

SMEs in Cambodia

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ABSTRACT

Small and Medium Enterprises (SMEs) drive industrial progress, improve an economy's ability to deal with shocks and are recognized as breeding grounds of innovation which is a crucial part of the Cambodian economy, contributing to both economic and social development. SMEs play an important role in: (i) creating jobs (ii) generating income for low-income people and vulnerable populations, and (iii) fostering economic growth, social stability, and contributing to the growth of a dynamic private sector. This paper focus on the production issues only where it aims to find factors affecting the growth of SMEs, that are divided into three folds such as technology, labor force, and capital. The research will employ the grounded theory as methodology. However, SMEs have many challenges. Access to finance is still the main issue while SMEs bank has been established. Technical knowledge and skills are the main issues for labor including migration problems. Technology updated is still limited for growing SMEs.

Keywords: *Small Medium Enterprise; SMEs; production issues; labor force; capital*

1. INTRODUCTION

Small and Medium sized Enterprise (SME) is a very significant sector participated in a development of the Cambodian economy since the sector contribute 58% to the GDP of Cambodia in 2018 (Layhy, 2019). SMEs drive industrial progress, improve an economy's ability to deal with shocks and are recognized as breeding grounds of innovation. The original idea formed at the end of the 19th century that large firms are the greatest support for the economy has been challenged since the 1950s. Nowadays, the significant role SMEs play in the economy cannot be underestimated. Furthermore, SMEs growing provides profit generation and employment opportunities to the local which is account for two-third of Cambodia employment. As elsewhere in the world, SMEs make up the vast majority of businesses in Cambodia. Almost 40% of the nation's enterprises have between 10 and 100 employees, and almost 99 percent have between 1 and 100 workers (Layhy, 2019). By the year 2019, there are 269 units of new factories were built with 131,551 workers were created, and 67 of them were closed with 63,506 workers were jobless.

However, among 520 000 firms there are only 155,640 firms registered as micro, small, and medium enterprises in which 15,707 firms are SME and 139,933 firms are Micro (Phnom Penh Post,

2018). Beside the numerous of SMEs in Cambodia, Federation of Association for SMEs of Cambodia (FASMEC) illustrated that there are many problem (Por, 2020) facing for SME growth, including legal issue and production issues.

Like other developing countries, small and medium enterprises (SMEs) are a crucial part of the Cambodian economy, contributing to both economic and social development (World Bank, 2010). They play an important role in: (i) creating jobs (ii) generating income for low-income people and vulnerable populations, and (iii) fostering economic growth, social stability, and contributing to the growth of a dynamic private sector.

As the development of SMEs is significant to the robust and resilient economic growth of Cambodia (Japhta, et al. 2019), the Royal Government of Cambodia (RGC) has shown its commitment to support private sector-led growth and has introduced a series of policies concentrated on SME development. One among them was the establishment of the SME Sub-Committee in 2004 as the key body to organize SME development strategies (Baily, 2008). The key output of the SME Sub-Committee was the SME Development Framework approved by the Council of Ministers on 29 July 2005, and officially launched by the government on 21 February 2006. The SME Development Framework aims to "create a conducive business environment, which will lead to a competitive SME sector contributing to the creation of quality employment and improve the

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range of goods and services available to the people of Cambodia.” (Japhta, et al., op cit.),

In Cambodia, there are 4 categories of enterprises, namely micro, small and medium enterprises (MSMEs) and large enterprises. The micro enterprises are unsystematic and dominate the SME sector. The SME Development Framework, developed by the SME Sub-Committee of the Private Sector Steering Committee, classifies SMEs according to the number of their employees (based on equivalent full-time employees) and the size of their assets.

Despite a growing number of registered SMEs, there are many challenges facing entrepreneurs and government in the development agenda for SMEs. Challenges listed in Cambodia’s Industrial Development Policy 2015–2025 (Roth, 2014) and other studies include access to finance, technical knowledge and skill, inadequate support and facilitation, and competition and market expansion.

Access to finance is still difficult. In Cambodia, around 66% of enterprises stated that access to finance is still challenging and the main challenge of MSMEs is the access to working capital (BD Trust Research, 2019). While access to financial services has grown quickly in recent years, almost a third of people do not use formal financial services (NBC, 2019).

Technical knowledge and skills are scarce. The limited human capital such as trained and skilled workers, technicians and engineers discourages the country from absorbing and utilizing modern technology for industrial development. Dealing with a shortage of workers, low productivity, skills mismatch and rising wages poses a great challenge to Cambodia’s further development (ADB, 2015).

Inadequate support and facilitation from relevant institutions hinders development and fails to address emerging concerns faced by SMEs. A monitoring mechanism needs to be introduced in order to exert additional pressure on the responsible institutions and government agencies to take measures and improve the business environment for SMEs (RGC, 2015, op cit.).

Competition through regional and international market expansion is rising through transition in industrial revolution and globalization. Doing business in Cambodia is relatively costly, from starting to operating and closing a business. Inadequate electricity supply puts Cambodia at a competitive disadvantage compared to neighboring countries (Roth, op cit.).

Informality of MSMEs, especially micro enterprises. As addressed earlier, micro enterprises are mostly family-owned businesses and operate informally, making it difficult for the government to collect taxes and design and implement support policies to help MSMEs move up the value chain (ibid).

This paper focus on the production issues only where it aims to find factors affecting the growth of SMEs, that are divided into three folds such as technology, labor force, and capital.

2. LITERATURE REVIEW

The Cambodia economic growth is continuing at the speed of 7% per annum until 2019, according to Ky and Lim (2020). However, the growth goes through two different ways. The first growth is for Foreign investment firms, and the second way is for domestic firms which mostly are small and medium enterprises (SMEs). The main factor for SMEs in the market competition against the imported products is cost of production including cost that derived from technology, labor, and capital. Arce, Lopez, and Sanjuan (2011) illustrated that working capital is one of important factors for growing SMEs, especially during crisis. As well as UNCTAD (2001), Shinozaki (2014) reveals that the working capital supported by government play important role in raising working capital for the SMEs. However, capital financing is a big constraint for SMEs, especially in developing countries. According to Bouri et al. (2011), and Almansour B. et. al. (2019) SMEs in developing countries are often hampered by an inability to obtain financial capital for growth and expansion. Financing for SMEs is limited, particularly when compared to commercial debt for large firms. Furthermore, Baily (2008) mention that there are four main factors constrained the financial accessing for SMEs in Cambodia: a lack of collateral, an in-adequate legal framework, a limited number of financial products on offer, and an ability of SMEs to prepare basic financial statement.

Moreover, labor force is also another key factor affecting the growth of SMEs. According to Baily (2008) 97% of manufacturing workers were unskilled and less than a quarter of Cambodian firms provided formal training to workers. Cambodians generally have limited formal educated and training and have few opportunities to enhance their human capital. As mentioned by ILO (2015) quality of employment is the restriction of SMEs, even the SMEs provides the adverse effect to job creation. Robertson (2003)

mentioned that SMEs often lack the knowledge and resources to engage in training programs, however, their success in upgrading themselves technologically may depend crucially on subsidized educational and training infrastructure provided by their governments.

Another issue of labor factor is an enterprise manager. As revealed by Wang (2016), the biggest obstacles SMEs are confronting and the determinants that influence the obstacles as perceived by enterprise managers.

Last but not least, the productive capital used by Cambodian SMEs is often old and inefficient relative to that used in neighboring countries. Companies are hampered in their abilities to upgrade due to an under-developed financial market. Many lenders simply increase the cost of credit to compensate for perceived risks. Investment is further hindered by a weak rule of law and weak institutions. It can cost considerably more than a loans value for a lender to seek legal recourse following a default, according to Baily (2008). That is called, the lack of technology. Technological progress is one of the theoretically accepted measures applied to eliminate the frontier barrier of an economy because it helps to increase the productivity and efficiency of factors of production of the economy—labor, capital, and other resources, and increase the production input usage in the production. The technological progress is the process of invention and innovation in the economy. The invention means the scientific discoveries required to upgrade the production system of the economy, while innovation implies the utilization of new scientific breakthroughs for the commercial purpose of the output. Freeman and Soete (1997) illustrated that in economic growth, technical innovation is a critical parameter. According to Schumpeter (1934), innovation needs entrepreneurial skills to manage existing or new resources to match with new scientific discoveries in the production process and organize the output. One way of presenting the effects of technological progress on the growth of economies is the shift of production possibility frontier (PPF). Kamara (2019), Subrahmanya et. al. (2020), and Subrahmanya et al. (2009) express that technological progress leads to shifting the entire frontier right with a given level of production inputs and without bothering about finding a new resource base. As revealed by Nadide and Dogan, (2014), FDI promotes the transfer of new technology and know-how between countries and exchange technological ideas among the firms. Doh and Kim (2014) stated that SMEs benefit from

large firms in several ways, including technology transfer. Chew and Yeung (2001) noted that the large firms exceed the SMEs in innovative capacity and the complementarity between SMEs, and they can enhance the process of technology transfer in supplier-buyer linkages. Thus, the development of linkages between firms is increasingly identified as a factor that promotes technology transfer. Wong (1991) classified technology transfers as follows: 1. Hardware (e.g., Plants, capital equipment and machinery, materials, and suppliers). 2. Codified knowledge (e.g., Computer programs, design, operations, systems, and procedures). 3. Unmodified knowledge (e.g., Human experience, organizational culture). However, Ankrah et al. (2013) and Prasana et al. (2019) revealed that firms should be encouraged to establish close ties with academic institutions to get some benefits, including technology transfer.

3. METHODOLOGY

The issues as identified in the literature are the main constraint for the growth of SMEs in Cambodia needing to be narrowed down. The issues are raised by many associations of SMEs, firm's owners, and entrepreneurs in practical reasons.

The research employed the qualitative data research by conducting interview with firm's owners in SMEs sectors, since the quantitative data is not available as time-series. The grounded theory (Glaser and Strauss, 1976) is employed for this research both in both data collection and data analysis which is useful for behavioral data and responsive data. The key-informant interview (KII) is conducted to 14 enterprises in the four target provinces including Phnom Penh, Kampong Thom, Siem Reap, Banteay Meanchey where cashew, dried fish, is produced to find the key barriers.

The target group (firms) is registered firms as SMEs in ministry of commerce or provincial department of commerce. The interview has been done during October and November 2020.

Capital accessing is one of the main obstacles that was also identified as in many researches for SMEs. So, we should identify and target a major barrier and provide commentaries, our main attention will be focused on Capital accessing as the main obstacle. Drawing from this Capital accessing, the following hypotheses can be made with regard to finance as the major barrier:

H1. SMEs are more likely to access to finance as a significant obstacle to their growth.

Labor force is another main obstacle in Cambodia, as well as in the survey conducted by the World Bank. The following hypotheses can be made with regarding to labor barrier:

H2. SMEs are more likely to lack of labor's skill, labor responsibility, and to face labor movement as a significant obstacle to their growth.

Technological update is also an important factor influence the growth of SMEs in Cambodia that may be defined the ability of labor in accessing and using new modern technological machine. The following hypotheses can be made with regarding to labor barrier:

H3. Technological update more likely to access and use the up-to-date technology as a significant obstacle to their growth.

4. FINDING

Currently, SMEs in Cambodia plays very important role in Cambodian economy which contributed 58% to the GDP. According to the criteria set by ministry of industry science technology and innovation, SMEs can be define as firms which makes up by 11 to 100 employees. By the way, the definition is a bit different if we look at the definition set by tax department. SMEs can be defined as firms which the start-up capital is below 500,000 USD.

However, the number of firms which is recorded as SMEs doesn't available from 2018. According to the Table 1 below, the 80.41% of SMEs are in foods, beverage, and tobacco sectors. This sector is very important that is competing with the imported products, especially from Vietnam and Thailand.

According to the respondents selected for interview, 78.57% of the firms interviewed are in food sectors including dry fish processing, rice mill processing, cashew processing, soy and fish sauce processing, moringa processing.

Table 1: Number of firms in SMEs

Number of SME firms	2013	2014	2015	2016	2017	2018*	2019*
Foods, Beverages, and Tobacco	30,681	30,880	31,220	31,465	31,565	125,793	41,617
Garment, and footwear	1,822	1,823	1,828	1,831	1,833	7,347	2,652
Paper and printing	68	68	70	71	71	300	106
Rubber product	259	292	319	336	344	1,459	476

Non-metal mine	1,089	1,104	1,126	1,136	1,140	4,609	1,511
Metal production	4	11	11	11	11	155	55
Metal processing	2,405	2,406	2,407	2,413	2,413	9,674	3,232
Other	1,867	1,875	1,875	1,876	1,876	7,556	2,505
Total	38,195	38,459	38,856	9,139	39,253	156,853	52,154

Source: data from ministry of economy and finance

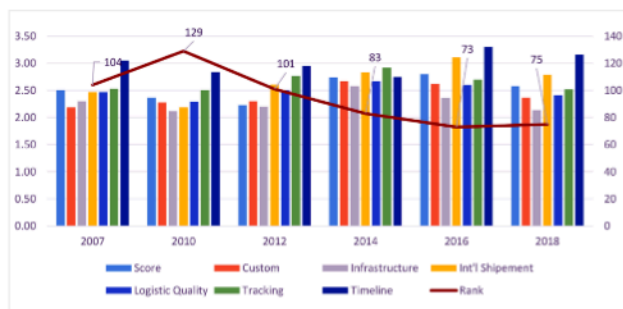
* Data from annual report 2018 and 2019 of ministry of industry science technology and innovation

The data from KII reveals that the SMEs in Cambodia is very competitive sector, especially for food processing manufacture. There are two types of competitors, local producers and importers from Vietnam and Thailand the most. With the expansion of globalization, especially in the ASEAN context, manufacturing SMEs in Cambodia are facing increasing international competition and need to improve quality and efficiency of output to international standards to survive. The Cambodian business environment needs improving, and SMEs need developing, to be able to compete with imports. Creating a level playing field and encouraging SME development will not only enable Cambodian SMEs to compete successfully in their domestic market; it will also pave the way for their involvement in exporting.

The challenges of SMEs are higher cost of production. Among 14 observations, all firms draw that there are three costs, including transportation, electricity, and labor cost. Transportation and logistics are factors challenging in competition both locally and internationally is logistic where is the rank is still low, 75 according to the Doing Business index. The most challenging point is Timeline. The number of days spent for importing is 24 which 10 days longer than Vietnam and Thailand. Beside the number of days spent, the data from the KII illustrated that the cost of custom clearing is not standardized yet while some firm can pay less than 1000USD per container and some other pays more than that. The cost of logistic including customs import permit, customs clearance, Cam-control survey fee, custom processing fee, handling fee, carrier charge, document fee, container imbalance charge, equipment management fee 875USD and also including port charge and trucking 400USD, totally is 1,275USD.

In accordance with the data from the World Bank (2014), the transportation cost in Cambodia is 30% and 33% more expensive than that in Vietnam and Thailand, respectively.

Figure 1: Logistic in Cambodia



Source: World Bank (2020): Country Score Card: Cambodia 2018

Beside the transportation cost, electricity cost is also still high compare to the cost in Vietnam and Thailand. In 2011, the cost of electricity in Phnom Penh and Kampong Thom, Banteay Mean Chey, and Siem Reap are 800 riels/kwh, 750 riels/kwh, and 700 riels, respectively. However, in 2020 the cost of electricity in all four-target area reduced to the same price for medium voltage customers, 720riels for manufacture and 660 riels for agricultural product processing. Even though the cost is a bit decreased, it is still higher than that in our neighboring countries, which is 500riels and 320 riels for Thailand and Vietnam, respectively. The data from KII reveals that diesel is not good choice for producing electricity. Moreover, solar-source electricity is not yet confidence since the installation and material cost is still very high.

However, the factors above are the key factor for international competition, and assumed to be the same for local enterprise in competitive market. For growing SMEs locally, there are three factors including assessing to capital, lacking of labor, and updating technology, needed improving. Repeatedly the literature review, Wang (2016) illustrated that there are 23.1 percentage points of SMEs more likely to perceive access to finance as the biggest obstacles to their growth than large firms. In accordance with KII, the data demonstrates that all SMEs in Cambodia are facing difficulty in assessing to finance even the Bank of SMEs are introduced. This confirms our Hypothesis 1. The observation proves that all target groups have debt asset ratio in between 25% to 60% already. They cannot access more finance from SME Bank since there is not enough collateral or/and turn over. Furthermore, the fund supported by Rural Development Bank (RDB) mostly provided as working capital rather than investment capital.

The observation illustrates that collateral requirements is a restriction in accessing to finance by SMEs. It is evident that 12 among 14 SMEs

observed are denied by the lenders in provision of financing. This is because of not having adequate resources to provide as collateral. The data also reveals that houses, land, and businesses are used as security and that money lenders, microfinances, and banks demand SMEs to post the collateral in order to reduce moral hazard. This finding is in line with the findings of Mullei and Bokea (2000), Wang (2016), that banks ask for collaterals in order to finance SMEs and to accept loan proposal and that the collateral must therefore be 100 % or more, equal to the amount of credit extension or finance product.

Another key beside the collateral is SMEs in Cambodia is high risk business. This finding is in line with Kihimbo et al. (2012) that most SMEs are denied and discriminated by the lenders in providing financing.

The KII data reveals that awareness of funding affects access to finance. It was found that

there is information asymmetry. The financial institutions know very little about the SMEs since the accounting system doesn't well used. This is such an asymmetric information that are actually concerned with the two players in the financial market. In this case, the borrowers know more about their business cases and the bankers may not know more about it.

To provide financial support for SMEs, Royal Government of Cambodia created a state-owned policy bank, which aspires to be consistent and has aligned itself with the strategic goals. As set out under the Cambodia Industrial Development Policy 2015-2025, the bank will provide better and affordable access to financing for SMEs in key priority sectors, including food manufacturing and processing, the manufacturing of local consumer goods, waste recycling, the production of goods for the tourism sector and making finished products, spare parts or assembling parts to supply other manufacturing, research and development associated with information and technology (IT), or the supply of IT-based services and enterprises located in SME cluster zones and enterprises developing a cluster zone.

SME Bank of Cambodia endeavours to provide four main value-added benefits to the SME community, such as better and more affordable access to financing, technical assistance to SMEs to enhance their productivity and efficiency, downstream business advisory support and facilitating access to regional markets. The SME Bank of Cambodia provides a wide range of SME loan products and services including an SME Co-Financing Scheme (SCFS) and Cambodia

SME Scheme (CSS). The SME Co-Financing Scheme of \$100 million was distributed on April 1, 2020.

The study revealed that the financial institutions require more information to evaluate potential risks associated to SMEs. The financial market information is very broad for SMEs. So that SMEs can identify potentially financial institution, they require enough information. This will enhance the understanding of the potential risks associated with the SMEs that apply for accessing capital from financial institution. So that this data is also in line with Othieno, (2010).

SMEs are more sensitive to vacancies than larger business since there may be only one person filling a particular role and no one who can easily step in. For instant, in a ten-person enterprise, one vacancy can leave a business 10% short in terms of staffing. As the data from KII reveals that in all 14 respondents the owner is the only skilled labor which lead the firm success and growth. Even if it isn't a specialized position, the rest of the staff and often the owner will have to take on the added responsibilities, which hurts productivity.

Furthermore, labor issue is another challenge for SMEs. Cambodia's labor force grows by 22 per cent between 2005 and 2019 (ILO). An estimated 250,000 to 300,000 new young workers are entering the labour force each year, for whom decent employment opportunities need to be found. However, the domestic labor market still generates limited employment opportunities and relatively low wages, compared to opportunities that exist abroad. As a result, more Cambodians are considering leaving the country to find work abroad. There were an estimated 350,400 Cambodian migrants in 2019.

The labor shortage is a big issue for SMEs in Cambodia due labor migration and unskilled. Chheng et. al. (2019) demonstrates that 73.45% of labors that the age is in between 16 to 35 years old migrated to Thailand, Malaysia, Korea, and Japan. This is a huge challenge to the labor supply in Cambodia. The data reveals for KII that all enterprises interviewed show their difficulty to get labor force in Cambodia. Beside the ease of getting labor force, the getting good labor forces which is including working habit and working effort is very difficult, even the wage rate is higher than the market wage. Some case likes soy and fish sauce enterprise in Areyksat, Phnom Penh, is a family business. The workers in the enterprise are trained to accomplish their only one hour. And some other are appealing to workers based on workplace flexibility and a family-friendly culture, especially dried fish

enterprise in Siem Reap.

The main issue for labor migration to abroad is working condition, and wage rate. The majority of Cambodians are employed in the informal economy, and according to the 2019 census only 17% of employed Cambodians were salaried employees. Salaried employment was significantly higher in the cities, at 52%, compared with 9% in rural areas. According to our KII, labor force who is working with SMEs, mostly paid by performance rather than salary. This is one of incentive for the labor to work productively. For Stuang dried fish firms, the waged workers receive 40,000 riels per day on average while the salary workers receive 25,000 riels per day.

For all workers in the target firms are trained by employer only, which causes them work with limited performance. The data also reveals that most employee is SMEs leaves school at grade 6 on average that causes them work with their own physical power only.

Another key factor for growing SMEs is technology updates. In general, SMEs are known for informal technological innovations and updates. That is, they carry out their innovations along with their day-to-day manufacturing operations within the same premises. However, the small enterprise in Cambodia cannot update technology to meet exported requirement, especially for rice mill in Banteay Mean Chey, and Kampong Thom. The data from KII is contrasting with Subrahmanya, Mathirajan, and Krishnaswamy (2009). Another case such cashew processing enterprise in Kampong Thom, and dried fish processing in Siem Reap, they cannot update the packaging technology since it is difficult to access to finance as mention above, and lack of technological awareness.

However, the case of moringa processing enterprises, soy and fish sauce enterprises in Phnom Penh, reveals that technological update helps them to growth their business especially technology for production as well as for packaging. This is in line with the Subrahmanya, Mathirajan, and Krishnaswamy (2009), and Roper (1997).

Osano et al. (2016) illustrate that SMEs need to use ICT to sustain businesses and to become more competitive and growth. That is consistency of the data from our observation, moringa enterprises in Phnom Penh, reveals that computerized accounting system and management help SMEs growing, especially increase competitiveness in the both local market and exported market.

Finally, it is interesting to find out the outcomes of innovation achievements of these SMEs. If innovative SMEs are able to convert their innovations into sales, they might be able to increase their sales turnover and increase capacity utilization or energy utilization or manpower utilization or improve inventory management or enter international market.

5. CONCLUSION

In conclusion, it has been observed that SMEs in Cambodia face the three main problem for growing including financial and capital assessment, labor, and technology. The key barrier for financial and capital assessment is limitation of collateral assets, and limited business profit. In addition, SMEs are discriminated by banks due to high risks in lending to them. To growth the SMEs in term of financial development, technical development and quality assurance should be done first and follow by market behavior change in order to reduce the risk of SMEs. Further work to do for SMEs is to build a resilience specific product association for growth together which is the key guarantee for financial and capital assessment.

The key barrier for labor force is low productive labor, working habits, and working efforts. Since the unskilled labor received lowest wage, the wage efficiency theory cannot be hold. In order to solve this problem, SMEs association should offer both pre-job training and on-the-job training especially along with the SME specific product association. Beside the recommended activity conducted by SMEs, the royal government of Cambodia, especially school of vocational training should go back to provide technical training rather than provide academic program. Vocational training should be encouraged, improved, and expanded. If these recommendations can be done, the efficient-wage effort will work in the SMEs sector.

Last but not least, the key barrier for technology are technological innovation and technological update. With the limitation of the market access, high rivalry in competitive market, and limitation of business supportive knowledge such as accounting system and business management, they cannot update the technology. So, to grow SMEs in term of technology, firstly SMEs should increase their profit earning by reducing rivalry and competition from imported products. Secondly, accounting system and accounting standard should be encouraged by using computerized system in order to improve

business management for SMEs. These can help SMEs in technological innovation and updates. For the further research, the topic of "Role of SMEs bank in the development SMEs" may be considered.

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