

BUSINESS ISSUES BULLETIN

CAMBODIA

No. 7



Doing Business in 2005: Comparing the Cambodian Business Environment with the World

In its Rectangular Strategy, the government of Cambodia states that it “considers the private sector to be the engine of economic growth... [and that] a healthy private sector is the key to the promotion of economic development.” Yet, for the private sector to be healthy, the country’s “[business] environment has to be conducive to enhance private enterprises.” The Rectangular Strategy shows that the government clearly recognizes the need to institute a number of economic and judicial reforms to improve the business environment so that Cambodia will be better able to compete in the global economy and attract private sector investment.¹

This issue of the Business Issues Bulletin (BIB) examines the health of the Cambodian business environment by using a number of indicators of business environment performance and comparing Cambodia’s performance with countries in the region and with international best performers. The comparisons made here have been drawn from the wealth of data collected, analyzed and published in Doing Business (2005) a report prepared by the World Bank Group that provides objective measures of the regulatory environment in 145 countries around the world.² These indicators assess the extent to which common types of business regulations enhance or constrain investment, productivity and growth.

The Doing Business indicators cover six areas of regulation that are widely recognized to promote or hinder private sector growth, including starting a business, registering property, enforcing a contract, hiring and firing workers, getting credit, and bankruptcy. Since Cambodia does not have regulations concerning bankruptcy, and (standardized) comparable data with specific reference to Cambodia on the credit market is not available in the Doing Business data, this Bulletin does not cover these last two indicators of business environment health.

Starting a Business: Entry Regulation

When an entrepreneur draws up a business plan and goes into business, the first hurdles to overcome are the legal procedures required to incorporate and register the new firm. According to *Doing Business (2005)*, which is based on data collected in 2004, it took a great deal of time to legally register a business in Cambodia. Up until August 2004, it took as many as 94 days to complete all the procedures required to set up a business and the cost was as much as US\$1,500, which is nearly five times Cambodia’s per capita income (see Figure 1). These figures include both official and unofficial costs and time spent to register a company, including bribes to cut through bureaucratic “red tape.” The long time frame and high costs of legally registering a business made Cambodia one of the worst places in the region to set up a company (better only than Indonesia).

The consequences of cumbersome and costly registration procedures are serious. New investment is discouraged and the majority of businesses that are established remain in the informal economy where it is much more challenging for them to raise the financing they need to operate successfully and grow. Informal businesses also contribute much less to government revenue.

Recognizing that burdensome business registration hurts the economy, the Cambodian government issued new regulations in August 2004. These reduced the



The *Business Issues Bulletin* provides those interested in business issues with a short summary and analysis of a particular topic affecting the business environment in Cambodia. Also included are opinions on topic from a number of relevant stakeholders.

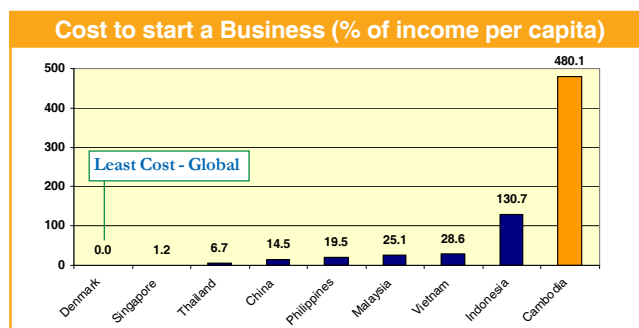
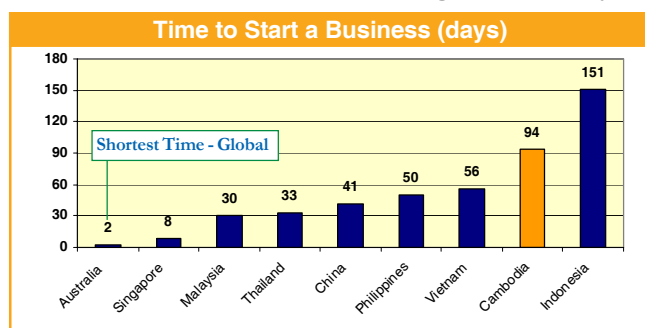
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The statements and opinions presented here are only meant to provide additional reference material and do not reflect the official opinion of the Mekong Private Sector Development Facility or of IFC.

¹ Rectangular Strategy for growth, employment, equity and efficiency of the Royal Government of Cambodia, delivered by Samdech Hun Sen, the Prime Minister, in the first cabinet meeting of the third legislature of the National Assembly, July 16, 2004.

² Unless otherwise noted, the information provided in this *Bulletin*, including statistics, charts and graphs, conclusions and recommendations are drawn from the Doing Business 2005 Report, a joint publication of the World Bank and the International Finance Corporation. The full Doing Business 2005 report can be found at URL: <http://rru.worldbank.org/DoingBusiness/Main/About.aspx>

Figure 1 - Entry Regulation before reform



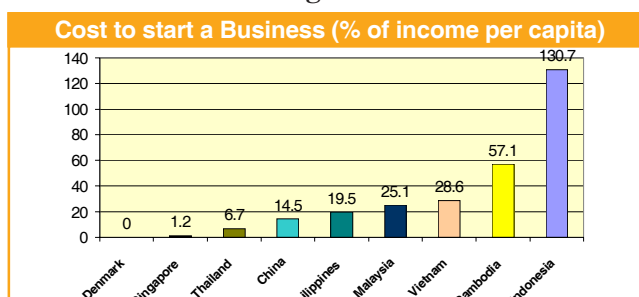
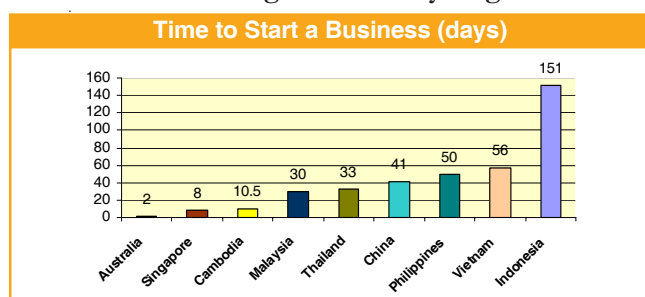
official costs of registering a company from US\$635 to US\$177, and the official time required from 30 to 10.5 days. There is no information to date as to whether unofficial fees and delays have also declined, since the change in regulations is too recent. However, since the new regulations have been widely disseminated, it is likely that unofficial costs and delays have gone down too.

Reducing registration time to only 10.5 days makes Cambodia a leader in Southeast Asia, trailing only Singapore, which has a registration time of 8 days (see Figure 2). However, the cost of registration in Cambodia remains high when compared with per capita income (US\$310 in 2005). Cambodia also compares unfavorably with other countries in the region (see Figure 2). Only in Indonesia is registration more expensive.

tered. This can be a hindrance to private sector investment as securing rights to property through proper registration strengthens the incentive for owners to build on their property. Holding formal title to property also enables entrepreneurs to mortgage their land and buildings, and thus raise the financing they need to develop their businesses.

However, formalizing property rights through registration is of little value if this does not make it easy and inexpensive to formally transfer property rights. If the procedures for transferring property rights from seller to buyer are too slow and costly, the transfer will occur informally – without proper updating of titling records in the property registry. This turns formally registered titles back into informal ones – which means that owners

Figure 2 - Entry Regulation after reform in Cambodia in August 2004



The current standardized cost of starting a business in Cambodia is based on the new official cost and the data on per capita income provided in the Doing Business database [(US\$177/US\$310) = 0.5709677]

H.E. Sok Siphana, Secretary of State, Ministry of Commerce

It may be hard to further reduce the cost of registration. Putting the cost of doing business into perspective, \$177 is relatively small. And, because it is just a one time cost, companies can amortize the cost over the life of the business.

Nou Tepirith, Attorney At Law (Senior Partner), Bou Nou Ouk & Partners

When companies start their businesses, relevant ministries also evaluate them. These include the Ministry of Environment, Ministry of Tourism, and the Ministry of Energy, Mines and Industry. These ministries don't have clear procedures and a time table for assessing companies. For example, when the Ministry of Environment conducts an environmental assessment of a garment factory, they don't do it when the factory prepares for construction – they do it when construction is almost complete. This makes the investment climate unpredictable and can adversely affect the costs paid by the investor.

Registering Property

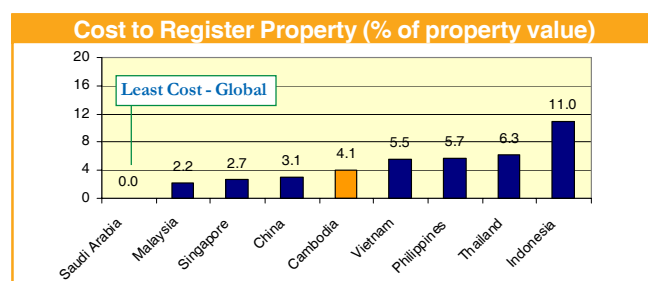
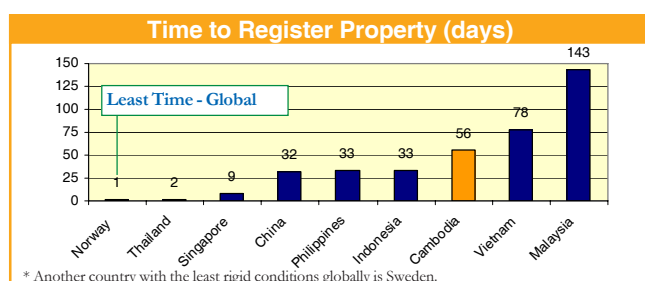
Land and buildings account for between half and three-quarters of country wealth in most economies. In developing countries such as Cambodia, however, very little property is legally regis-

no longer have the benefit of formal property rights.

Compared to other countries in the region, Cambodia's performance with regard to formalizing property rights is about average. Data from *Doing Business* indicate that in Malaysia, Singapore and China it is less expensive to register and transfer the rights to property (see Figure 3). The official cost is 4.1% of the property value in Cambodia, compared to 2.2% in Malaysia. However, the time it takes to legally register property in Cambodia is slow compared to other countries in the region. Only in Vietnam and Malaysia does the transfer of legal title to property take more time than in Cambodia. For example, for a business to purchase land and the building(s) on it in peri-urban Phnom Penh, the law requires the completion of seven different procedures which take an average of 56 days to complete. In contrast, business owners in Thailand can accomplish the same transaction in only two days with only two procedures.

One thing stands out in the process of registering property in Cambodia: over half of the time spent on registration – at least 30 out of 56 days – is devoted to obtaining the Certificate of Title from the Municipal Land Office. If the time on this one procedure could be reduced, property registration could be completed more quickly. The consequences of it taking so long to acquire legal title to land, is that much of Cambodia's land is never prop-

Figure 3: Benchmarking— Registering Property



erly registered.³ This greatly limits opportunities for business owners to use their land as collateral to raise financing.

Mr. Lan Sinara, Director of Marketing & Sales, Cambodia Real Estate

The official cost of registering and transferring title is 4% of the total value of a property. This tax that has to be paid by purchasers of the property. The average actual cost of transferring the title of an apartment is US\$1,300, around half of which is for informal fees paid to officials dealing with property registration. The average actual cost of transferring the title of a villa is US\$2,000. Again, half of the fees are informal.

The actual time spent registering title to a property ranges from two weeks to a month and a half, with the average being a month.

Fee schedules for property registration vary for different sizes of property, but these are not published. Only officials working in the Cadastral Office have access to this information, which enables them to pocket some money.

Mr. Hem Hour Narith, Managing Partner, BNG Advocates & Solicitors

Checking property title to verify ownership, a common procedure in property transactions worldwide, is very time consuming in Cambodia. This slows down property transactions. I think that property title records should be available on the Internet so that they can be verified quickly. The government should also develop guidelines on property tax payment and make these accessible to the public.

Enforcing Contracts: Court Efficiency

When one party to a contract fails to live up to the terms of the contract, the court is usually the default institution for resolving the problem, especially in developing countries where alternative dispute resolution mechanisms such as commercial arbitration are not established or do not function well. But enforcing contracts through the court system can be costly and time-consuming,

as Figure 4 shows. The time and costs required to enforce a contract in Cambodia compare unfavorably with other countries in the region.

As Figure 4 indicates, going to court to enforce a contract in Cambodia does not make economic sense for a company. It takes an average of 401 days to enforce a contract, and court and attorney fees cost 121.3% of the value of the debt. Thus for every \$100 of unpaid debt, a Cambodian business must pay \$121.30 in court and legal fees to recover it. This compares unfavorably to \$9 per \$100 in Singapore, and \$13.40 per \$100 in Thailand. This makes resorting to the court system more expensive in Cambodia than in any other country in the region, except Indonesia.

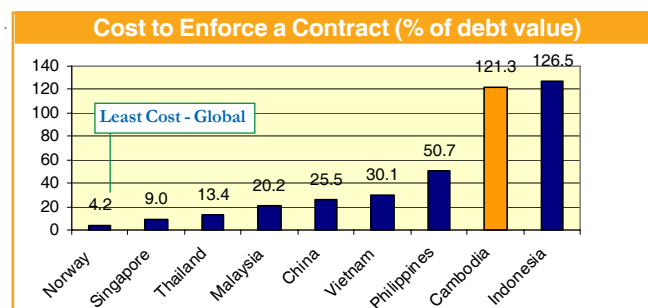
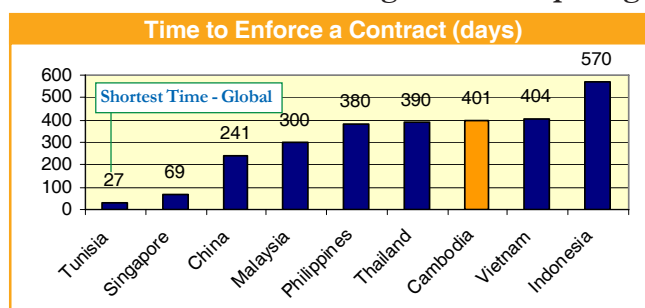
Almost all of this expense is fees to attorneys. While not mandatory, the use of an attorney to collect unpaid debts is common and the high costs for court and attorney in Cambodia put smaller businesses and the poor at a disadvantage because they cannot afford high legal costs. As a consequence of the high cost to recover a debt in Cambodia, business owners, and especially SME owners, are reluctant to do business with anyone they do not know well. This forces companies, particularly SMEs, to adopt conservative business practices. They deal only with customers they trust and structure transactions with new business partners to ensure that credit will be repaid. Both approaches restrict the growth of SMEs and because SMEs comprise 99% of the firms in Cambodia, and provide 45% of total employment, limiting SME growth means hampering job creation and overall growth of the economy.⁴

H.E. Sok Siphana, Secretary of State, Ministry of Commerce

Contracts are the foundation of commerce. It is the belief that the court will enforce contracts that drives businesses to explore opportunities throughout the world. If businesses have no confidence in the court system to resolve their commercial disputes, then no economic policies of government will have much result.

Our court system needs swift reform. Besides reforming the court, alternative dispute resolution (ADR) mechanisms, such as commer-

Figure 4: Comparing Contract Enforcement



³ Chan, Sophal, Tep Saravy and Sarthi Archarya (2001). Land Tenure in Cambodia, a Data Update. Working Paper 19, Cambodia Development Resource Institute, Phnom Penh p. i.

⁴ Royal Government of Cambodia, SME Secretariat of the SME Subcommittee (2004), SME Development Framework, Phnom Penh, page 1.

cial arbitration, have to be introduced to expedite and lower the cost of settling commercial disputes. It is important too that the private sector is actively involved in ADR because it's their business, so they know their issues very well.

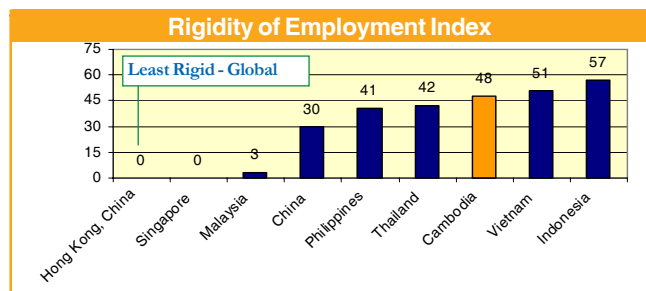
Hiring and Firing Workers

Providing jobs to new labor force entrants and maintaining employment for those who already have jobs is a contentious issue for many governments. Hence, governments work hard to promote the growth of businesses so that more jobs are created, while at the same time establishing laws and institutions to protect the interests of workers.

Figure 5 compares Cambodian labor regulations with those of other countries in the region and beyond. As Figure 5 indicates, Cambodia's labor regulations are among the more rigid when it comes to hiring workers. Hiring is only more difficult in Vietnam and Indonesia. However when it comes to firing workers, Cambodia has the most liberal regulations.

Although well-intended, some employment policies can have adverse consequences for workers if they are too rigid. When employment regulations are not flexible enough, employers fail to officially record the hiring of workers in order to save themselves the trouble of following time-consuming and costly official rules. This puts workers at a disadvantage because they do not receive legal protections such as regulated work hours, rights to collective bargaining, etc.

Figure 5: Labor Regulations



of temporary job holders, however, should be three to five times as much as those of regular job holders.

CONCLUSIONS

Cambodia has made great strides in improving the business environment in some areas. As already discussed, the most notable improvement is "entry" regulations. In August 2004, Cambodia cut the cost and time required to register a business, and also reduced capital requirements from US\$5,000 to US\$1,000. As a result, the number of new companies legally registering their businesses has grown significantly, averaging 122 registrations per month since September 2004, compared to only 61 per month before that.⁵ The success of the company registration reform clearly shows that when there is political will, the government can achieve impressive results.

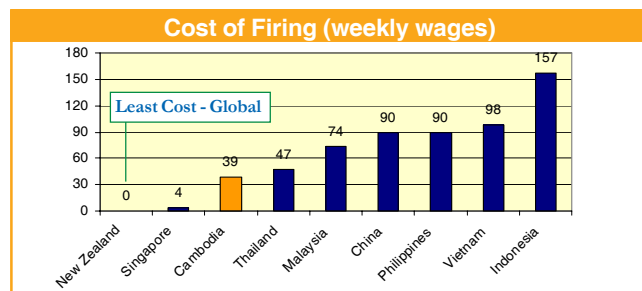
RECOMMENDATIONS

Improve court efficiency in enforcing contracts

Among the most pressing challenges are the costs and delays involved in contract enforcement. Cambodia needs to make it easier and faster to collect debts. To improve the efficiency of contract enforcement and the collecting of debts, Cambodia could look to the Philippines' abridged procedures that save time and money because they do not require an attorney's expertise.

Speed up property registration

For faster property registration, Cambodia could follow Thailand's lead in consolidating all procedures in one place – the registry – which would eliminate duplication by different agencies, unnec-



Mr. Ken Loo, Secretary General, GMAC

Although labor supply is abundant, procedures for hiring staff are cumbersome. An employer has to inform the Ministry of Labor every time a new employee is hired. In law, firing a worker is easy, but in practice it is not. According to the labor law, a company has to pay compensation when no valid reasons [for firing the worker] are offered.

To ease the difficulty in hiring workers, the government could allow an employer to report new hires quarterly or bi-annually. With regard to firing, there is no need for additional provisions.

Mr. Seng Phally, Executive Director, Cambodian Labor Organization (CLO)

The finding in this study (both for hiring and firing workers) is relevant only to the formal labor market, particularly in the garment sector. It's not true for the less productive and mostly non-wage informal labor market, which comprises 70% - 80% of employment.

To address the issue of difficulty in hiring, the government should allow more flexible hiring policies. That is, employers should be able to hire workers on irregular or temporary bases. The salary base

essary red tape, costs and delays. Much simpler and less expensive procedures to register property will encourage many more people to register their property. This could free up an enormous amount of "dead capital" currently tied up in untitled property.⁶ If more businesses had legal title to their land and buildings, more could borrow against these assets and thus get the financing they need to operate their businesses effectively or expand.

Revise rigid requirements for hiring and firing workers

Cambodia needs to strike a balance between creating jobs and protecting workers. Issues such as statutory limits on the number of overtime hours allowed, the size of the premium paid for overtime, and restrictions on night work should be re-considered in order to allow employers and employees to decide these issues collectively. If employers had more leeway to determine these issues with employees, they would likely be more willing to formally employ workers and thus entitle them to more benefits.

⁵ Ministry of Commerce, as presented in the "Kick-off Workshop for the SME Development Program" jointly organized by the Ministry of Industry, Mines and Energy and the Asian Development Bank, May 11, 2005.

⁶ Soto, Hernando de (2001). *The Mystery of Capital: Why capitalism triumphs in the West and fails everywhere else*. Black Swan. London. Page 27.