping functions of the several agencies involved and to reduce the time needed to deal with Government officials. The twelve steps needed to clear customs at the port should be reduced significantly to reduce the points of contact and the time needed for processing. The Government should introduce a Single Window process to manage trade facilitation at the Port of Sihanoukville to streamline and automate the trade facilitation process. The Government should also introduce an overall risk management strategy to consolidate and rationalize all customs inspection requirements to consolidate the examination requirements of different control agencies.

¹⁵ Cambodia: Seizing the Global Opportunity: Investment Climate Assessment & Reform Strategy, World Bank, August 2004.

¹⁶ Report of the Working Party on the Accession of Cambodia, World Trade Organization, August 15, 2003.

110. To combat smuggling the Government should take serious measures to reduce the incentive for smuggling and strengthen border controls. Strengthening the capacity of the anti-smuggling task force headed by the Customs and Excise Department (CED) is a key factor in reducing illegal imports, including the increased automation of customs processing. Strengthening Khmer labeling requirements would also have a positive effect on reducing smuggling. The anti-smuggling task force should improve its efforts to control illegal trade by strengthening border controls as well as controls at product destination in stores and markets.

111. The Government should also enact the Law on Customs, which has been submitted to the National Assembly, and develop the implementing regulations needed to support the new legislation. These should be incorporated into a Policy and Procedures Manual. The draft law provides a sound legal basis for customs administration and fully complies with WTO requirements and international standards set by the World Customs Organization.

Actions to be taken: Phase II

112. The Government should further rationalize the number of agencies involved at border checkpoints in order to establish accountability and streamline processing. The Single Window process established at the Port of Sihanoukville should be implemented at all border checkpoints. In addition, a flat fee-for-service compensation mechanism that enables the private sector to pay once for all customs clearance processing should be established. The fee structure should be publicly stated and tied to set standards for levels of service.

113. Under the Technical Cooperation and Assistance Program (TCAP) coordinated by UNDP and supported by the International Monetary Fund, ADB, United Kingdom and Netherlands, the CED should develop a human resources plan as well as a training program to strengthen management skills and technical expertise. The CED should also implement the customs integrity program envisioned by TCAP, which will encompass an internal audit unit, an updated code of ethics, a policy of strict disciplinary action for employee malfeasance, an improved system of internal controls and monitoring and publicity plan. The CED should implement a code of conduct for customs officials and enhance the accountability of officials.

B. ACCESS TO FINANCE

114. Improved access to finance remains a fundamental need for Cambodian SMEs and is identified as the first of the thirteen policies in the Government's SMEs side two of the 'Rectangular Strategy'. All surveys of Cambodian SMEs, in urban and rural areas, list finance as an important problem that needs to be addressed. Small scale entrepreneurs express the problem in different ways, including too high interest rates, lack of available funds, problems with collateral and timeliness of processing. All of these problems point to the need to understand and find appropriate solutions that fit within best finance sector practices.

115. Analysis of the financial sector has shown high liquidity and capital requirements, as well as banks' cautious approach to lending has resulted in loans being only 37 percent of total assets, whilst liquid assets (cash, deposits at the National Bank of Cambodia (NBC), overseas bank accounts) are nearly 55 percent of total assets. Reduction in the liquidity ratio from 100 percent to 80 percent has led to some credit expansion. For example, from the end of 2002 loans increased 31 percent from a year earlier. It is likely that a large proportion of credit is being extended to large and very large enterprises.

116. It is recognized that one of the major constraints faced by SMEs is access to finance for working capital and investment. There is an almost total absence of medium to long-term finance¹⁷ due to banks' short-term funding base, and their practice of providing overdrafts that may be rolled-over instead of providing fixed term debt. At the end of 2002, bank loans were 7 percent of GDP, one of the lowest rates of banking intermediation in the world.¹⁸ While interest rates have been slowly declining, they remain high. Many banks are reluctant to lend given the risks inherent in the incomplete legal framework and weak law enforcement. Poor financial reporting abilities of SMEs and other risks have also contributed to the sustained high interest rates. A further constraint is that apart from one bank (ACLEDA), credit outreach is concentrated almost exclusively in urban areas, with most credit provision concentrated in the Phnom-Penh/Kandal area.

117. Surveys and interviews with banks highlight a high-risk lending environment with a poor credit culture (many borrowers do not take their debt-repayment obligations seriously). A weak and corrupt court system makes enforcement of contracts and actions to recover collateral difficult and costly. Defaulters are often able to use the court system to delay or avoid repaying loans.

118. Because there is no legal framework for lending on movable assets either through leasing or taking collateral over movable assets, banks lend only on land and buildings as collateral. Even here, banks complain that the weak land titling system or an absence of land title (requiring banks to investigate land ownership rights) constrains credit outreach. SMEs that lack land and buildings are not able to qualify for credit. Access to credit is further constrained by the inability of most SMEs to prepare even basic financial statements to demonstrate to banks that they can service their debt obligations. All these problems point to the need for the SME Sub-Committee to work closely with the financial sector in improving access to finance.

(i) Collateral and Land Titling¹⁹

Background

119. A draft law on secured transactions has been submitted to the Council of Ministers. It is quite comprehensive and deals with the provision of collateral over movable property, and certain kinds of intangible assets, like book debts. Phase II (2005-2007) of the Financial Sector Blueprint requires the establishment of a secured transactions system and Phase III (2008-2010) a legal framework for public registration for movables is required.

120. The Land Law of 2001 allows security interests in land to be created, however this kind of security interest is only briefly covered in the law and many issues are left to the interpretation of the courts. The Land Law supports systematic land registration and the establishment of a legal framework to enforce property rights and zoning. The Government is implementing a Land and Administration Project (2002-2007) to complete land registration in Cambodia and to strengthen land-management capacity covering certain provinces and

¹⁷ This is also the conclusion of an MPDF study on bank financing for SMEs in May 2003. An earlier MPDF study in November 2000 of 63 firms involved in private-sector manufacturing found that over 60% considered that a lack of working capital was their major problem. Seventy percent of the firms needed long-term loans.

¹⁸ At the end of 2002, Cambodia's GDP was about US\$4 billion, and at the end of the same period, loans were \$275m = 7% of GDP.

¹⁹ Another issue relevant to collateral is insurance. Normally, banks will require the borrower/lessee to insure assets which are subject to collateral interests, or being leased. The issue of insurance is not covered in the Roadmap, as the Financial Sector Blueprint has a number of actions dealing with the insurance sector over the period 2001 to 2010. Some of the actions include "facilitate private insurance companies' entry into underwriting business, and refine prudential regulations to cover expanded insurance products".

one municipality. As of August 2004, over 80,000 certificates of title from a total target of 1 million were issued through provincial-municipal Departments of Land Management.²⁰

Objectives

121. The objectives are to: (i) establish a legal framework for secured transactions, supported by a public registry system so that banks have confidence to expand credit to SMEs on the collateral of movable assets; and (ii) establish an effective mechanism for enforcement of the Land Law through securing land tenure and reducing land conflicts. Over time, the objective should be that at least all urban property owners have secure title that can be relied upon by banks.

Actions to be taken: Phase I

122. To meet the objective of enabling banks to use movable assets as collateral and to improve their collateral position with respect to land and buildings and to strengthen SMEs' land ownership rights, the draft law on secured transactions should be enacted and strategies put in place to improve land titling and dispute resolution.

123. It is likely that the law on secured transactions will be enacted during this first Phase, as this is a requirement of the Financial Sector Blueprint and is an accession condition for the WTO. The first step is to harmonize the provisions of the secured transactions law with the Civil Proceedings Code to ensure that contract enforcement can be effective. Therefore, the authorities should improve the law where necessary and enact the law with implementing regulations.

124. The authorities should also strengthen initiatives to establish and enforce land rights and to speed up and reduce the costs of obtaining land title. This is essential for improving the use of land as collateral.

Actions to be taken: Phase II

125. During the second phase a public registry of secured interests should be created. Methods should be explored to make registry information available on-line to subscribers like banks, or by other means for financial institutions and prospective creditors to avoid multiple collateralization of the same property.

126. The SME Sub-Committee should then work together with MOC, NBC and the Association of Banks in Cambodia (ABC) to create an awareness of the enabling legal framework for secured transactions amongst SMEs, banks, lawyers, accountants and industry associations.

127. During this phase, the authorities should ensure that the mechanism for establishment and enforcement of land rights is operational and is facilitating land titles for all urban properties through a transparent process.

(ii) Leasing

Background

128. At present, a limited amount of operating leasing (called "rental") is being provided by

²⁰ Information from the Land and Administration Project, Ministry of Land Management.

enterprises that are not financial institutions.²¹ However, banks are not providing leasing. This is constraining SMEs' access to medium and long term finance. For SMEs that cannot meet the normal collateral requirements of banks, leasing offers an alternative form of finance where a bank (lessor) relies on its ownership of the leased asset and the lessee's cash flow to service the lease payments. However, for leasing to be attractive to lessors, the lessor should be able to exercise his ownership rights quickly in case default occurs. Benefits of leasing include simpler security arrangements and fewer requirements for historical financial information. In many developing countries, leasing may be the only medium to long-term finance available. Other advantages include lower transaction costs and flexibility as well as lease payments being geared to the cash flow needs of the lessee.

129. The International Finance Corporation (IFC), as a major promoter of leasing in developing countries, generally advocates a specific legal framework to promote and bring certainty to leasing transactions. In 2000, IFC undertook a preliminary study to assess a possible involvement in leasing in Cambodia. The report concluded that the following should be considered in establishing a leasing business in Cambodia: (i) leasing will have to be a bank product until the banking law is changed; (ii) banks will have to rely on their personal relationship with the customer (i.e., rely on the customer taking his lease obligations seriously); (iii) repossession may not be feasible if the lessee does not cooperate; and (iv) VAT provisions should be changed so as not to discriminate in favour of loans.

130. Each of the two types of leases requires different contractual arrangements. For example, with *finance* leases, the obligation to repair an asset and the risk of damage or loss is placed on the lessee. If the asset is destroyed, stolen, or damaged, or for any other reason cannot function, then the leasing law or lease agreement will provide that the payment of all future rentals accelerates with the full amount due under the agreement becoming payable. In the case of an *operating* lease, if an asset is damaged or destroyed, the lessee stops payment as the risk lies with the lessor. The lease is then cancelled or the lessor has to find a suitable replacement asset for the lessee.

131. Article 2.1 of the 1999 Banking and Financial Institutions Law provides that banking operations include leasing. Article 2 of the law provides that any entity carrying out a leasing activity shall be considered de facto to be engaged in banking. Therefore, at present only banks can provide leasing. As a bank is a legal entity licensed to carry out banking operations, it would seem that although a bank can offer leasing services directly, it cannot do this through another legal entity, like a subsidiary. NBC however interprets the banking law as follows: leasing refers only to *finance* leasing, and only banks or their subsidiaries can provide *finance* leasing.

Objective

132. The objective is to create an enabling legal framework for banks and non-banks to provide finance and operating leases. This will expand the provision of medium to long-term financing to SMEs. Changes to the legal framework should include amendments to the law on taxation law and to related regulations. In addition, the legal framework should enable

²¹ Two types of leases should be distinguished. *Finance leases* are defined in International Accounting Standard 17 (IAS-17) as a transaction where one party, the lessor, owns the asset and leases it to another party, the lessee, for a term that in essence covers all or most of the useful life of the asset and where the transaction contemplates that the lessee will or may become the owner of the asset at the end of the lease. IAS-17 considers a finance lease to be a financial transaction. Although the lessor owns the asset, the transaction should be treated as a loan with equal periodical payments containing an interest and principal component. Because a finance lease is like a loan, banks prefer this kind of lease. *Operating leases* are the more generally understood form of lease (rental), where the lease term is shorter, does not cover the useful life of the asset, and the asset returns to the lessor at the end of each lease - short-term leases of motor vehicles are good examples. Operating leases are usually provided by specialized leasing companies for assets where there is a substantial second-hand market for such assets.

both banks and non-banks (i.e., leasing companies) to provide finance and operating leasing facilities to SMEs.

Actions to be taken: Phase I

133. NBC should prepare a plan for the development of a leasing industry. This will entail making changes to the existing taxation regime, enacting a new law, and taking steps to promote the new financial products once the enabling framework is in place. During this Phase, in association with the MOC, NBC should consider whether leases should be regarded as security interests, subject to registration in a register of security interests.

134. To enable banks and non-banks to provide finance leasing once an appropriate leasing law has been enacted, the Ministry of Economy and Finance (MEF) (through the Taxation Department) should amend tax legislation to tax a lessor only on the interest component of a finance lease receipt and also to allow a tax deduction to the lessee of only the interest component of the lease payment. In addition, the regulations need to clarify the rights and obligations of both lessors and lessees in relation to the depreciation entitlement. MEF should amend tax legislation to remove the imposition of withholding tax and VAT on finance lease payments by lessees so that there is a level playing field between finance lease payments and loan payments. This would allow all lending products, including collateralized loans, leases and secured transactions to compete on how they satisfy market needs rather than on regulatory or tax advantages.

135. During the later part of Phase I, NBC, in consultation with MOC, should prepare and submit to the Council of Ministers a draft law on leasing (that will cover both finance and operating leases). The law on leasing should enable banks to provide finance and operating leases and should enable non-banks and companies that are not subsidiaries of banks to engage in finance and operating leases. The law should also give authority to MOC or NBC to regulate such non-banks and other entities.

136. The next step should be to implement finance and operating leases as new financial products. Therefore, in accordance with the new leasing law, regulations should be drafted to implement the law's provisions, with NBC drafting regulations for banks, and MOC or NBC for non-banks. In addition, NBC or MOC should provide banks and leasing companies with a list of the essential terms that should be included in lease agreements.

Actions to be taken: Phase II

137. During this Phase, the MEF, through the National Accounting Council (NAC), should issue International Accounting Standard 17 (IAS-17) that specifies best accounting practices for leasing and should require compliance with its provisions by lessors and lessees (if the latter are public companies).

138. To expand the institutional framework for leasing, NBC should promote joint-venture finance leasing companies, while MOC or NBC should promote joint venture or stand-alone leasing companies that provide operating and/or finance leases.

139. Finally, NBC and MOC should encourage the development of a leasing market by enhancing the capacity of banks and SMEs to understand and implement leasing and by raising awareness among banks, SMEs, lease providers, equipment suppliers, merchants and business associations of the benefits and opportunities of leasing.

(iii) Credit Information Sharing²²

Background

140. At present there is no formal system of credit information sharing in Cambodia. This is a serious deficiency in such a high-risk lending environment. Banks use collateral as one method to reduce asymmetric information, but the effectiveness of this is constrained by SMEs' lack of significant assets, particularly land and buildings. In its Financial Sector Blueprint 2001 – 2010 the Government established the following phased plan for implementing Financial Market Infrastructure (credit information):

- (i) Phase 1 (2001 – 2004): establish an arrangement for sharing credit information in the bankers association;
- (ii) Phase 2 (2005 – 2007): expand scope of credit information sharing by formalizing membership of the arrangement for credit information sharing to include other credit institutions and automating the credit information system; and
- (iii) Phase 3 (2008 – 2010): enhance system by introducing a credit rating system.

141. Currently, NBC and ABC are assessing methods to develop credit information sharing. As one option, the association has proposed an informal arrangement based on goodwill. The procedure is described as follows. The bank (prospective lender) asks the prospective borrower to provide details of liabilities. The borrower will then usually cooperate by providing the information verbally, or will produce documentation from another bank (preferred evidence). Then the prospective lender writes to the existing lender for a cross-checking report; the existing lender is not required to respond. To facilitate a response, the borrower should request the existing bank to respond, or the borrower can provide written authority to the existing lender to respond to the prospective lender.

142. The information to be disclosed is in a specified reply format that contains the following information: name of business (and contact details), date of registration, nature of business (company, sole proprietor), names of management, type of facilities (e.g., term loan, overdraft, trade financing, housing loan, bullet loan, trust receipt, other to be specified), amount of borrowing within a specified range (e.g., up to \$100,000), whether secured or unsecured, opinion (e.g., active, satisfactory, well conducted, other to be specified (presumably this refers to adverse comments, like unsatisfactory)). The reply format at the end has a caveat that the information is to be treated as private and confidential, and the responding bank declines any responsibility for the accuracy of the information and is not liable for the consequences arising from such information.

143. There are several deficiencies with the current voluntary arrangements, including:
- (i) It contravenes the secrecy provision of Article 47 of the Law on Banking and Financial Institutions -- exceptions are only made for disclosures to the supervisor, auditor or in a court of law;
 - (ii) The system fails if prospective borrowers *do not disclose their existing liabilities*. This defeats one of the major objectives of any credit information

²² A World Bank survey of 56 countries with credit registries (CRs) highlighted the different functions of private and public CRs (the latter are almost always operated by a central bank). The survey of October 2003 found that most developed countries have private CR. Latin America has the most widespread CRs, most having both private and public CRs. Africa, Eastern Europe and CIS have the least developed credit reporting. Developed countries that have both public and private CRs include Germany, Italy, Portugal and Spain. France has only a public CR. Other developed countries with public CRs include Austria and Belgium. Countries with only private CRs include Canada, Sweden, Australia, UK and USA. In the region, Philippines, Singapore, Malaysia and Thailand operate private CRs, although Indonesia, Laos, Vietnam and Malaysia have public CRs. Including overlaps, i.e. countries that operate both kinds, 27 countries operate public CRs, and 28 private CRs.

- sharing system which is to find out what other liabilities a prospective borrower has and his management of credit;
- (iii) The system is not automated and depends on banks taking the time to respond;
 - (iv) The arrangement does not provide a vision for the future, i.e., for the development of a formal public or private credit registry (CR) supported by an appropriate consumer protection law and amendment of the bank secrecy provision.

144. Although banks have been discussing the above system since 2002, none has shown much interest in implementation. Apart from the deficiencies listed above, many banks are not interested in participating in a credit information sharing system where the borrower discloses the name of the existing lender to the prospective lender. Existing lenders do not want to give information directly to their competitors.

Objective

145. An improved system of credit information-sharing should be developed that is not based on disclosing the names of existing lenders and that is electronic. The improved system should be supported by an appropriate legal framework. An improved system will later encourage all banks to join the voluntary private system, which will result in more efficient credit decisions being made, thereby increasing the supply of finance to SMEs with good credit histories.

Actions to be taken: Phase I

146. A phased-plan should be developed and implemented for credit information sharing, so that a comprehensive system will develop that is controlled by banks and that serves their needs. To set the stage for Phase I, NBC should support ABC, acting through its members, to jointly agree on a concept to develop a credit information sharing system with members of ABC on a voluntary and pilot basis (policy matrix condition). In addition, NBC should support ABC to procure a memorandum of understanding (MOU) from those members of ABC that have shown an interest in participating in the system (policy matrix condition).

147. During Phase I, NBC, ABC, and participating banks should design a credit information sharing system. In addition, NBC should also establish the enabling legal framework to implement the pilot project, including establishing a code of conduct for participating banks, which incorporates strict penalties for falsification of information, and rules to protect the rights of borrowers.

148. Towards the end of Phase I, NBC and ABC should jointly issue a study to review the system, examine options to expand it and assess the feasibility of establishing a fully-fledged private credit bureau that operates on a sustainable basis.

Actions to be taken: Phase II

149. Under Phase II, depending on the development of the credit information sharing system, consideration should be given to including information provided by merchants and utilities, and a credit-scoring system could be developed. Finally, during this phase, consideration should be given to establishing a joint-venture with one of the international firms that operate CRs and is known to support the strengthening of CRs in developing countries.

(iv) Simplified Accounting for SMEs

Background

150. An MPDF study on financing SMEs in Cambodia found that the quality and availability of financial information on SME borrowers ranges from minimally acceptable to wholly non-existent. Banks have identified this as one problem for providing finance to SMEs. Once bank lending practices improve, and with banks over time accepting a wider range of collateral, banks will start to give more emphasis to an SME's historical financial performance and projected cash flows to service debt. At present, not only can very few SMEs provide this kind of information, but the legislated financial-reporting requirements are a disincentive for SMEs to develop or improve financial reporting.

151. In May 2002 the "Law on Corporate Accounts, their Audit and Accounting Profession" was passed. This law requires *all* enterprises (irrespective of size), whether natural or legal persons, to keep books of account and to have them audited. Article 16 of the law requires a *prakas* to be issued to determine the employment or financial limits above which an *external audit* is required. The law also requires the books of account and financial statements to comply with Cambodian Accounting Standards, the latter to be determined by NAC. Severe penal and financial sanctions can be imposed for failure to comply with the requirements, e.g., failure to comply can result in a prison sentence of 1-2 years while failure to prepare proper financial statements results in additional penalties (another 3-6 months in prison). In April 2003 NAC approved 15 Accounting Standards, based on international accounting standards. The English version of the 15 standards is contained in 223 pages (Khmer version - 385 pages).

Objectives

152. NAC recognizes the necessity for developing simplified financial reporting standards or guidelines for SMEs, in order to: (i) improve their access to finance; (ii) improve financial management of their business; and in the longer-term (iii) to improve tax collection. In addition, NAC recognizes that it is not feasible for all enterprises to be subject to external audit because it would be too costly and development of the accounting profession is still at a very early stage.

Actions to be taken: Phase I

153. Therefore, NAC should develop simplified financial reporting guidelines as an incentive for SMEs to prepare financial statements and a regime that enables SMEs to comply with the accounting law. This will improve SMEs' access to finance by providing better information to banks. MEF should establish an SME Accounting Task Force with NAC and private-sector representatives. Its task will be to develop a set of financial reporting guidelines for SMEs based on Cambodian Accounting Standards. Another task will be to revoke the two *prakas* issued in October 2003 and make compliance with the simplified system voluntary for all SMEs, or possibly compulsory for SMEs operating as companies. Thereafter, the SME Accounting Task Force should implement its terms of reference by drafting the SME accounting guidelines, including the standard forms and submit them to MEF. To promote effective use of the SME accounting guidelines, MEF should issue training and dissemination programs and materials for SMEs. Subsequently, MEF should issue the SME financial reporting guidelines and the standard forms and should implement a training program.

Actions to be taken: Phase II

154. During Phase II, to promote effective use of the simplified financial reporting system, NAC, with the assistance of the Institute of Certified Public Accountants and Auditors, shall recommend appropriate computer-based accounting and management information systems for medium-sized enterprises and appropriate manual bookkeeping systems for those who prefer this form of recording accounting transactions.

155. To implement the Cambodian Accounting and Auditing Standards approved by NAC on 11 April 2003, MEF should issue one or more ministerial prakas to:

- (i) require only public companies to comply with the accounting and auditing standards specified in the Law on Corporate Accounts, their Audit and the Accounting Profession; and
- (ii) remove the requirement for SMEs and private companies to comply with Articles 4 & 5 of the law (that requires the preparation of financial statements and keeping of accounts in accordance with the accounting standards).

156. To comply with the requirement of Article 16 of the law (that requires criteria be specified to determine which enterprises are subject to external audit), MEF should determine the employment and financial limits above which an external audit is required. Only public companies should be subject to compulsory external audit by Certified Public Accountants.

157. In addition, MEF should remove the conflicting sanctions regime of Article 18 of the Law on Corporate Accounts (that provides two different kinds of penalty for the same offence of failing to prepare proper financial statements) by amending this article so that the sanctions regime is consistent.

158. To determine the future financial system architecture, the SME Sub-Committee in association with NBC should establish a working group to determine what kinds of non-bank financial institutions are required in the future to meet micro-enterprise and SME requirements, especially those operating in rural areas.

For future consideration

159. Other measures for the Government to consider for the future could include NBC promoting the establishment of non-bank financial institutions (NBFI) and determine strategies for improving their outreach to include rural areas.

C. SME SUPPORT ACTIVITIES

160. In a well-developed open market, SME support activities span a wide range of services designed to enhance and complement the activities of SME entrepreneurs. In a competitive market, ready access to information enables and drives entrepreneurs to seek out services and products that they themselves do not have or cannot develop. In a dynamic market a wide range of BDS providers compete on price and quality for the entrepreneur's business.

161. Furthermore, in a dynamic and well developed economy, BDS is complemented by public sector activities and PPP. Such services may include delivery of public goods that compensate for market failures. Through the delivery of private sector BDS and government support activities provided through public goods and PPP, SMEs are able to become more competitive and overcome some of the constraints imposed by their small size.

162. Cambodia does not yet, however, have a dynamic marketplace for either BDS or the provision of support activities through public goods or PPP. A study of BDS delivery in several countries found that market penetration for more advanced BDS, such as technical training, was very low in Cambodia (1% penetration). In comparison, Sri Lanka and Thailand had 15 and 11 percent penetration, respectively.

163. Even for low-end BDS, penetration is often insignificant in Cambodia. Only for certain low end BDS services, such as fixed lines and mobile phones, is the penetration rate high (91%). Usage is also good for product transport (60%) and delivery and commercial fax and call centers (35%). But for all other BDS, the same survey of 300 SMEs showed very low penetration. Internet services, for example, scored below 2 percent and accounting and bookkeeping scored zero percent. The above example illustrates that Cambodia is still a very under-developed market for BDS. This is the case for both the supply and demand side of the equation. Similarly, while some delivery of services by the Government (either directly or in PPP) and donors exist, it remains relatively small with low capacity of many Ministries to deliver. Overall, SME support services are relatively under-developed in Cambodia.

164. SME support services accomplish a wide range of possibilities and strategies that can be delivered by the private sector, Government, donors, non-government organizations (NGOs) or some form of partnership among these stakeholders. The approach taken by each of these actors is normally different and is also influenced by the type of support being delivered. While acknowledging these differences, a generally accepted approach has recently emerged in the delivery of BDS and other support services. The focus in delivery has been on responding to demand signals and/or stimulating demand and private sector supply of BDS.

165. The focus of the BDS strategy is to have the SME Sub-Committee and its secretariat develop and implement appropriate SME support services during the two phases of the program. First, BDS is discussed in general and an approach for developing appropriate ways to stimulate demand as well as the supply of needed services is analyzed. Second, improving access to markets is discussed. The focus is on improving information flows for market research and facilitating promotional activities. Third, the promotion of technology upgrading is considered along with strategies related to technology concentrating on subcontracting, training and access to public research. Finally, the strategy examines linkages by considering strategies for association building, linkages, clusters and value chains. Together, these four areas represent a comprehensive strategy that can be undertaken by the SME Sub-Committee and its secretariat. It also spells out in more detail several of the 'policies' mentioned in the Government's 'Rectangular Strategy' for SMEs.

(i) Business Development Services

Background

166. In Cambodia there is very little demand by SMEs for business development services (BDS). Particularly, demand is low for specialized BDS that are stand-alone services and are paid for on a fee basis (compared to commission based). For example, specialist training or information related to market conditions is usually not highly valued. Also, there is little interest in services that are not essential for day to day running of the business. The most common reason for the low value placed on BDS is a lack of understanding of the usefulness of BDS to the business.

167. The supply of BDS in Cambodia is low and generally uneven in geographical coverage and quality. Market penetration of BDS is low and sporadic. While so-called

embedded BDS²³ are being used as part of other activities, stand-alone BDS are generally less frequently supplied and primarily found near urban areas and targeted at medium to larger enterprises. More specialized BDS are even less frequently supplied. The quality of BDS provided by donors and international organizations are usually of good quality, however, this is generally less likely for local companies. Some provision of BDS by the public sector also occurs.

168. Experience has shown that direct intervention by government and donor agencies in the delivery of such services to SMEs is usually costly, unsustainable and supply driven. Several decades of intervention in the BDS market by national governments in developing countries and multilateral organizations has proven such projects are at best welfare measures and at worst distort markets so as to push out existing commercial BDS operators.

Objectives

169. As a result, the Committee of Donor Agencies for Small Enterprise Development has developed a set of BDS guidelines which emphasizes the importance of market driven growth of BDS and the role of donors and governments in stimulating markets for BDS, rather than direct intervention. It advocates a market based approach that emphasizes:

- (i) a fundamental belief in the principles of a market economy, where the State has a role in providing an enabling environment, in correcting or compensating for market failures, and in the provision of public goods, but not in the direct provision of private goods that can be more efficiently provided by the market;
- (ii) the assumption that the majority of BDS are private goods and are thus similar in nature to any other service, so market rules apply; and
- (iii) the expectation that with appropriate product design, delivery and payment mechanisms, BDS can be provided on a commercial basis even for the lowest-income segment of the entrepreneurial SME sector.²⁴

Actions to be taken: Phase I

170. With these principles in mind, the SME Sub-Committee should focus on facilitating improvements in the supply and demand for BDS and promote wider outreach of BDS into rural and more remote areas. Given there is both weak demand for BDS by SMEs, particularly the smaller enterprises, which are the most numerous, and weak supply by the private sector, the focus in the early stages of the strategy should be on identifying existing BDS suppliers and the demand for their services.

171. BDS suppliers can be identified by province and district from existing registration records and in cooperation with local government offices. This information should then be made available to SMEs in the region.

172. An awareness campaign should accompany the distribution of the material. This would have the effect of stimulating interest and demand in BDS. At this early stage the awareness campaign should include information related to embedded BDS.

173. On the demand side, the secretariat should work with BDS facilitators (donors, NGOs, associations and others) to identify at the provincial level and in major urban centers

²³ Embedded services are linked or tied to other goods and services and are acquired indirectly as part of related transactions. The most obvious example is where a supplier provides finance to an SME by providing raw materials on credit. Work by the ILO has indicated such embedded services are likely to be of great importance for SMEs.

²⁴ Referenced from the Committee of Donor Agencies for Small Enterprise Development, 2001, Business Development Services for Small Enterprises: Guiding Principles for Donor Intervention.

the specific needs of potential BDS users. Such work should also include identifying barriers preventing SMEs from using BDS.

Actions to be taken: Phase II

174. In Phase II the SME Sub-Committee and its secretariat should build on the BDS market information collected in the earlier phase. This should take the form of an education campaign on the benefits of BDS. This may include information about local success stories or other education techniques, which incorporate local knowledge on how to most effectively reach entrepreneurs.

175. In Phase II, the SME Sub-Committee, working with other facilitators, should encourage new BDS suppliers into the market. The information gathered on BDS demand in phase one should be used to identify unmet and potential market demand.

176. Technical assistance and training through existing institutions should be used to improve the number and quality of BDS suppliers. For example, technical colleges and university training should be identified that is of benefit to enhance existing and potential BDS suppliers in areas where strong demand has been identified. The Government's 'Rectangular Strategy' also recognizes the importance of promoting vocational/skills training (see 'policy' eleven of the thirteen SME policies in side two of the strategy).

177. To develop the supply of market-based BDS and demand for fee-based BDS, the Sub-Committee should facilitate the delivery of a voucher scheme by a third party. Voucher schemes have been used extensively in Latin America and Asia to develop BDS markets. Other BDS promotion or marketing techniques could also be tested at this stage.

178. In the second phase of the strategy, support services developed for SMEs should be decentralized as much as possible. Components of the strategy that focus on direct delivery of services and are being provided from Phnom Penh should become more decentralized. Experience has shown that it is difficult for services to be very effective when centralized. It is important for services to be field-based and designed to apply solutions in a local context.

For future consideration

179. Depending on the needs of SMEs, activities in Phase I and II may need to be continued. Monitoring and evaluation of all aspects should be carried out on a timely basis.

180. Through public institutions and with private sector partnership, assistance may be provided to develop new BDS products. Universities, technical training colleges, donors and associations may all form part of PPP developing new BDS products.

181. Where successful and/or profitable BDS suppliers have emerged, the SME Sub-Committee may wish to facilitate in the replication and branching of such services. This assumes that the market for BDS has developed and that Phase I and II have been successful.

182. The SME Sub-Committee may also consider promoting the development of a code of practice and minimum standards for BDS suppliers. This should include voluntary certification by an independent body, preferably a BDS industry association.

183. Finally, support services should primarily be demand driven with some cost recovery component eventually included in all support services directly delivered. The first option for the SME Sub-Committee should be to stimulate delivery by the private sector or in PPP. In

the second Phase and after the Government should consider moving to partial or full cost recovery.

(ii) Access to Markets

Background

184. Access to markets is primarily determined by access to information useable by SMEs. Information can be of various types. It may include technical information related to product specifications or information related more generally to market channels, demand or production techniques. Information may also deal with Government bureaucratic procedures. Sources of information may also vary widely and may include official Government publications and advisory services, public or private research institutions, promotional events, as well as advertising or private sector BDS providers.

185. In Cambodia major sources of information on the domestic market, include the Cambodia Development Resource Institute, local media, various Ministry and agency publications (trade, industry, agriculture, banking, finance, legal, oil and gas, etc), research institutes and specialized associations, local internet, local market research and consulting firms and donor projects. Most Ministries produce publications on either a monthly or quarterly basis, which are usually available on a fee basis. The information collected, however, is not always reliable and generally of limited use. Other public institutions and business associations do not regularly collect information or disseminate the information.

Objectives

186. The objective is to improve SMEs access to domestic and export markets. Improved access to markets requires better information, which is of greater use to SMEs. Access to markets encompasses market information, market research, product development information and promotional activities. Improved access to markets should be delivered in a sustainable way and through a variety of mechanisms that include public providers, private enterprises, NGOs and PPP. The most appropriate mechanism and provider will be primarily determined by the type of information flows.

Actions to be taken: Phase I

187. The SME Sub-Committee should facilitate the flow of quality and timely business information. Access to useful and timely information related to prices, suppliers and markets is crucial for SMEs entering domestic and export markets. Second, the SME Sub-Committee should increase awareness among SMEs of available information and its usefulness.

188. As an initial starting point, a rapid stocktaking and assessment should be carried out of information produced by the Government and of its availability and usefulness to SMEs. The stocktaking and assessment in itself should be a useful document for BDS providers, donors and NGOs working in the area of improving market access.

189. Government information sources should be selectively targeted for improvements. Improvements should include reliability and quality of the data, timeliness in delivery and the format in which it is presented to SMEs. Mechanisms for distributing the information to targeted groups should be developed and implemented. A separate strategy may be required for rural and urban areas and/or by economic sector. Partnership and cooperation with other stakeholders should also be explored and used.

190. An ongoing education program on utilizing information for accessing markets should be carried out. Such an education program could utilize existing channels and popular

media formats. The ongoing education campaign should include information on the variety of sources for information, including consulting and market research firms.

191. The SME Sub-Committee should encourage SME participation in trade fairs and exhibitions and provide assistance to SMEs on how to take part. Such trade fairs provide exposure to national, regional and international buyers and introduce buyers to products and services offered by Cambodian SMEs. There may also be opportunities for the SME Sub-Committee to work closely with SME associations to develop multi-functional and flexible facilities that can be used for:

- (i) trade fairs;
- (ii) display areas;
- (iii) meeting place; and
- (iv) locations for short courses or training.

192. The SME Sub-Committee in conjunction with other stakeholders should provide information for buyers looking for local partners. In particular, the SME Sub-Committee should work with associations to provide information on regional clusters of various products. The Government's 'Rectangular Strategy' also recognizes the importance of working with clusters (see 'policy' seven of the thirteen SME policies in Table 2).

Actions to be taken: Phase II

193. To improve market access, the SME Sub-Committee should develop an SME portal site. A portal site usually contains a much wider range of information and services than a website and has a well-defined audience, in this case SMEs, for which it offers a specific set of information. It should also promote the website to SMEs.

194. A strategy should be developed and implemented for Provincial government offices to improve local SMEs access to the internet. Such a strategy should utilize the expertise of donors and assistance of business associations and NGOs.

195. The SME Sub-Committee should work with public institutions such as universities and technical training colleges to improve the usefulness and flow of information between institutions and SMEs. This may be in the form of specialized information or more generic information needed by businesses.

For future consideration

196. To enable SMEs to access export markets, the SME Sub-Committee may wish to consider facilitating linkages between local and international business associations, particularly SME business associations and SME networks. Linkages also form part of the Government's 'Rectangular Strategy' (see 'policy' six of the thirteen SME policies in Table 2).

197. To improve the use of the internet, the SME Sub-Committee could also consider developing a legal and regulatory framework for e-commerce. The private sector with the support of Government and donors should then be encouraged to develop e-commerce.

198. In partnership with the private sector, the SME Sub-Committee may wish to consider facilitating trade fairs and product exhibitions. These promotional activities should draw on sectors where Cambodian SMEs have a competitive advantage and opportunities exist for market development. Such promotional activities should occur in Cambodia as well as through selected international markets where it has capacity to deliver quality information.

199. Finally, the Government should consider the concept of matching grants to support SMEs to access export markets. Given the high cost to SMEs of entering export markets, a matching grant scheme will reduce the risk for producers to enter new export markets. Successful entry by SMEs into export markets will also provide an example for others to follow. The schemes should be managed in partnership with the private sector and include BDS support for new export entrants.

(iii) Technology and Human Resource Upgrading

Background

200. Upgrading technology and human resources is essential for the Cambodian economy to improve the standard of living of its people. By improving the level of technology and the quality of its human resources, value added is increased and industry becomes more competitive. In this part of the strategy a broad definition for technology is given to include both the technology embodied in machinery and the 'know how' that goes with the technology. Human resource upgrading includes all aspects, from management training to specific technical training.

201. SMEs in Cambodia place a low value on technology transfer while the availability of training is often of low quality. Moreover, information related to technology is often not readily available to SMEs, making it difficult for entrepreneurs to make informed decisions. While the Government encourages the transfer of technology, the cost of machinery is often high. Given that most machinery has to be imported, it faces additional barriers resulting from costly and difficult customs procedures. In the case of information technology, consulting services remain very limited.

202. Some donors are involved in the delivery of SME training. ADB is providing entrepreneurial training for micro-businesses. MPDF is funding the development of 36-hour training courses and self-study workbooks in Khmer to support SMEs in production management, marketing, human resources and operations management. JICA, UNDP, GRET and the GTZ are all involved in some training of SMEs or are planning projects for SME training.

Objectives

203. The objective for technological upgrading should be to: (i) improve awareness among SMEs of the benefits of improving technology; and (ii) provide cheaper and more widely available access to technical information sources. The Government should also ensure that there is a conducive environment for the transfer of technology either through information sources or through its embodiment in machinery.

204. The call of the 'Rectangular Strategy' for a national center of productivity (Policy 7) and national laboratories (Policy 9) should be met through the creation of virtual centers and institutions which draw on existing resources and expertise to be found in national research and teaching institutions. By linking together these institutions and the relevant Government agencies, best use can be made of existing resources. In addition, Government capacity to promote national standards will be enhanced.

205. The objective is for technical and management training to be valued by entrepreneurs. Market demand for training should be met by public and private technical, vocational and training institutions. Supply by these institutions should be responsive to the needs of the market. Where possible quality assurance should be established and PPP encouraged in the delivery of services. These objectives are in line with existing Government education policy and ADB's Education Sector Strategy for Cambodia.

Actions to be taken: Phase I

206. The SME Sub-Committee should enable SMEs to upgrade technology and improve their human resources. This will require working with the private sector and other stakeholders in developing greater awareness and appreciation of the role of technology and improve the supply of technology and technical information sources. The SME Sub-Committee should also develop a mechanism for identifying the needs of SMEs and work with public and private institutions, as well as in PPP in meeting these needs. An SME awareness campaign promoting the importance of human resource development for businesses should also be carried out.

207. As a starting point the SME Sub-Committee should examine the needs of SMEs for technology and training and evaluate the incentive structures and barriers for businesses to invest in technological upgrading, acquiring technical information and improving their human capital. Such a review would identify opportunities and hurdles to improve technology transfer and increase human capital development.

208. In order to identify vocational training needs of SMEs, the SME Sub-Committee should coordinate with the private sector, donors, public and private institutions to identify actual and potential needs. Donors and other agencies are already involved in the delivery of various forms of training. By coordinating SME training it ensures their needs are met by existing providers and that synergy can be developed across the specialist field of management and specific worker training. An example of such cooperation is in the garment sector where specialized training is provided.

Actions to be taken: Phase II

209. An action plan should be developed and implemented for the opportunities identified in the Phase I review of incentives structures and barriers. The most obvious barriers and greatest opportunities should be prioritized. Because training is often a public good it is advisable for the actions to be focused on developing PPP.

210. Donors and training institutions should cooperate to identify the need for and develop appropriate toolkit packages for self-reliant capacity building by SMEs. Such packages could include accounting, financial and business planning and reporting and more technical sector-specific packages. Already, MPDF offers some of these packages and the development of such packages should draw on this experience and use PPP to develop and deliver additional packages.

For future consideration

211. Issues for future consideration include sub-contracting for encouraging SMEs to meet quality standards. Such standards should be certified by an independent body, ideally through an ISO 9000 certification process. The SME Sub-Committee, through the use of independent private service providers and in cooperation with donors, can train SMEs in management quality systems and ISO-9000. A registry of qualified SMEs should be kept and made freely available to larger firms looking to sub-contract. The Government's 'Rectangular Strategy' also recognizes the importance of establishing standards (see 'Policy eight of the thirteen SME policies in Table 2).

212. Linkage programs could also be considered to bring together training and research institutions and clusters of SMEs. Non-clustered groups of SMEs could also be linked through the use of specialized associations. In the process of forging these links, the SME

Sub-Committee should work as a catalyst and facilitator rather than through direct intervention.

(iv) Linkages

Background

213. Linkages represent a key element for improving the competitiveness of SMEs. They allow SMEs to specialize and overcome the disadvantages related to low economies of scale and assist in the establishment of new industries and enterprises. There are several forms of linkages, including clusters, business associations, value chains and other business to business linkages. General agreement exists among policy makers that clusters and associations are important linkages needed for the development of SMEs.

214. In Cambodia several forms of linkages are in a nascent stage of development. There are about a dozen trade associations representing a range of interests with at least one representing SMEs (Phnom Penh Small and Medium Industry Association). However, associations are often sector specific such as the brick and tile, hotels and tourism associations. Few represent SMEs per se. There also exist a number of clusters such as those related to clay pottery and silk weaving. In relation to value chains, SMEs are generally poorly integrated, particularly into global value chains. Overall, linkages in Cambodia remain under-developed, both in terms of number of activities and in quality. This lack of development represents an opportunity for the Government to enhance the performance of SME activities.

215. Donors are involved in a range of activities related to linkages. For example, the Asia Foundation is actively involved in building regional SME advocacy groups while the US Agency for International Development (USAID) and the United Nations Industrial Development Organization (UNIDO) are targeting cluster development. GTZ and the International Labour Organization are proposing new programs that include linkage components. MPDF is also involved in linkage related activities as are a number of other donors. The Government has also taken very limited steps in building linkages. Its primary activity has been through MIME assisting in the establishment of the Phnom Penh Small and Medium Industry Association (established in 2003).

Objectives

216. Extensive literature exists on the development and growth of clusters, business association building and integrating SMEs into global value chains. While early work on clusters saw governments intervene more directly, it is now recognized that emphasis should be on assisting SMEs to work together and cooperate in integrated networks so as to overcome their own limited capacity and improve technological uptake and increase output. The result would be to make SMEs more competitive in the local and international marketplace.

217. Ideally, independent business associations with links to the Government should be encouraged to take collective actions on behalf of its members. Strong and effective SME business associations are able to: (i) represent SME interests to governments; (ii) assist with access to finance; (iii) provide market information; (iv) promote networking in clusters; (v) provide assistance with technological upgrading; and (vi) assist in the development of human capital.

218. In general, strong business associations allow SMEs to overcome the very difficulty of being small. Through cooperative efforts, SMEs can find solutions to the problems of their members. For example, many business associations will bring in expertise to provide

capacity building or assist with market information that is demanded by a majority of members.

Actions to be taken: Phase I

219. The SME Sub-Committee should encourage linkages between the Government and more self-regulating business associations that deliver quality services to members and act as advocates for members. Clusters should be encouraged to form integrated networks that move SMEs beyond their own limited capacity in order to gain greater competitiveness through improved technology, better information flows and increased specialization. Finally, in consultation and partnership with other stakeholders, the SME Sub-Committee should assist SMEs to integrate into global value chains by improving their understanding of their position and core competency within it and by identifying a business and product strategy.

220. To encourage the formation of business associations the SME Sub-Committee should review the draft Law on Associations and NGOs and MOC Prakas No. 267PN/KBTKRK dated September 21, 2000, as well as MOC Circular No. 3560 PN/KBT dated October 10, 2000 and other relevant regulations and administrative procedures related to the licensing of chambers or business associations. The report should evaluate the impediments resulting from the legislation and make recommendations for improvements.

221. The SME Sub-Committee in consultation with donors and existing business associations should produce an action plan for encouraging the formation and strengthening of SME associations. Lessons and strategies can be drawn from available international experience. For example, the Centre for International Private Enterprise provides a step by step process for setting up an association (see <http://www.cipe.org/>).

222. An initial stock-taking of clusters should be carried out. This should identify the number, size, type and location of clusters. It could also include some initial identification of major problems faced by each cluster. Given the extensive work done by several donors, such as USAID and UNIDO, on issues of clusters, their advice and input should be sought.

Actions to be taken: Phase II

223. Media programs should be encouraged to improve outreach and awareness of issues related to SMEs. Initiatives may take the form of SME TV (debate forum, pros and cons of SME issues, etc.) or newspaper columns or series of articles on best practice in specific sectors. The media programs need to be: (i) well targeted at specific groups and pitched at an appropriate level; (ii) self-funding so as to be sustainable (this may be done through selling advertising space); and (iii) include feedback and evaluation mechanisms. One such weekly television program targeting SMEs, Business Edge, provides a good example of the type of media programs, which improve outreach to SMEs.

224. In order to assist clusters, the SME Sub-Committee in coordination with business associations and donors should facilitate the development of: (i) common services to improve forward and backward linkages with markets and supplier inputs; (ii) upgrading of technology to improve efficiency; (iii) dissemination of best practice related to the cluster industry segment; and (iv) sub-sector business associations.

225. New industries and enterprises should also be promoted through encouraging the private sector, assisted by donors, to set up incubator systems. The SME Sub-Committee should encourage and provide incentives for larger private enterprises to setup incubator systems that have advantages both for the large firm and the firms participating in the incubator system.

For future consideration

226. The SME Sub-Committee should consider identifying appropriate international organizations to assist in building links with clusters. Such links may be forged around similar industry segments, different parts of the value chain or to international suppliers or buyers.

227. The SME Sub-Committee, together with other stakeholders, may wish to consider supporting SMEs in clusters becoming more integrated into global value chains. This can be done by:

- (i) Improving information about international markets;
- (ii) Promoting joint international marketing and selling;
- (iii) Promoting standards and quality control through certification; and
- (iv) Promoting learning networks.

V. CONCLUSION

A. SUMMARY

228. In order to meet the challenges faced by SMEs the Government has established an SME Sub-Committee and provided it with an agenda through the 'Rectangular Strategy'. The SME Development Framework provides the SME Sub-Committee with a detailed 'road map' for implementing and operationalising the 'Rectangular Strategy'. The overall thrust of the SME Development Framework is to create a conducive business environment for enterprises. This requires reforming and strengthening institutional structures and encouraging business to enter into the formal sector.

229. Entry of SMEs into the formal sector improves their access to markets and finance. It also extends the institutional framework of the Government to SME activities. By becoming part of the formal sector, the ability of SMEs to enter into contractual agreements improves, as does their recourse to contract enforcement.

230. For most businesses, entry into the formal sector is an economic decision and is influenced by at least three variables. First, as a business grows larger, the incentives and pressure to enter the formal sector increase. Second, small and medium entrepreneurs are rational actors that weigh up costs and benefits. When the advantages outweigh the disadvantages, entrepreneurs will enter the formal sector. Third, a business environment that is transparent, predictable and low cost encourages entry into the formal sector. The objective of the SME Sub-Committee, therefore, is to reduce the costs to SMEs associated with entry while increasing the benefits.

231. Implementing governance reforms is a key element in creating a more conducive environment for SMEs. In particular, business registration needs to become simpler and less costly while the myriad of licenses need to be rationalized and justified. Furthermore, implementation of licenses needs to be formalized and provide a recourse mechanism for businesses that believe they have been unfairly treated. Similarly, reforms are required related to trade and taxation. Overall, the objective for the SME Sub-Committee is to improve governance of institutions related to SMEs.

232. Developing a commercial legal framework and supportive government institutions is also a major requirement for a more conducive business environment. Crucial components of the framework include: (i) secured transaction framework; (ii) credit information sharing system; (iii) commercial contract law; (iv) insolvency law; (v) commercial court system; and (vi) a commercial enterprise law, to name but a few of the key components required. Many of these components are currently being considered but still need to be implemented. Therefore, the objective for the SME Sub-Committee is to support the establishment and proper functioning of institutions that support the legal framework so that SMEs can benefit from them in terms of lower transaction costs.

B. NEED FOR REGULAR REVIEW

233. The SME Development Framework itself should be reviewed on a regular basis to ensure that it remains relevant by addressing the appropriate issues for SMEs and taking into account the rapidly changing business environment. Undertaking a regular review of the 'road map' and carrying out an assessment of the business environment and adjusting the SME Development Framework through a process of consultation with key stakeholders can do this.

234. Consultation with key stakeholders is an essential part of the implementation and review process. Regular dialogue between the Government, the private sector and donors is important for successful implementation of the SME Development Framework. Therefore, an institutional mechanism should be instigated for making sure this is carried out on a regular basis. The most appropriate mechanism would be to use the existing private sector forum through the Manufacturing and SME Working Group to provide inputs for the SME Sub-Committee. Consultation and guidance should be sought on a regular and formal basis, and in the form of at least one meeting and formal documented input on at least all of the following key functions of the SME Sub-Committee:

- (i) Prioritizing policy actions to be taken;
- (ii) Design and implementation of policy actions;
- (iii) Evaluation of policy actions' outcomes;
- (iv) Reviewing the business environment for SMEs: and
- (v) Reviewing and updating the 'road map'.

235. In addition to reviewing the SME Development Framework, the impact of specific policy actions should also be measured and lead to adjusting future actions accordingly. This becomes more important the longer the time period of the strategy and the larger the number of interrelated actions taken. The number of actions spanning over five years should be carefully monitored over time and adjusted where necessary.

C. DONOR COORDINATION

236. A significant part of the SME strategy is the involvement and support of donors. The support of donors is crucial for the success of the strategy. Support from donor groups will be required for their technical expertise in the area of SME development and for funding specific components of the strategy. Moreover, coordination is also needed in donor acceptance and assistance with implementing various aspects of the SME development framework. Therefore, the SME Sub-Committee should implement a mechanism for regular consultations with all donors active in the sector of SME/private sector development. This may take the form of regular meetings and a web based newsletter to inform donors and seek responses.

237. Donors already fund significant components of the strategy through their respective programs. Various programs have been carried out by multilateral and bilateral donors focusing on institutional and legal reform, which have indirectly impacted on the SME sector. Studies have been carried out by ADB and the World Bank to assess major issues facing the private sector. These studies have focused heavily on the need for legal and regulatory reforms to improve the business environment and enhance the competitiveness of the private sector.

D. CAPACITY BUILDING AND FINANCIAL RESOURCES

238. In addition to donor coordination, there needs to be a significant and ongoing program of capacity building within Government Ministries affected by the SME Development Framework and particularly within the SME secretariat. It is expected the secretariat will have attached to it several international consultants. The international consultants will build capacity, provide guidance and assist in policy development and implementation in the early stage of implementing the SME Development Framework.

239. The international consultants attached to the secretariat are likely to have higher degrees in appropriate fields as well as experience working with Government and the private sector and in the task of implementing policies. A possible configuration may include ten permanent government staff with one or more international consultants attached. The international consultants will assist and advise the secretariat and train the domestic staff in

the implementation of the SME Development Framework. Possible international staff could include expertise in: (i) SME policy implementation; and (ii) BDS/market development.

240. Finally, implementation of the SME Development Framework and action plan will require funding. Funding is essential for the SME Development Framework to be implemented. It is particularly crucial for adequate funding to be secured during the early stage so as to build capacity within the secretariat and begin the initial work program.

APPENDIX 1: THE SME SECTOR ROAD MAP (2005-2010)

An overall Vision: Develop a conducive business environment, which will lead to a competitive SME sector contributing to the creation of quality employment and improve the range of goods and services available to the people of Cambodia.

Major Issues	Phase I: (2005-'07) Establish the Framework for an Enabling Environment for SME Development	Phase II: (2008-'10) Enhance and Expand the Framework for Enabling Environment for SME Development	Future Consideration Foster Competitiveness of SMEs through Integration into World Economy
I. SME Policy Framework – Implementation Process			
Vision: Develop a specific framework and institutional arrangements for effective policy formulation and implementation, as well as monitoring of impacts. Involve private sector representatives and obtain donor support to ensure its overall success.			
<p>(A) Government Organization</p> <p><i>Objective:</i> Develop an institutional arrangement among key Government agencies for effective and coordinated policy formulation and implementation</p>	<ul style="list-style-type: none"> • Formulate and implement the First SME Development Framework based on public/ private partnerships • Establish a Secretariat for the National SME Sub-committee with detailed work plan • Develop and implement a plan to provide and collect information to and from SMEs • Publish a report on the state of the SME sector and the achievements of the First SME Development Framework • Develop a specific plan for capacity building programs for the Government officials and private sector representatives • Ensure that the implementing agencies are allocated sufficient resources to implement the reforms 	<ul style="list-style-type: none"> • Formulate and implement the Second SME Development Framework based on public/private partnership • Expand the system to provide and collect information to and from SMEs • Publish a report on the state of the SME sector and the achievements of the Second SME Development Framework • Expand the specific plan for capacity building programs for the Government officials and private sector representatives 	
<p>(B) Promotion of Public/Private Partnership</p> <p><i>Objective:</i> Support the development of active private sector representation in policy advocacy</p>	<ul style="list-style-type: none"> • Develop a specific consultation process with business associations and other stakeholders to foster public/private partnership • Formulate a plan to enhance the capacity of business associations to provide policy advocacy on behalf of SMEs 	<ul style="list-style-type: none"> • Facilitate the establishment of private policy research institutions for support in policy formulation, evaluation, and monitoring of impact 	

II. Regulatory and Legal Framework

Vision: To reform the regulatory and legal framework for the purpose of creating an enabling business environment based on the rule of law and designed to minimize the impacts of government interventions on the private sector while providing the necessary protection of public goods.

<p>(A) Company Registration</p> <p><i>Objective:</i> Reduce the barriers and build the necessary system for effective registration</p>	<ul style="list-style-type: none"> • Reduce administrative and cost barriers in registration, including reduction of the minimum capital requirement • Engage in public awareness campaign, including issuing a manual on registration processes and a series of necessary templates • Conduct pilot decentralization of company registration outside Phnom Penh 	<ul style="list-style-type: none"> • Commence full decentralization • Plan for on-line registration system • Link business registration at MOC with tax and VAT registration at MEF and eventually merge into one procedure 	<ul style="list-style-type: none"> • Implement the online registration • Expand registration to a wider segment of the economy by further developing practical thresholds for firms to register
<p>(B) Regulatory Review and Recourse Mechanism</p> <p><i>Objective:</i> Reduce regulatory compliance costs by enhancing governance and responsibilities of the relevant state agencies</p>	<ul style="list-style-type: none"> • Establish regulatory review processes for existing and proposed licenses and remove or streamline the requirements for both operating and regulatory licenses • Formulate a recourse mechanism to appeal administrative decisions • Plan for a pilot program for one-stop window for all relevant business licenses 	<ul style="list-style-type: none"> • Continue to evaluate and remove unnecessary licenses • Implement a comprehensive system for issuance of new licenses and recourse mechanism • Develop a comprehensive program for one-stop window for all relevant business licenses 	<ul style="list-style-type: none"> • Continue to implement the reforms as outlined • Expand the one-stop window program for licensing of SMEs
<p>(C) Commercial Legal Framework</p> <p><i>Objective:</i> Develop basic legal infrastructure needed for businesses and strengthen the rule of law</p>	<ul style="list-style-type: none"> • Enact draft laws on commercial enterprises, insolvency, secured transactions and contracts, among others and harmonize them with the civil code • Enact legal framework necessary to create a specialized court to resolve commercial disputes and strengthen training of judges 	<ul style="list-style-type: none"> • Engage in extensive capacity-building program for the commercial court system • Enact legislation to establish commercial arbitration • Implement anti-corruption legislation to improve transparency and fairness and adopt code of ethics • Develop and implement the specific institutional arrangement for effective implementation of intellectual property rights 	<ul style="list-style-type: none"> • Establish small claims court to strengthen contract enforcement for SMEs
<p>(D) Smuggling</p> <p><i>Objective:</i> Improve trade facilitation to make it low cost, efficient and transparent.</p>	<ul style="list-style-type: none"> • Review all related licenses and introduce a Single Administrative Document for customs • Replace current system with a Single Window process at ports and introduce a risk management strategy • Enact the Law on Customs and develop implementing regulations 	<ul style="list-style-type: none"> • Rationalize the number of agencies involved at border checkpoints and extend the Single Window concept to land border checkpoints 	<ul style="list-style-type: none"> • CED to develop a human resource plan in conjunction with donors to strengthen management skills and technical expertise • Strengthen the capacity of the anti-smuggling task force headed by CED

III. Access to Finance

Vision: To ensure that SMEs have access to necessary working capital as well as medium and long-term finance by strengthening the collateral system and by providing a greater range of products from a wider variety of financial institutions.

<p>(A) Collateral and Land Titling</p> <p><i>Objective:</i> Establish secure titling to improve collateral base, and effective mechanism of enforcement of the land law</p>	<ul style="list-style-type: none"> • Issue the legal framework for secured transactions and land registration • Initiate the registration system for both movable and immovable properties 	<ul style="list-style-type: none"> • Develop and implement support programs for banks and other financial institutions for effective collateral valuation 	<ul style="list-style-type: none"> • Expand the on-line registration systems on nationwide basis
<p>(B) Leasing</p> <p><i>Objective:</i> Create an enabling framework for banks to provide finance leasing</p>	<ul style="list-style-type: none"> • Amend the tax law to enable finance leasing to occur • Issue the legal framework for leasing covering both financial and operating leasing 	<ul style="list-style-type: none"> • Issue IAS-17, specifying best accounting practices for leasing • Develop and implement awareness building and training programs for banks, SMEs and equipment suppliers to promote leasing 	<ul style="list-style-type: none"> • Promote joint venture or stand-alone finance/operating leasing companies
<p>(C) Credit Information Sharing</p> <p><i>Objective:</i> Facilitate enhanced access to finance by reducing the risks associated with limited information on potential borrowers</p>	<ul style="list-style-type: none"> • Implement a credit information sharing system between banks • Establish an enabling legal framework for operation of the system and to protect the rights of borrowers 	<ul style="list-style-type: none"> • Expand the credit information system by providing historical and other information • Facilitate the establishment of a private credit bureau • Develop and implement a plan to include other financial institutions to participate in the system 	<ul style="list-style-type: none"> • Continue to implement the plan for expanded credit information system and the inclusion of non-bank financial institutions • Draft a plan for the feasibility of developing new information products, such as credit scoring
<p>(D) Simplified Accounting and Taxation Systems for SMEs</p> <p><i>Objective:</i> Facilitate enhanced access to finance by reducing the risks related to the lack of appropriate financial information</p>	<ul style="list-style-type: none"> • Issue simplified SME accounting guidelines (including the related templates) • Develop a simplified tax-reporting system for SMEs operating as companies • Engage in extensive training programs for both accounting professionals and SMEs (through private sector representatives) 	<ul style="list-style-type: none"> • Continue to support the development of accounting professionals • Issue guidelines and specific requirements to assist SMEs to adhere to the formal tax system • Establish a working group to determine what kind of non-bank financial institutions are required in the future to meet micro-enterprise and SME requirements, especially those operating in rural areas 	<ul style="list-style-type: none"> • Develop corporate governance guidelines and disclosure requirements on financial information • Promote strategies for the establishment of NBFIs and for improving their outreach to include rural areas

IV. SME Support Activities

Vision: Create a dynamic market for SME support services. Assure that services are supplied in the most efficient means possible by the private sector and government. Encourage suppliers of services to respond to market signals and cater to a range of enterprise sizes. Finally, create a marketplace where SMEs are aware of the benefits and range of services available.

<p>(A) Business Development Services</p> <p><i>Objective:</i> Create a dynamic market for BDS supplied as private goods and offering a range of services demanded by SMEs</p>	<ul style="list-style-type: none"> Identify existing BDS suppliers and demand for services and develop a registry by district of BDS suppliers making it available to SMEs In cooperation with BDS facilitators (NGOs, donors and associations) identify BDS needs of SMEs and barriers to greater use 	<ul style="list-style-type: none"> Develop and implement education campaign for SMEs on the benefits of BDS In cooperation with BDS facilitators, encourage new BDS suppliers into the market Encourage existing institutions to enter the BDS market and/or link with existing BDS providers to improve their services (for example, linkages between educational institutions and BDS providers can improve quality) To stimulate demand and supply, encourage third parties to deliver pilot projects for voucher schemes 	<ul style="list-style-type: none"> Develop new BDS products in public/ private partnership Facilitate the replication of successful BDS providers Encourage a BDS industry association, a code of ethics and independent certification of BDS providers Direct delivery of BDS should be avoided by the government, however, where it does occur, some cost recovery components should be introduced
<p>(B) Access to Markets</p> <p><i>Objective:</i> Improve SME access to domestic and export markets through better information, market research, product development and promotional activities</p>	<ul style="list-style-type: none"> Design and implement an education program on utilizing information for access to markets Encourage and assist SMEs to participate in trade fairs and exhibitions In cooperation with SME associations develop multi-purpose facilities In conjunction with other stakeholders link buyers with SMEs or clusters of SMEs 	<ul style="list-style-type: none"> Develop and implement a strategy for regional SMEs to have improved access to the internet Facilitate better flow of useful information between public institutions (such as technical colleges and universities) and SMEs To improve access to export markets, facilitate linkages between local and international business associations 	<ul style="list-style-type: none"> To enhance the use of the internet, a legal and regulatory framework for e-commerce should be implemented In partnership with the private sector, facilitate trade fairs and product exhibitions Develop and implement a matching grant scheme for SMEs to access export markets
<p>(C) Technology and Human Resources Upgrading</p> <p><i>Objective:</i> Improve availability and awareness among SMEs of technology and technical and managerial training</p>	<ul style="list-style-type: none"> Review current technology and training needs, incentive structures and barriers Coordinate with providers of vocational training to identify needs and develop links with SMEs Strengthen the capacity of current research institutions and foster linkages with the private sector (including academic institutions) 	<ul style="list-style-type: none"> Develop an action plan for implementing opportunities identified in the Phase I review Coordinate and work with training institutions and donors to develop toolkit packages for training and capacity building in SMEs Encourage quality standards in SMEs through ISO 9000 certification process Promote specific linkages among universities and related institutions on applied research Develop and implement the specific institutional arrangements for effective implementation of intellectual property rights 	<ul style="list-style-type: none"> Encourage linkages between training and research institutions and SMEs Facilitate the private sector (including universities) to establish and enhance the institutions on technical standards Draw on existing public education/ research institutions to enhance their capacity for applied research and product quality testing
<p>(D) Linkages</p> <p><i>Objective:</i></p>	<ul style="list-style-type: none"> Review relevant regulations and procedures for the registration of 	<ul style="list-style-type: none"> Encourage the development and use of media outreach programs for raising awareness of 	<ul style="list-style-type: none"> To help improve the competitiveness of clusters, encourage linkages between local clusters and

<p>Assist SMEs to work together and cooperate in integrated networks to improve their competitiveness and access to local and international markets</p>	<p>associations and make recommendations for improvements</p> <ul style="list-style-type: none"> • In cooperation with other stakeholders, develop and implement an action plan for encouraging the formation and strengthening associations • Carry out stock taking of clusters, including identifying number, size, type and location 	<p>issues related to SMEs</p> <ul style="list-style-type: none"> • Develop common service provisions and other related support for clusters in cooperation with donors and associations • Foster private sector-led incubator systems for developing new industries and enterprises. 	<p>international organizations</p> <ul style="list-style-type: none"> • Working together with other stakeholders, assist SMEs in clusters to become integrated in global value chains. This can include promoting learning networks, joint international marketing as well as a range of other services
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Support Mechanisms for the Effective Implementation of the SME Development Framework:

- Specific consultation process to foster public/private partnership
- Establishment of the necessary infrastructure for the implementation of the Framework
- All related institutions to have necessary resource allocations and capacity building measures
- After the 1st Phase, review of the Progress and Plan for the Next Phase
- After the 2nd Phase, review of the Progress and Plan for the Next Development Framework