

BUSINESS ISSUES BULLETIN

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COMPANY REGISTRATION IN CAMBODIA: WHY DO FIRMS STAY INFORMAL?

The private sector in Cambodia is characterized by a high degree of informality—as of late 2003, only approximately 9,000 companies had registered their businesses while 27,000 other industrial enterprises did not.¹ Yet for any country to achieve long term, sustainable economic development, the private sector must have room to grow to its full potential. Thus, in this bulletin, we discuss reasons why private companies in Cambodia may be deterred from registering their businesses and suggest recommendations to improve the process.

Company Registration Process According to Cambodian Law²

All merchants engaging in commercial activities are required to register with the Ministry of Commerce (MOC), its provincial or municipal office, or other places determined by the Ministry. In addition, a company must also secure patent tax and value added tax (VAT) identification numbers from the Ministry of Economy and Finance and approval for its Internal Rules from the Ministry of Labor before it is considered legally registered. A company whose type of business falls under the jurisdiction of another Ministry which requires technical oversight must also secure an operating license from that Ministry.¹

The total cost of the process if carried out by an entrepreneur on his/her own, is approximately US\$1,500, and the average total time spent is 94 days, counting the time needed for processing the registration application at the MOC and licenses from other Ministries (see below). Only some of these costs are official fees; others are informal.

Table 1: Starting a Business (Regional Comparison)

Country	Numbers of Procedures	Duration (days)	Cost (US\$ value and % GNI per capita)
Cambodia	11	94	US\$1550.50 553.8
Indonesia	11	168	US\$ 103.01 14.5
Lao PDR	9	198	US\$ 60.41 19.5
Malaysia	8	31	US\$ 960.51 27.1
Philippines	11	59	US\$ 243.48 24.4
Singapore	7	8	US\$ 248.50 1.2
Thailand	9	42	US\$ 143.59 7.3
Vietnam	11	63	US\$ 128.66 29.9

Source: The World Bank Group: Doing Business
(<http://rru.worldbank.org/doingbusiness/>)

¹ The Asian Development Bank's Private Sector Assessment for the Kingdom of Cambodia, December 2003, Phnom Penh, p. 10.

² The Law on Commercial Regulations and Commercial Register (1995) and the Law on the Amendments of the Law on Commercial Regulations and Commercial Register (1999).

³ Detailed information on the steps can be obtained from the World Bank website at <http://rru.worldbank.org/doingbusiness/>



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, and exposure to different opinions held by various stakeholders on the topic.

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These costs are very high for an economy where per capita income is less than US\$300. Compared regionally, costs in both time and money (calculated as percentage of gross national income 'GNI' per capita) are among the highest in ASEAN countries—the registration costs in Cambodia are 76 times higher than in Thailand, 28 times more than in Lao PDR, and 18 times more than in Vietnam.

In terms of amount of time spent, it takes Cambodian firms 52 days longer to start their businesses than it does for counterparts in Thailand, and 30 days longer than counterparts for in Vietnam; these countries are Cambodia's closest competitors for Foreign Direct Investment (FDI). Such high fees and long delays in registering a business are unfavorable signals to investors that they may face serious bureaucratic difficulties if they invest in Cambodia.

I haven't registered this business with the Ministry of Commerce because once I register I will be subject to VAT (10%) and real regime tax. This is a lot money, and I would not be able to compete with smuggled eggs and chickens.

To encourage more companies to register, the government should decentralize the process to the district level. To make this possible, requirements for "Memorandum of Association" should be simplified by creating a standard form to fill in. Staff in the district office of the MOC should be properly trained to carry out company registration. However, large firms that involve import and export should remain under the jurisdiction of the MOC.

*Anonymous businessman
Owner of a poultry farm*

The problem with the company registration process is that the legal framework needs to be improved. Moreover, weak enforcement of the tax law discourages business people from registering their company. Non-registered companies are "free" from any kind of tax and duties including profit tax, patent tax and VAT. Consequently, the prices of goods or services offered by non-registered companies are more competitive than those of registered companies.

*Mr. Bun Youdy
Secretary General of the Bar Association of the
Kingdom of Cambodia*

It is untrue that it takes 94 days to register a company in Cambodia. You have to be clear whether you are talking about an "investment company" or a "non-investment company." For investment companies, it takes only 28 days to register, and that is administered by the Council for Development of Cambodia (CDC).

For non-investment companies, registration is administered by the MOC. It takes only 7–10 days to register if all of the company's paperwork is correct. It can take longer if a company applying for registration happens to operate in technical areas where the Ministries that have technical oversight require an "operating license" first before a company can register.

The official fee that the MOC charges to companies registering a business is only \$30, which the Ministry uses for administrative and stationery expenses. Another \$30 is also collected to include the name of the company in the Official Business Bulletin published by the MOC. Other costs are not associated with the MOC. For example, the \$300 for preparing the "Memorandum of Associations" is a payment for the service that is provided by the person who writes the Memorandum for the company.

*H.E. Mao Thora
Secretary General of the Ministry of Commerce*

Company Registration According to Practice

Because the registration process is expensive and time consuming, many Cambodian companies do not complete the registration process themselves; instead they hire facilitators, who either work for government agencies, are free agents associated with government, or are lawyers. A survey by MPDF found that among 13 businesses registered in Phnom Penh, the total cost of registration using a facilitator ranges from \$700 to \$8,000; of those, eight paid \$1,850 or less. The higher costs paid by the remaining five companies are attributed to lawyers' fees.⁴

⁴ MPDF's unpublished survey on company registration, 2002. In total, 23 entrepreneurs who had registered their businesses and 20 government officials whose agencies have authority over the registration process were interviewed.

Using a facilitator, we paid \$700 to register. Registering was worth it because it assures customers that they are dealing with a legitimate company. To minimize confusion and reduce costs in the registration process, the government should publish all the procedures and costs of registration, and issue receipts.

*Mr. Srun Angkaren
Manager NAS Business Consultants*

We paid US\$1,500 in registration fees for the whole process. We used a facilitator because the procedures are complicated. It took about 3 weeks. We have never been bothered by the local authorities since registration. We never pay bribes for anything.

To simplify the registration process, the government should establish a “one-stop” service for company registration, and differentiate fees according to the size of a company.

*Mr. Sin Dina
Business Manager, Unilever Cambodia Ltd.*

The registration process is expensive for SMEs, but not for large and foreign firms. The actual cost is a little bit less than what was found in MPDF’s study. Registration is \$1,300 for a standard limited liability company (\$650 for MOC, \$500 for the Tax Department, and \$150 for the Phnom Penh Municipality).

In my opinion, fees should vary with the size of company. However, there should be no discrimination based on the nationality of company owners.

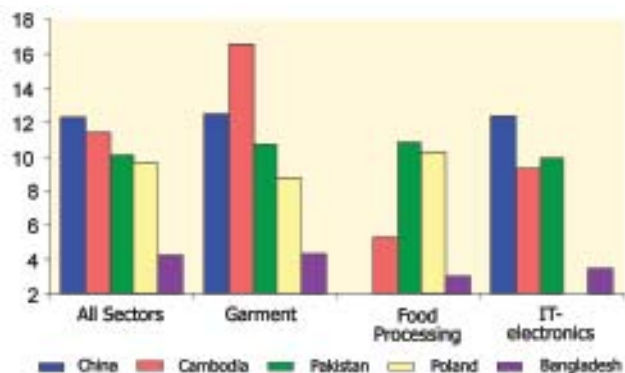
*Mr. Naryth Hem
Senior Partner, BNG Advocates & Solicitors*

Firms stay informal to avoid bureaucratic scrutiny

While the high cost of registration is discouraging firms from registering their businesses, more serious are the bureaucratic problems that firms encounter once they formally register. According to the World Bank Investment Climate Survey (ICA) carried out earlier this year, formally-registered firms spend more time dealing with public officials.⁵ In the garment sector—where most businesses are formally registered—owners spend more time dealing with public officials

than those in other sectors in Cambodia, and in the garment sector in other countries (see Figure 1). Conversely, in the food processing sector—where most businesses are not registered—companies spent considerably less time dealing with government officials relative to other sectors in Cambodia and to the food processing sector in other countries.

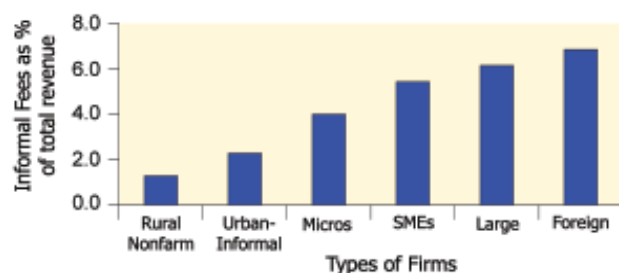
Figure 1: Percent of Management Time that is Spent Dealing with Public Officials & Regulation



Source: World Bank Investment Climate Survey (2003)

The study also found that formally-registered firms in urban areas pay a far higher percentage of total revenues as informal fees than is the case with informal firms in urban areas (three times as much). In addition, the total amount paid in informal fees increases with the level of formality. The rate of informal fees varies from 5.5% of total revenue for SMEs, which might or might not register, to 6.1% and 6.9%, respectively, for large local firms and those that are foreign-owned and very likely to register. Hence, it appears that the more visible a business is, the more administrative scrutiny it faces and the more likely it is to pay kickbacks.

Figure 2: Informal Fees are Strong Incentives to Remain Small and Informal



Source: World Bank Investment Climate Survey (2003)

⁵ The ICA was carried out as part of the World Bank’s global exercise to investigate the investment climate in 133 economies. In Cambodia, the ICA surveyed 502 businesses in five major cities, plus 100 more informal urban firms (in Phnom Penh), and 200 rural non-farm businesses.

Conclusion

The low number of formally-registered businesses in Cambodia is at least partially the result of the costs involved in company registration. Ambiguities in the process allow room for bureaucratic discretion and corruption by the agencies involved in registration, and thus make the costs of registration unpredictable. This gives rise to facilitators who see opportunities to make money by providing services to those who are reluctant to register by themselves. Hence, the actual cost of company registration becomes even higher and further discourages firms from registering their businesses.

An even greater deterrent to registering, however, may be the costs companies incur after registration. Paying at least 5.5% of annual revenues in unofficial fees after they register their business could be just too high for many companies. The costs that result from legally registering a business may outweigh any potential benefits to be derived.

Recommendations

If the two major impediments: a) high costs and delays in registration; and b) the requirement to pay more informal fees after registration were eliminated, more firms would be likely to register their businesses. This would benefit the government both by increasing tax revenues and facilitating better planning of private sector development. Thus, the following reforms are suggested:

Reduce registration costs and increase transparency

The government should review all the steps, fees and time periods involved in registering a business to see if they can be reduced to become more competitive with other countries in the region.

Clear guidelines for registration and information on costs and time requirements should be published and widely distributed so that they are well-

understood by entrepreneurs. To speed up the registration process, creating a time bound “one-stop service” office could be considered, similar to the one already available to large investors at the CDC.⁶ However, it is important that employees of such an office receive adequate training and monitoring, as they will have significant amounts of discretionary power.

In Indonesia, the Asia Foundation has supported the development of “one-stop shops” (OSS), and has found that a well-run OSS can reduce the formal and informal costs of obtaining required permits and licenses, as well as dramatically reduce the time spent shepherding the application across various desks in the bureaucracy. An efficient OSS can also unleash local economic growth and may even increase government tax revenues by bringing more firms into the formal sector.

*Ms. Veronique Salze-Lozac’h
Economic Program Manager, The Asia Foundation*

Reduce the penalties of formality

While lower registration costs may encourage more companies to register, a more important incentive would be assurance of a reduction in unofficial fees after a company has registered.

Visits by government authorities to companies should be restricted to only those agencies that have genuine reasons to visit. Visits should not be, as they are now, at the discretion of an individual who may simply be looking to extract a bribe from an entrepreneur. Having clearly defined rules about inspections would enable business owners to protest if unauthorized visits take place; it would also help the government’s inspection system work more efficiently.

Since 2002, visits by the local authorities have declined between 90-95%. Visits were much more frequent before 2001. I don’t know why this has changed. The remaining 5% of visitors we get now are from the Fire Department and the Police.

*Mr. Ear Meng Sun
Owner of Golden Eagle Fish Sauce Company*

⁶ Private Sector Assessment Mid-term report: Private Sector Strategy (June 2003), Phnom Penh: Asian Development Bank, page 49.