The Provincial Business Environment Scorecard in Cambodia

A Measure of Economic Governance and Regulatory Policy

Summary Report

April 2009
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¹ The Provincial Business Environment Scorecard (PBES) is a partnership between the International Finance Corporation and The Asia Foundation, with funding support from Danida, DFID and NZAID, through the Multi-Donor Livelihoods Facility.
Table of Contents

Abbreviations .................................................................................................................................................... vi
List of Tables .................................................................................................................................................... vii
List of Figures .................................................................................................................................................... vii
Acknowledgments ............................................................................................................................................. viii
1. Introduction ............................................................................................................................................ 9
2. Provincial Business Environment Scorecard and Sub-Indices ............................................................ 11
   2.1 Overall scoring strategy ................................................................................................................ 11
   2.2 The sub-indices .............................................................................................................................. 11
   2.3 Survey strategy ............................................................................................................................... 12
3. Profile of Cambodian firms .................................................................................................................... 13
   3.1 Cambodia’s firms are micro-enterprises ..................................................................................... 13
   3.2 Increase in small and medium enterprises ................................................................................... 14
   3.3 Concentration of firms in the Phnom Penh region is decreasing ............................................. 14
   3.4 Firms tend to operate only within their home province.............................................................. 15
   3.5 Most firms are in services or commerce ...................................................................................... 16
   3.6 Women are active in business. ..................................................................................................... 16
   3.7 Firms are young.............................................................................................................................. 17
   3.8 Business growth is likely to continue ......................................................................................... 17
4. The 2009 PBES Rankings: Explanation and Analysis ........................................................................ 19
   4.1 Rankings......................................................................................................................................... 19
   4.2 Improvement in some provinces’ rankings over time ................................................................. 21
   4.3 High ranking, but far from perfect .............................................................................................. 23
   4.4 Impact of governance improvements ............................................................................................ 23
   4.5 Individual policies .......................................................................................................................... 24
5. Conclusion ............................................................................................................................................ 31

Appendix A1 - Methodology .......................................................................................................................... 33
Appendix A2 - Constructing the PBES .......................................................................................................... 37
Appendix A3 - Relationship between the 2006 and 2009 PBES results ..................................................... 39
# Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
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<tr>
<td>DANIDA</td>
<td>Danish International Development Agency</td>
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<tr>
<td>DFID</td>
<td>United Kingdom’s Department for International Development</td>
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<tr>
<td>DIME</td>
<td>Department of Industry, Mines, and Energy</td>
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<tr>
<td>DOC</td>
<td>Department of Commerce</td>
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<tr>
<td>DOT</td>
<td>Department of Tourism</td>
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<tr>
<td>ICA</td>
<td>World Bank’s Investment Climate Assessment</td>
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<td>IFC</td>
<td>International Finance Corporation</td>
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<td>MDLF</td>
<td>Multi-Donor Livelihoods Facility</td>
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<tr>
<td>MIME</td>
<td>Ministry of Industry, Mines and Energy</td>
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<td>MOC</td>
<td>Ministry of Commerce</td>
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<td>MOT</td>
<td>Ministry of Tourism</td>
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<td>MSME</td>
<td>Micro, small, and medium enterprises</td>
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<td>NZAID</td>
<td>New Zealand’s International Aid &amp; Development Agency</td>
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<td>PBES</td>
<td>Provincial Business Environment Scorecard</td>
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<td>VAT</td>
<td>Value added tax</td>
</tr>
<tr>
<td>WB</td>
<td>World Bank</td>
</tr>
</tbody>
</table>
List of Tables

Table 1: Changes in Distribution of Enterprises by Size (2006 and 2009 PBES).................. 15
Table 2: Comparison of Phnom Penh to Business Environments in Other Provinces .......... 21
Table 3: Impact of Individual Sub-indices on the Probability that Business Owners Will Expand their Businesses .................................................................................................. 26
Table 4: Levels of Cambodian Business Formalization...................................................... 28
Table A1: Who Answered the 2009 PBES Survey?............................................................... 35
Table A2: Detailed Descriptions of Sub-Indices and Component Indicators....................... 41

List of Figures

Figure 1: Distribution of Enterprises by Size........................................................................ 14
Figure 2: 2009 PBES Listing – Geographical Distribution of Enterprises.............................. 15
Figure 3: 2009 PBES Listing – Distribution of Enterprises by Sector..................................... 16
Figure 4: 2009 PBES Listing – Distribution of Enterprises by Sex of Owner........................ 16
Figure 5: 2009 PBES Listing – Distribution of Enterprises by Years of Operation .............. 17
Figure 6: Final 2009 PBES Ranking........................................................................................ 19
Figure 7: Final 2006 PBES Ranking....................................................................................... 20
Figure 8: Performance on Individual Sub-indices ................................................................. 24
Figure 9: Relationship Between Governance and Business Expansion.................................. 25
Figure 10: Relationship Between 2006 and 2009 PBES Rankings......................................... 40
Acknowledgments

The 2009 Provincial Business Environment Scorecard Project is a collaborative effort between the International Finance Corporation and The Asia Foundation. We are grateful to donors of IFC and The Asia Foundation for their financial support.

The process of conducting the 2009 PBES survey, including the listing of business establishments, would not have been possible without support from H.E. Sar Kheng, Deputy Prime Minister and Minister of Interior; H.E. Cham Prasidh, Senior Minister and Minister of Commerce; H.E. Suy Sem, Minister of Industry, Mines and Energy; and H.E. Dr. Hang Chuon Naron, Secretary General of the Ministry of Economy and Finance. The Deputy Prime Minister, Senior Minister, Ministers, and the Secretary General issued separate letters of endorsement for the project.

Like other research endeavors, the 2009 PBES is the result of the collaborative efforts of many individuals. The project’s technical advisor and author of the report was Dr. Edmund Malesky, with support from Krislert Samphantharak and Paul Schuler. Overall supervision and advice on the 2009 PBES was provided by Charles Schneider, Soneath Hor and Veronique Salze-Lozac’h. Khy Touk and Sambath Sak took the lead in developing and managing the production of the 2009 PBES. Lang Sok and San Tea carried out spot checks on the quality of interviews in the field to ensure accuracy. Kent Helmers managed the field research and was assisted by Sinin Kith and Vuthy Bun. Ann Bishop was the technical editor and proof reader. Kunthea Kea undertook graphic design and layout. Tonie Tan provided valuable administrative support.
In Kratie Province, a window and door shop owner states: “In my province, provincial officials do not support business activities. They never visit or invite us to talk about our business environment problems.” However, in the neighboring province of Kampong Cham, the owner of a small brick factory feels that his province’s business climate has improved. “Bribes have declined sharply. A reduction in administrative procedures has helped to reduce corruption.”

As these stories indicate, entrepreneurs’ experiences with local authorities can vary dramatically from one Cambodian province to another. While laws and regulations are decided at the national level, how they are understood and implemented depends very much on provincial authorities. Differences in the quality of economic governance from one province to another contributes to uneven levels of growth across Cambodia.

In order to understand how provinces are supporting or preventing business growth, International Finance Corporation and The Asia Foundation have collaborated in developing the Provincial Business Environment Scorecard (PBES). The 2009 PBES ranks all 24 provinces on the quality of their economic governance.

The PBES provides reliable data to help businesses and local governments identify which governance factors are most in need of improvement. This evaluation is particularly important because it will help Cambodia’s micro, small, and medium enterprises (MSMEs), which represent over 95% of private enterprises, to achieve their potential in creating jobs in rural areas where the majority of Cambodians live and poverty rates are highest. Creating jobs is more important than ever with 230,000 young people joining the labor market every year.3

The PBES, which covered 10 Cambodian economically important provinces in 2006, and all 24 provinces in 2009, relies largely on the perceptions of business owners to generate a scorecard that ranks provinces on measures of business environment quality. In this way, the PBES helps public officials identify province-specific areas for reform.

The PBES also gives business owners the evidence they need to advocate effectively for reforms and engage public officials in productive discussions about how to achieve reforms. Numerous obstacles such as lack of information on regulations, time consuming procedures, unofficial charges, and the poor delivery of essential public services all hamper business growth.

In addition to pointing out areas for reform, the PBES identifies provinces engaging in good practices so that other provinces can learn from these examples. Also, 2006 PBES and 2009 PBES provide a baseline against which policymakers and regulators can monitor the results of reforms over time.

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2 Economic governance refers to the nature and practice of economic management, regulation and development; or the institutional environment that governs economic activities.

3 Cambodia Economic Watch, Economic Institute of Cambodia (April 2005).
2. Provincial Business Environment Scorecard and Sub-indices

2.1. Overall scoring strategy

The PBES scores are generated through a mixture of responses to survey questions and ‘hard’ data collected from government sources and other published materials. These data are all grouped into 10 broad sub-indices (categories), which are assessed on a 1-10 point scale. Added together, these 10 sub-indices create a 100-point overall score for economic governance. Technically, it is possible for a province to receive a perfect score of 100 if it earns top scores on all 10 indicators, however, perfection is very difficult to achieve. Indeed, all provinces have low scores in some areas.

Before describing the sub-indices and the survey strategy, it is important to note that the sub-index rankings are based on how provinces perform relative to other provinces on particular survey questions and other data. Therefore, the point totals are not comparable to point totals in other countries or some ideal measure of governance. Rather, the sub-indices should be viewed as measures of comparative achievement of provinces in the Cambodian context. For a more detailed explanation of the scoring strategy, see Appendix A2 of this report.

2.2. The sub-indices

The following 10 sub-indices were used to grade all 24 of Cambodia’s provinces.

1. Entry Costs: A measure of the time it takes for firms to register and receive all the necessary licenses to start a business; the number of licenses required; and the official costs of registering and obtaining all required licenses/permits.

2. Property Rights: A measure of the formal rights businesses have to the land and buildings they occupy and their security of tenure once land is properly acquired and titled.

3. Transparency: A measure of whether firms have access to the information they need about government regulations and procedures, as well as the related legal documents necessary to run their businesses; whether regulatory information and legal documents are available to everyone who asks; and whether new policies and laws are communicated to firms and enforced in a predictable manner.

4. Time cost of regulatory compliance: A measure of how much time firms spend on complying with government regulations, how long they wait for procedures to be completed, as well as how frequently firms are inspected by local government agencies.

5. Informal Charges/Bribes: A measure of how often firms pay informal charges such as bribes and kickbacks to obtain government contracts; the extent to which these informal
payments are obstacles to business operation, and whether informal payments are predictable and achieve the expected results.

6. Participation: A measure of whether firms are consulted about proposed provincial policies and whether business associations or other interest groups advocate on behalf of business owners.

7. Crime Prevention: A measure of how much firms pay in costs that result from theft as well as the costs to prevent crime by paying for security services and/or ‘protection money’.

8. Tax Administration: A measure of both administrative procedures related to paying tax and the cost of tax in the province.

9. Proactivity of Provincial Leaders: A measure of the creativity and willingness of provincial authorities to interpret national policies and regulations in favor of local private firms and develop their own provincial initiatives to promote private sector development.

10. Dispute Resolution: A measure of firms’ satisfaction with the outcomes of formal and informal methods of dispute resolution in their province.

2.3. Survey strategy

Each sub-index is based primarily on responses to survey questions answered by Cambodian business owners in the 2009 PBES. To ensure that the results accurately reflect conditions throughout the country, sophisticated survey and sampling techniques were used to ensure that no region or type of business was over or under-represented, and that survey questions generated meaningful responses. In total, 1,234 business owners from all 24 provincial capitals plus ten economically important districts across the nation were surveyed.

Among the randomly selected 1,234 interviewees, the PBES also interviewed representatives from 152 firms that participated in the 2006 PBES survey. These previously interviewed entrepreneurs were critically important in 2009 PBES because they experienced the business environment in 2006 and could directly compare this with conditions two years later. This provided the best opportunity to compare changes in economic governance over time.

For a more detailed description of how the survey and sampling were conducted and how the panel respondents were selected, see Appendix A1.
3. Profile of Cambodian Firms

To help understand the results of the PBES survey, it is useful to look at the listing of businesses from which survey respondents were drawn. Since exhaustive and comparable lists of businesses in Cambodia’s 24 provinces had not been made, the PBES research team gathered basic information on MSMEs in the capital city of each province, plus one additional district in Cambodia’s 10 most economically-active provinces. Counting all businesses operating within three kilometres of the center of each provincial capital and in selected districts added up to a total of 63,507 firms. Of these businesses, 95.5% agreed to provide the information requested by the research team so the data in the listing are extremely reliable.

Because we only counted businesses within provincial capitals and selected districts, we cannot claim that our listing covers all businesses in Cambodia. Since we only included 10 districts, in addition to provincial capitals, there is a slight urban bias to the findings. Also we have likely missed some large manufacturing establishments (particularly in food processing) that are located more than three kilometres from the center of town. That said, the listing of businesses created for the PBES is certainly the most comprehensive listing of businesses to date and systematic data collection procedures mean that data is directly comparable across Cambodian provinces. Also, the listing of more than 63,507 businesses in all 24 provinces, served as an ideal sample frame for randomly selecting the 1,234 entrepreneurs who were surveyed for the 2009 PBES.

Before examining how the index was constructed, it is helpful to review some key features of Cambodia’s private sector. First, while private sector development attracts a lot of attention, very little statistical information is currently available on Cambodia’s private enterprises. What do Cambodian businesses look like? By providing a valuable profile of Cambodia’s private sector, the listing and descriptive information from the survey provide general answers. Second, a more accurate picture of the Cambodian business environment will provide a framework for understanding the needs of specific business environments. Third, and most important for this report, a picture of the nation’s firms provides more context regarding who responded to the survey which was used to generate the PBES scorecard.

3.1 Cambodia’s firms are micro-enterprises

The most striking finding from the listing of almost 64,000 businesses across Cambodia is the very small size of most firms. For 69% of businesses, the only employee is the owner, 90.4% of enterprises in the listing have fewer than four employees, and 96% have fewer than 10 (Figure 1). If one refers to the general definition of a micro-enterprise as an enterprise with less than 10 employees,4 then 96% of Cambodian businesses are micro-enterprises.

4 Definition used by the Ministry of Industry, Mines and Energy.
While this report uses the terms ‘MSMEs’, ‘firms’, ‘enterprises’ and ‘establishments’ interchangeably, readers should keep in mind that 96% of firms are micro-enterprises. Table 1 compares the 2006 and 2009 PBES listings in order to study changes in the business community over time. Overall, the distribution of enterprises by size has changed only slightly since 2006. Businesses with fewer than four employees still make up the vast majority of enterprises (92% in 2006 and 90.4% today).

### 3.2 Increase in small and medium enterprises

Overall, more businesses are opening in Cambodia. If we look just at the firms surveyed in the 10 provinces covered by the 2006 listing (hereafter referred to as the ‘Original 10’), we see that the total number of businesses grew by 27% in the past two years. Although there were some differences in the methods used in the 2006 and 2009 PBES to generate the listing of businesses, the difference would probably lead to an underestimate of the extent of business growth. It is clear that more and more entrepreneurs are taking the risk of starting a business, and moreover, the growth rate was highest for larger businesses. The number of business with between 10 and 20 employees has nearly doubled over the past two years, while those with over 20 employees grew by almost 200%. Both of these trends, while still at an early stage, should contribute to employment growth and poverty reduction in the long run.

### 3.3 Concentration of firms in the Phnom Penh region is decreasing

As Figure 2 demonstrates, the listing shows a strong concentration of enterprises in the capital city and surrounding provinces. Phnom

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5 For a more detailed analysis of changes in firms and how the numbers were re-weighted to reflect population differences between provinces, see Appendix A1 and Table A1.

6 The 2006 PBES counted all businesses in the three largest districts and capital of a province, while the 2009 PBES only considered enterprises in the capital city and one additional district in each of Cambodia’s 10 most economically active provinces.
Penh accounts for 45% of all enterprises. While this is a substantial share, it is much smaller than in 2006, where Phnom Penh accounted for 60% of businesses. In the current listing, Battambang comes far behind Phnom Penh with 10% of all enterprises listed, and Phnom Penh’s neighboring province, Kandal, has 7% of businesses. The high percentage of businesses concentrated in Phnom Penh is comparable to that in other capital cities in developing countries in Southeast Asia and beyond.

3.4 Firms tend to operate only within their home province

Not only are businesses small, they are also quite ‘provincial’. Ninety percent of surveyed businesses operate solely within their home province, and only 10% export. Businesses in Phnom Penh are more sophisticated than those in other parts of Cambodia, with 16% of firms engaged in exporting.  

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7 As a result of Phnom Penh’s disparity and its under-representation in the national sample, the nationally-weighted sample differs slightly from the PBES sample. See Table A1 for more details.
3.5 Most firms are in services or commerce

If we disaggregate by sector, both the listing and the PBES survey show that 93.5% of enterprises are concentrated in services or commerce (48.2% and 45.3%, respectively), while manufacturing and construction account for only 5.4%, and natural resource exploitation account for only about 1%. Figure 3 displays this data from the comprehensive business listing.

3.6 Women are active in business

The important role that women play in the private sector is shown in Figure 4. With women owning 62% of listed enterprises, their role in economic growth is substantial. However, gender distribution varies tremendously by province, with Prey Veng, for example, showing a large percentage of women business owners (almost 75%).

![Figure 3: 2009 PBES Listing - Distribution of Enterprises by Sector](image)

![Figure 4: 2009 PBES Listing - Distribution of Enterprises by Sex of Owner](image)
3.7 Firms are young

Finally, the listing shows that the majority of the enterprises listed are young. Forty-two percent of businesses have operated for less than two years, while another 22% have operated for less than five years (Figure 5). This indicates dramatic growth in entrepreneurial activity over the past few years. This result has critical implications for analysis of the survey results. The rapid growth of new start-ups in the past few years means that many firms have only just begun operations, and have not yet registered their enterprise and joined the formal sector.

3.8 Business growth is likely to continue

Drawing on data from the PBES survey, it seems likely that rapid growth in the private sector will continue. Forty-nine percent of businesses surveyed for the PBES intend to increase their business activities over the next two years. However, these figures should be treated with some caution as the survey was conducted before the international financial crisis began in late 2008.

![Figure 5: 2009 PBES Listing – Distribution of Enterprises by Years of Operation](image-url)
4. The 2009 PBES Rankings: Explanation and Analysis

The following sections show the PBES rankings and discuss them in the context of Cambodian economic development.

4.1 Rankings

Figure 6 presents the results of the 2009 PBES. This is the sum of provincial scores on each of the 10 sub-indices. Because 10 possible points are available for each sub-index, the final ranking is on a 100 point scale. To achieve perfection, a province would need to be ranked first in every one of the PBES indicators. It is important to remember that the rankings are relative, based on best practices in Cambodia. Provinces are not being compared to some ideal and possibly unobtainable measures.

4.1.1 Kampong Cham retains top position

As in 2006, Kampong Cham is the top-ranked province, though in 2009, the gap between the provinces ranked first and second is much smaller. Kampot, the fourth-ranked province in the 2006 index, has moved up to second place. Now only two points separate Kampot from

For a detailed explanation of how the scores were compiled, see Appendix A2 and the Technical Reports (2006 & 2009).
Testimonials about entry costs from Koh Kong Province, the highest ranked newcomer in the 2009 PBES.

Manufacturing Enterprise Manager: I did not need to go to a government office to apply for a permit for my business. Government officials came to me, instead. It took one week to receive a Patent and three days for a license from the Provincial Department of Industry, Mines and Energy.

Electric Equipment Shop Owner: A government official came to my business with an application for a permit. It took only one week to receive a Patent and one more week for a permit from the Provincial Department of Commerce.

Restaurant Owner: A Patent took only one day to process after we collected and submitted all required documents from village and commune chiefs. I had to negotiate the application price as there is no official price schedule. It would be good to have one-window service to take care of business establishment paperwork.

Figure 7: Final 2006 PBES Ranking

Kampong Cham; in 2006, the gap between Kampong Cham and Svay Rieng, the second ranked province, was almost 9 points.

Although consistently ranking first, Kampong Cham still has aspects of economic governance that need to be improved. While provincial officials continue to earn high scores on proactivity and dispute resolution, ratings concerned with entry procedures, land access, transparency, and informal charges have declined noticeably.

Sihanoukville and five newcomers (Koh Kong, Pursat, Oddar Meanchey, Rattanakiri, and Prey Veng) complete the list of provinces that scored above 60 points. Phnom Penh, the national capital and heart of the Cambodian economy, ranks last. A margin of over six points separates it from the other low-ranking provinces.

4.1.2 The case of Phnom Penh

The extremely low score for Phnom Penh warrants special explanation. To some extent, Phnom Penh is handicapped by urbanization and population density, problems that do not burden its peers. Municipal officials in Phnom Penh are stretched to capacity in order to provide services for such an enormous population and cater to the many and complex demands of the country’s most diverse population. It is not surprising that waiting periods for business documentation and land titles take longer. There are simply not enough government officials and resources to meet the demands. In addition to a shortage of officials, urbanization poses distinct problems (crime, pollution, heavy use of infrastructure and maintenance costs). These
Table 2: Comparison of Phnom Penh to Business Environments in Other Provinces

<table>
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<tr>
<th>Indicator</th>
<th>Phnom Penh</th>
<th>Other</th>
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<tr>
<td>Percentage of enterprises denying the occurrence of bribery</td>
<td>45%</td>
<td>68%</td>
</tr>
<tr>
<td>Percentage of enterprises denying commission payments on government contracts</td>
<td>13%</td>
<td>32%</td>
</tr>
<tr>
<td>Percentage of enterprises paying protection payments to local police</td>
<td>30%</td>
<td>5%</td>
</tr>
<tr>
<td>Percentage of enterprises negotiating tax payments with local officials</td>
<td>67%</td>
<td>57%</td>
</tr>
</tbody>
</table>

issues pose challenges not found to the same extent in other regions. Thus, Phnom Penh’s low performance can be justified, in part, by its unique position as the centre for Cambodia’s economic and social life.

On the other hand, many of Phnom Penh’s sub-index scores cannot be explained only by its urban status. Interviewee responses in Phnom Penh indicate that civil servants stand out for their low level of service quality. The 2009 PBES data show that this is not matched elsewhere in Cambodia. As Table 2 shows, compared with other provinces, business owners in Phnom Penh are far more likely to: 1) pay small bribes to local officials; 2) pay commissions in order to win government contracts; 3) give protection payments to local police officers to avoid criminal activity; and 4) negotiate their tax payments with local officials.

It is little wonder that business owners in Phnom Penh appear to blame the government for their troubles (only 32% rated officials’ attitudes as positive) and many lack confidence in public institutions (only 18% believe that local institutions will protect their property rights). Worse yet, poor governance has affected the attitudes of local entrepreneurs in the capital. Whereas 60% of entrepreneurs elsewhere in the country plan to expand operations over the next two years, just 45% of businesses in the capital have such plans. In fact, 3.6% of Phnom Penh firms are planning to close down in the next two years, compared to only 1% of firms in the rest of the country.

Phnom Penh will remain the center of the Cambodian economy for the foreseeable future. It will continue to have the largest share of business activity, as well as attract the most investment and the most talent. These successes result not from good governance, but from Phnom Penh’s endowments which include: a large urban market for goods and services; the country’s most highly educated population; far better infrastructure; cheaper energy prices; and close proximity to government and thereby to opportunities for lucrative national contracts. Nevertheless, governance in Phnom Penh will continue to constrain overall growth. Phnom Penh will never reach the full economic potential that its endowments provide unless something is done to improve service quality and reduce the risks of doing business.

4.2 Improvement in some provinces’ rankings over time

Since the 2006 PBES, a number of provinces have taken important steps to improve their business environment.

The largest improvers were Sihanoukville and Siem Reap. Both ranked near the bottom in the 2006 rankings, but have since moved up to the top and middle tiers respectively. Siem Reap demonstrates improvement in nearly 9 of 10 categories. Sihanoukville has taken a less consistent path, improving radically on five sub-indices, despite slight declines and stagnation in others. In general, Sihanoukville's advances outweighed its set-backs. Both provinces showed
the most dramatic advances in preventing crime, facilitating entry costs, securing property rights, and enhancing transparency.

It is useful to think about the rapid governance improvements of Siem Reap and Sihanoukville in contrast to decline in the nation’s capital. Like Phnom Penh, these localities benefit from propitious endowments. Siem Reap attracts tourists every year due to the unparalleled splendor of the Angkor Wat complex, while Sihanoukville receives investment because its Cambodia’s only deep water port, tourism has strong potential and Sihanoukville has possible oil reserves off its coast. Both locations could easily rest on their laurels, attracting investment every year while making minimal advances in governance and regulation. Yet, in the last two years, both locations have invested significant resources to create more efficient and transparent regulations. Siem Reap especially stands out as one of only a few provinces that have easy-to-understand regulatory information readily available in the lobbies of government agencies.

Sihanoukville also excels in transparency of business information. The research team, which visited all 24 provinces, found that Sihanoukville agencies were among a select group with regulatory information clearly posted, and

**Land Titles in Battambang**

A businesswoman described her experience applying for a land title. First, she went to the village and commune offices for an application and had to make a payment for the application and for each required signature. At the tax office, she had to negotiate the tax fee. At first, tax officials wanted to collect taxes on 2.5 times the actual market price of her land.

“My land cost 10 USD per square meter on the market, but [the government officials] quoted the price at 25 USD per square meter. I asked them to buy my land if they were sure about the price. I had to negotiate the tax price three times and pay fees for all kinds of services, including paper, pen, stamp, and even for them to complete the form. I wondered for what do they receive their government salaries? My last stop was at the Department of Land Management, Urban Planning and Construction. My application for the land title will take two to three months to process and cost $5,000 for a 30m x 80m plot.”

**Governance Improvements in Siem Reap**

A guest house owner said he finds out about new laws and regulations that affect his business from newspapers, media coverage, and respective government departments. “The provincial tax department comes four times per year to give information on tax issues,” he said. “The provincial department of tourism provides information on tourist trends, rules, and regulations.”
where maps of future infrastructure projects were readily accessible, without having to make special requests or contacts to obtain them.

By contrast, other provinces (Phnom Penh, Battambang and Banteay Meanchey) have slipped over time. These declines were primarily a result of lower scores on land access, informal charges, and tax administration.

### 4.3 High ranking, but far from perfect

In contrast to other countries, where sub-national indices have been created⁹, Cambodian provinces are tightly clustered in their final scores. No single province stands out as having far better governance than its peers. With very little reform effort, low ranking provinces could quickly climb up the ladder in future surveys. Even the top-ranked provinces of Kampong Cham and Kampong have much room for improvement. This fact is vividly displayed in the star charts in Figure 8, where branches represent performance on each of the individual sub-indices. An ideal province that scored a 10 on each sub-index is represented in the top left-hand corner of the figure. After this perfect score, figures for each province are displayed according to their final PBES score. It is important to note that no province comes close to the ideal.

Furthermore, significant deficiencies are evident, even in the provinces with the very highest rankings. For instance, informal charges and tax administration continue to pose obstacles to business owners in Kampong Cham. Similarly, Kampot officials have more work to do in improving transparency and proactivity in local decision making. By contrast, lower ranked provinces have achieved success in isolated areas. Their policies for achieving these scores deserve study and emulation. As an example, Kandal (ranked 16th overall) ranks among the top provinces in terms of property rights and the time spent complying with regulations.

### 4.4 Impact of governance improvements

By improving governance in areas where their scores are lowest, provincial officials help MSMEs to prosper. When regulation and arbitrary enforcement costs are reduced, entrepreneurs are more likely to risk their capital and energies on business expansion. A ten-point improvement in PBES scores, roughly the difference between Kratie and Kampong Cham, results in a 9.9% increase in the chance that an entrepreneur will expand his/her business. This relationship is illustrated more succinctly by the blue line in Figure 9.

Table 3 shows that five sub-indices are of primary importance for provinces to consider improving in order to encourage entrepreneurs to expand their businesses: informal charges, ease of regulation, entry procedures, crime prevention, and tax administration. For instance, a single point improvement on the informal charges sub-index is associated with a 3.3% increase in

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Crime in Kampong Cham

A small-sized steel window and door entrepreneur, said that armed robberies and burglaries often go unreported because of lack of faith in the authorities. “The victims didn’t report crimes to the authorities because they don’t believe that the authorities can solve the cases and return what has been stolen… People, especially business owners, have tried to protect their property by themselves…”

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⁹ The Provincial Competitiveness Index (PCI) in Vietnam, the Economic Governance Index in Sri Lanka, and similar indexes in Indonesia or the Philippines. For more information see: http://www.youtube.com/watch?v=7UPgfRT8bm0
the chance of business expansion. Time cost of regulatory compliance, entry procedures, crime prevention, and tax administration are associated with changes of similar size. The other sub-indices are of lower priority with regard to business expansion.

Policy decisions always involve trade-offs. Devoting time, energy, and financial resources to one policy goal, generally means that other objectives are left wanting. Knowing which policy choices will provide the biggest spur to business activity can be a crucial factor in helping narrow the choice of initiatives that provincial officials should consider. Table 3 should be a useful tool for provincial authorities to use in choosing among these important policy trade-offs.

It is, however, important to note that although participation or transparency rank very low, they may be instrumental in achieving progress in the high impact sub-indices.

4.5 Individual policies

Table A2 details the different sub-indices and indicators that combine to give the overall score. A few highlights from the PBES indicators are:

4.5.1 Improvements in the overall business environment

Entry Costs: Entry costs appear to have improved generally across the country. In addition to the provinces that have implemented a ‘One-window’ office for registration procedures since the last PBES, we can also see that the total number of documents required in order to become fully legal has declined (down from 5 to 4). The total number of days for business registration at the Provincial Department of Commerce has also declined (down from 20 to 16.75 days), and the time required to pay the Patent Tax for very small operations is considerably lower too (down from 15 to 12.25
The one exception to this general trend is the time required to obtain a one-year operating license, which has actually increased somewhat. Formal fees for business documentation have also increased, but their increase is far below the rate of inflation recorded over the same period.  

**Time Costs of Regulatory Compliance:**
Regulatory procedures show some sign of easing. While firms do report spending more of their time on bureaucratic procedures, the median number of business inspections has declined (from four to two times per year) and waiting periods for new land for existing businesses has been cut in half from 60 to 30 days.

**Tax Administration:** Some improvement in tax administration is also apparent. Fewer firms negotiate their final payment with local authorities (64% on average in 2006, compared to 54% in 2009) and consequently fewer owners complain that paying bribes to lower taxes is a problem (80% down to 75%). Of course, these are only marginal improvements. Seventy-five percent of businesses still consider that paying bribes to the tax authority is an obstacle to business operations. This is a very high proportion by international standards. In addition, more firms cited frustration with tax rates and tax administration. This shows that there is much more work to be done to construct a fair and equitable tax system that appropriately taxes firms for government services, but is not so prohibitive that it handicaps their ability to conduct business. It is notable that the number of firms not paying any taxes at all has nearly doubled in the past two years. In part, this may be a reflection of the youth and informality of new operations, but it could also be, in part, a reaction to a tax system that many business owners believe is unfair. This has negative consequences for national and provincial

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10 Fees for business documentation include formal and informal fees that business owners have paid to obtain formal documents for starting up a business.
11 The median is the middle value in a list of numbers.
governments because they are deprived of important revenue they could use to improve infrastructure and public services.

4.5.2 Declines in key areas

The 2009 PBES also captures some deterioration in the business environment. Some of these indicators are critically important and should be given immediate attention by local, provincial, and national officials.

**Formality:** Most strikingly, there appears to be a growing proportion of businesses operating in the informal sector, as Table 4 demonstrates. In 2006, 3% of PBES respondents were formally registered nationally at the Ministry of Commerce and another 38% of businesses were registered at Municipal or Provincial Departments of Commerce. Most others either had a one-year operating license from the relevant line ministry or paid a simple fee to the local tax authority (the Patent Tax). Only 16% of firms had no documentation at all. Similarly, 11% of operations were in the real tax regime and therefore paying turnover taxes.

In 2009 PBES, a significant decline in registrations was evident. While the number of businesses registered centrally had increased to 14.4%, the number of businesses completing registration procedures at the provincial level had declined to 13.3% in the original 10 PBES provinces. Over 40% of operations now have no business documentation at all. Correspondingly, only 4.3% of operations are paying taxes under the real regime.

The size of a business matters a great deal with regard to formality. Fifty percent of respondents with more than $100,000 in total investment are registered at either the central or provincial level, as opposed to 25% of those with less than $100,000 in invested capital. This does not explain the decline in the 2009 PBES, however, as Table 1 shows, the number of large enterprises was greater than in the 2006 PBES.

For the most part, the decline in formality results from the youth of new businesses. Forty-two percent of businesses were started since 2006. These new businesses are an indicator of recent economic growth in Cambodia, and
may simply not have had time yet to fulfill all of the formalities of becoming fully formal. Of businesses of any size that have been established since 2006, only 17.3% are fully formal (8.9% at the national level and 8.4% at the provincial level). In fact, when we concentrate our attention only on the panel respondents (meaning respondents who agreed to be surveyed for both the 2006 and 2009 PBES), we can see that existing businesses have actually become more formal over time. Twenty-six percent of panel respondents are now registered at the central level.

Despite the fact that a business’ age is the primary determinant of formality, careful attention should be paid to this indicator over time to verify whether other factors may also be playing a role in continuing informality.

**Informal Charges:** Informal charges also appear to have worsened slightly. In the 2009 PBES, only 52% of businesses denied paying bribes to local officials, down from 56% in the 2006 PBES. Moreover, there has been an 8% increase in the number of businesses reporting that corruption is an obstacle to their business (now 42% in the median province). Most strikingly, 31% of businesses report that if they pay one bribe, additional agencies are also likely to visit them and ask for bribes. In 2006, only 17% of businesses in the median province reported this multiplier effect. While public procurement has improved marginally, much more improvement needs to take place. Only 19% of firms in the median province believe that there is sufficient and transparent information on public procurement contracts, while 62% of businesses believe that personal connections are necessary to win a bid. Moreover, 75% of businesses believe that ‘kick backs’ are regularly required to win government contracts.

**Transparency:** Transparency of business documentation has declined as well. Fewer firms have access to basic business documentation or even know whether such documentation exists at all. Only 20% of businesses in the median province know what a provincial budget is. In total, 73% of businesses claim to be uninformed about changes in laws that materially affect their businesses. Fifty-five percent of businesses in the median province believe some sort of relationship is necessary with local authorities to get such documentation. Furthermore, 47% believe there is overt favoritism toward politically-connected firms.

It has been said before, but it bears repeating: transparency is critical for small businesses. The more information they have, the better they can forecast business prospects and risk. This allows them to make educated decisions about investment and expansion. Without such information, firms avoid expansion for fear of experiencing unanticipated problems due to changes in laws and other factors that impact the business climate. Access to clear and reliable information about regulations, legal fees and taxes not only make business owners more responsible, but also less vulnerable to arbitrary decisions. Furthermore, transparency is among the easiest policy choices to make. It is far easier to increase access to information than to change local institutions. Provincial officials who are seeking a short-term boost in their province’s PBES score would benefit from simply making information available in the lobbies of the local agencies where business owners go to seek information.

**Dispute Resolution:** Dispute resolution shows significant decline as well. Most importantly, entrepreneurs report less confidence in formal institutions. Only 22% of firms in the median province believe that the legal system will protect their property rights; down from 34% in 2006. Correspondingly, only 41% of respondents were satisfied with resolution of their contractual disputes over the past year, and 65% of businesses were not successful in recovering
Table 4: Levels of Cambodian Business Formalization

<table>
<thead>
<tr>
<th>Levels</th>
<th>Description</th>
<th>Key Documents Required</th>
<th>Representation in PBES Samples</th>
</tr>
</thead>
</table>
| 1      | Fully Formal – National | Registration at Ministry of Commerce  
Three-year Operating License from relevant ministry†  
Patent Tax registration at Central Tax AuthorityΨ  
Value Added Tax (VAT) identification number from Ministry of Economics and Finance  
Paying profit tax under real tax regime.  
Labor permit certifying approval of company’s internal rules for enterprise with over 8 employees  
Environmental Certificate governing solid waste and water disposal from the Ministry of Environment  
Other licenses when applicable‡ | 2009 Full | 2009 Original 10 | 2006 Full |
|        |             |                        | 13.3% | 14.4% | 3.0% |
| 2      | Fully Formal – Provincial | License to Operate a Commercial Enterprise from Provincial/Municipal Department of Commerce*  
One-Year Operating License from Ministerial Department at Provincial Level† | 13.9% | 13.3% | 38.0% |
|        |             | Patent Tax registration at Provincial/Municipal Tax AuthorityΨ  
Paying estimated tax if under $1500 annual profits  
Other licenses including Labor Permit and Environmental Certificate when applicable‡ | 13.5% | 12.4% | 21.0% |
| 3      | Unregistered w/ Operating License | One-Year Operating License from Ministerial Department at Provincial Level† | 13.5% | 12.4% | 21.0% |
|        |             | Patent Tax registration at Provincial/Municipal Tax AuthorityΨ  
Other licenses including Labor Permit and Environmental Certificate when applicable‡ | 23.7% | 19.6% | 22.0% |
| 4      | Patent Tax | Patent Tax registration at Provincial/Municipal Tax AuthorityΨ | 35.7% | 40.3% | 16.0% |
| 5      | Fully Informal | No formal documentation | 23.7% | 19.6% | 22.0% |

2009 Full: PBES sample employing stratified random sampling to mirror the population in all 24 provinces.

2009 Original 10: Analysis limited to ten provinces studied in 2006.

2006 Full: PBES sample in 2006 that included only 10 provinces

† The 4 most common are the Factory Operating License for Industrial Enterprises from the Heavy Industries Section of MIME; the Handicraft Operating License from the Handicraft and Light Industries Section of MIME; the Service Sector Operating License from MOT; and the Agricultural, Forestry, and Fisheries Operating License from the Ministry of Agriculture, Forestry, and Fisheries.

‡ These include Construction Permits from the Ministry of Land Management, Urban Planning, and Construction; the Road Construction License from the Ministry of Public Works; Sanitation Permits; and Import/Export Licenses from the Customs Authority.

Ψ The Patent tax is an annual registration (or license) fee levied on all businesses, industries and professions, though farmers are exempted. The tax is based on turnover from the previous year. New businesses must register with the tax authorities within 15 days after beginning economic activity (Law on Taxation, 1999). The first Patent tax is estimated in accordance with the performance of similar enterprises. Firms that do not wish to export may register with the provincial-municipal commerce division (under Prakas 78-MOC-2002).

* Firms that do not wish to export and are not eligible to pay profit taxes under the “real regime,” as they earn less than $1500 in annual profits (Article 12 of the Law on Commercial Enterprises and Registration).
payments owed to them by delinquent clients. In 2006, 53% of businesses were unsuccessful in recovering monies owing to them. These findings are worrisome. First of all, the scale of unpaid bills is equal to about 2.8% of total sales, so poor dispute resolution is costing businesses a great deal of money. Secondly, as more businesses join the market and as Cambodia further integrates internationally, formal means of dispute resolution will become even more crucial. Businesses will no longer be able to rely on social relations, local leaders, and other informal measures to enforce contracts, as they will be doing a greater proportion of business with firms outside their social networks. This lack of confidence in formal means of dispute resolution raises the risk of doing business and has the potential to limit business expansion and growth.
5. Conclusion

The PBES provides valuable information on how local business owners perceive and understand their business environment, what constrains them and how they feel about the performance of their public sector counterparts on different aspects of economic governance. It also highlights differences among provinces and shows that some provinces perform better than others in specific areas. It is thus a useful tool for local officials, the private sector, and other stakeholders to use in comparing the performance of their province with the performance of other provinces. This tool can also help officials to identify the specific strengths and weaknesses of their local business environment. As such, the PBES provides a practical tool for provincial officials to use in developing an actionable policy agenda and in consulting with the private sector.

In depth analysis of PBES results will help local officials and businesses to develop strategic public-private partnerships to address weak links and build on better practices. Also, even more important than comparing their overall rankings with other provinces, provinces have a great opportunity to learn from each other and share best practices and lessons learned by studying how performance on each sub-index varies from province to province.

In terms of prioritization, provincial officials may want to concentrate their learning and reform activities on reducing informal charges, crime, entry costs, regulatory enforcement costs, and the burdens of tax administration. These sub-indices are most highly correlated with prospects for business expansion. Also, mechanisms for gathering the opinions of businesses and enabling them to participate in shaping local policy generally appear to be of great importance in achieving governance improvements.
Appendix A1 - Methodology

This section provides a simple summary of the methodology used in the PBES. For more detailed information, please use the 2006 and 2009 Technical Reports.

A1.1: Sampling and Selection

The 2009 PBES research sampling strategy consisted of three broad steps.

First, a listing of all MSMEs was undertaken by the PBES research team within three kilometers of the center of each provincial capital, plus one district each in Cambodia’s 10 most economically active provinces. The listing and firm-level information was used to draw a stratified random sample of businesses for face-to-face interviews.

Second, these face-to-face interviews were conducted with business owners in order to capture businesses’ perceptions on key aspects of provincial economic governance.

Third, the findings from focus group discussions and published data related to economic development were assembled to complement the perceptions of the interviewees who took part in the survey. This third step is referred to as ‘secondary data collection’.

A1.2: Comprehensive Listing of Active Operations

Researchers travelled to each province to undertake a complete listing of businesses within three kilometers of the center of the provincial capital, plus the selected districts. Every business operation in a fixed location, formal and informal, was recorded along with basic information: the location of the business, the activity, the gender of owner, the number of employees, etc. In total, 63,507 firms were listed across Cambodia’s 24 provinces. The listing exercise was necessary due to the lack of an updated and exhaustive dataset on provincial MSMEs in Cambodia that was comparable across provinces. The data from the listing can be considered extremely reliable and representative, as the total response rate was 95.5%. No single province had a response rate lower than 90%. Moreover, the median provincial response rate of 98.9%, with a standard deviation of 2.2%, indicates that non-response bias did not impact any province disproportionately.

A1.3: The Survey

The listing was then used to randomly select a stratified provincial-level sample of 1,082 firms across all provinces, with the strata based on the sector and the number of employees
For the purposes of the study, analysis was focused on growth-oriented businesses, as opposed to merely subsistence-oriented operations. So all enterprises where the owner was the only permanent employee were excluded before sampling. The median provincial response rate for initial contact with firms was 60%. When a firm refused, a replacement firm was randomly selected from the list, so that target quotas for each province could be achieved. All provinces had at least 39 target respondents, but some more populous areas, such as Phnom Penh (111), Battambang (65), and Siem Reap (66) had slightly larger targets to ensure representativeness. Following general practices for calculating sampling error, we can assume a 4% margin of error around aggregate responses.

In face-to-face interviews, business owners were asked more than 60 questions regarding their perceptions of their business environment. Covering all 10 sub-indices, the questions addressed a variety of topics such as the time business owners spend on administrative tasks; the type of licenses they must have and how easy or complex they think the procedures are to obtain them; how much various business procedures cost in terms of time and money; interviewees’ comprehension of regulations and access to business documentation; the willingness and efforts of provincial leaders to help local businesses; the extent of informal charges and protection payments; whether businesses have commercial disputes and how these are resolved; and whether they have regular exchanges with public officials. Interviewees were also asked a battery of questions about the performance of their business and plans for its future.

In addition to the 1082 firms interviewed in stage 2, and using the same questionnaire, 152 firms/establishments already covered by the 2006 PBES, were re-interviewed. This panel group was crucial for measuring the evolution of business environments between the 2006 and 2009 PBES, as perceived by individual firms in the 10 provinces covered by the 2006 PBES. This panel group was comprised of businesses randomly selected from all the firms surveyed for the 2006 PBES. The panel is especially useful, because the perceptions of interviewees are impervious to sampling error. Because panel interviewees experienced the business environment in 2006, they can directly compare this with current conditions.

Table A1 provides descriptive information on the respondents who answered the survey. Four samples of businesses are compared. Column 1 assesses the entire PBES sample of 1,234 businesses in 2009 without re-weighting. These data provide an accurate reflection for each province, but cannot be used for national-level analysis. By stratifying at the provincial level, the PBES data tend to underestimate large provinces such as Phnom Penh and Battambang. To provide national-level conclusions based on the PBES survey, Table A1 re-weights answers by the proportion of Cambodia’s total firms in each province, so that Phnom Penh’s importance to the economy is accurately reflected in the data. These proportions are the same ones

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12 The exception was Stung Treng, Oddar Mancheay and Preah Vihear, where the number of growth-oriented businesses was too small to support a statistically reliable sample. In this case, some single-employee companies were sampled. To maintain comparability with the other provinces, replacement firms were randomly sampled based on descending floor area size, so that larger subsistence-based businesses had a higher probability of selection.

13 The response is not perfect, but is extremely high for business surveys in general, especially in developing countries. Given the sensitive nature of the instrument and the fact that many firms were answering such questions for the very first time, the response rate is very impressive. Please note, however, that response rates were significantly reduced in provinces affected by the Preah Vihear border conflict. Bateay Meanchey (33%), Battambang (43%), Oddar Mancheay (39%), and Preah Vihear (29%) all had below average responses. Robustness testing indicated that low response rates did not impact final PBES rankings.
Table A1: Who Answered the 2009 PBES Survey?

<table>
<thead>
<tr>
<th></th>
<th>Provincially Representative Sample</th>
<th>Original 10 Provinces</th>
<th>Panel Respondents</th>
<th>Nationally Representative Sample</th>
</tr>
</thead>
<tbody>
<tr>
<td>Observations</td>
<td>1234</td>
<td>675</td>
<td>152</td>
<td>1234</td>
</tr>
<tr>
<td>Respondent’s Position in Firm</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Owner and Primary Manager</td>
<td>88.2%</td>
<td>86.4%</td>
<td>92.8%</td>
<td>83.2%</td>
</tr>
<tr>
<td>Owner without Management Responsibilities</td>
<td>1.30%</td>
<td>0.74%</td>
<td>1.3%</td>
<td>2.5%</td>
</tr>
<tr>
<td>General Manager</td>
<td>6.16%</td>
<td>7.70%</td>
<td>2.6%</td>
<td>10.2%</td>
</tr>
<tr>
<td>Employee</td>
<td>1.30%</td>
<td>2.37%</td>
<td>3.3%</td>
<td>2.53%</td>
</tr>
<tr>
<td>Relative of Owner</td>
<td>4.16%</td>
<td>2.82%</td>
<td></td>
<td>1.6%</td>
</tr>
<tr>
<td>Establishment Year</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Before 1991</td>
<td>6.2%</td>
<td>7.9%</td>
<td>7.9%</td>
<td>8.2%</td>
</tr>
<tr>
<td>Between 1991 and 1996</td>
<td>13.7%</td>
<td>15.6%</td>
<td>23.7%</td>
<td>15.6%</td>
</tr>
<tr>
<td>Between 1997 and 2002</td>
<td>23.6%</td>
<td>23.6%</td>
<td>30.3%</td>
<td>18.0%</td>
</tr>
<tr>
<td>After 2002</td>
<td>56.5%</td>
<td>53.0%</td>
<td>38.2%</td>
<td>58.1%</td>
</tr>
<tr>
<td>Size of Firm (Number of Employees)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2 or less</td>
<td>62.2%</td>
<td>58.1%</td>
<td>54.6%</td>
<td>52.3%</td>
</tr>
<tr>
<td>Between 3 and 5</td>
<td>24.1%</td>
<td>25.3%</td>
<td>27.0%</td>
<td>26.1%</td>
</tr>
<tr>
<td>Between 6 and 10</td>
<td>8.8%</td>
<td>9.8%</td>
<td>12.5%</td>
<td>12.7%</td>
</tr>
<tr>
<td>Between 11 and 30</td>
<td>4.4%</td>
<td>5.9%</td>
<td>5.9%</td>
<td>7.7%</td>
</tr>
<tr>
<td>More than 30</td>
<td>0.6%</td>
<td>0.9%</td>
<td>0.0%</td>
<td>1.3%</td>
</tr>
<tr>
<td>Percent Seasonal Hires</td>
<td>4.5%</td>
<td>4.9%</td>
<td>5.2%</td>
<td>3.8%</td>
</tr>
<tr>
<td>Size of Firm (Investment Size)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$10,000 or less</td>
<td>57.1%</td>
<td>54.8%</td>
<td>50.7%</td>
<td>55.8%</td>
</tr>
<tr>
<td>Between $10,000 and $50,000</td>
<td>29.2%</td>
<td>30.4%</td>
<td>34.2%</td>
<td>30.9%</td>
</tr>
<tr>
<td>Between $50,000 and $100,000</td>
<td>6.0%</td>
<td>5.9%</td>
<td>5.3%</td>
<td>5.2%</td>
</tr>
<tr>
<td>More than $100,000</td>
<td>7.7%</td>
<td>8.9%</td>
<td>9.9%</td>
<td>8.1%</td>
</tr>
<tr>
<td>Primary Sector of Operations</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manufacturing</td>
<td>9.1%</td>
<td>8.6%</td>
<td>7.9%</td>
<td>9.0%</td>
</tr>
<tr>
<td>Construction</td>
<td>0.2%</td>
<td>0.4%</td>
<td>0.0%</td>
<td>0.1%</td>
</tr>
<tr>
<td>Service/Commerce</td>
<td>90.4%</td>
<td>90.5%</td>
<td>90.8%</td>
<td>90.7%</td>
</tr>
<tr>
<td>Agriculture/Aquaculture</td>
<td>0.2%</td>
<td>0.4%</td>
<td>1.3%</td>
<td>0.1%</td>
</tr>
<tr>
<td>Primary Sales Location</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>In Home Province of Firm</td>
<td>89.4%</td>
<td>90.5%</td>
<td>98.0%</td>
<td>86.1%</td>
</tr>
<tr>
<td>In Other Cambodian Provinces</td>
<td>0.7%</td>
<td>1.0%</td>
<td>1.3%</td>
<td>0.9%</td>
</tr>
<tr>
<td>Exported Internationally</td>
<td>9.9%</td>
<td>8.4%</td>
<td>0.7%</td>
<td>13.1%</td>
</tr>
<tr>
<td>Plans over Next Two Years</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase Size of Operations Considerably</td>
<td>18.9%</td>
<td>19.3%</td>
<td>19.1%</td>
<td>17.1%</td>
</tr>
<tr>
<td>Increase Size of Operations</td>
<td>41.1%</td>
<td>38.2%</td>
<td>32.9%</td>
<td>32.8%</td>
</tr>
<tr>
<td>Continue Operating at Present Size</td>
<td>36.2%</td>
<td>38.2%</td>
<td>41.5%</td>
<td>45.5%</td>
</tr>
<tr>
<td>Reduce Size of Operations</td>
<td>1.9%</td>
<td>2.1%</td>
<td>3.3%</td>
<td>1.1%</td>
</tr>
<tr>
<td>Reduce Size of Operations Considerably</td>
<td>0.5%</td>
<td>0.4%</td>
<td>0.7%</td>
<td>0.6%</td>
</tr>
<tr>
<td>Plan to Close this Business</td>
<td>1.4%</td>
<td>1.8%</td>
<td>2.6%</td>
<td>2.9%</td>
</tr>
</tbody>
</table>

1. 2009 PBES drew a random stratified sample, based on the total number of employees in 24 provinces.
2. Analysis limited to ten provinces studied in 2006.
3. The 2009 PBES panel surveyed 152 firms that participated in the 2006 PBES.
4. Re-weighted PBES sample reflects the national proportion of firms within each province.
shown in Figure 2 above. Descriptive statistics by the national-level weighting can be viewed in Column 4. For comparative purposes, descriptive data are also provided just for firms in the ten provinces originally surveyed in 2006 (Column 2) and for the 152 panel respondents (Column 3).

### A1.4: Case Studies

In addition to the standard questionnaire used for the survey, 85 firms/estabhlishments were interviewed to develop case-studies and collect quotes that are included as vignettes in this and other publications.
Appendix A2 - Constructing the PBES

A2.1. Choosing the Sub-indices and Constructing the Score

Once survey data is collected, responses of business owners are aggregated at the provincial level. Province-level indicators are selected to capture critical areas of economic governance for private sector development.

Dealing with Perception Bias

As 90% of businesses only do business inside their home province, there is a strong probability of perception bias. It is difficult for business owners to rank their provincial leaders fairly against other leaders when they have no idea what the business environment is like in other jurisdictions. We address this dilemma in two ways. First, the survey questions selected for inclusion in the index are heavily tilted towards more concrete (often countable) concepts, such as “How many regulatory inspections did your firm experience in the past month?” as opposed to more abstract approaches such as, “Rank the burden of inspections on a five-point scale.” In some cases, however, abstract questions are necessary to truly capture the business environment concept under study. Recognizing that perception bias can affect rankings in these cases, we merge secondary data into these sub-indices to correct for the bias. For instance, in the transparency sub-index we did not rely solely on interviewees’ perceptions of access to business information; instead, we sent a team of researchers to provincial agencies in each province to record whether they could easily obtain the basic documentation necessary to register and run a business in the locality. Two forms of secondary data are employed. Data from published and verifiable sources and data from self-observation, derived from sending a research team to every province to record basic facts about regulatory procedures.

Standardizing Indicators

Table A2 below provides a full listing of all sub-indices and indicators included within them. Descriptive information for each indicator is also provided, allowing over-time comparisons. Each indicator within a sub-index is standardized to a 10-point scale, with 10 representing the best score recorded in Cambodia that year and 1, the worst. All other provinces rank somewhere between these two end points.

Constructing Sub-Indices

Construction of sub-indices is based both on broad concepts discussed internationally among economists, and more narrow categories of Cambodian-specific business obstacles. Using these theoretical guides, particular indicators are selected to represent the concept covered by each sub-index. Sub-indices are calculated by taking the simple average of their composite indicators. As a result, they are also on a 10-point scale. When secondary data are included in a sub-index, a weighted average is employed to ensure that secondary data account for 40%
of the sub-index score. This is enough to correct for perception bias, but not enough to dominate the opinions of respondents.

**Assembling the Final PBES**

After the creation of sub-indices, a final PBES score can be efficiently assembled by summing up the sub-indices. Different weighting approaches are certainly possible. In 2006, the number of provinces was too small to objectively create weights of interest to policymakers (number of firms, investment growth, and profitability) by determining the impact of individual sub-indices on key outcome variables by using regression analysis. However, with more data in 2009, such an operation is possible. Nevertheless, we maintain the same unweighted approach to facilitate over-time comparisons. Table 3, however, does provide the analysis of the most important sub-indices. Interested users can supply their own weightings, as they see fit.

**A2.2. Advantages of a Relative Approach**

Three features of the PBES approach are worth noting. First, the scores are generated by comparing an individual province to the best and worst provinces on a particular indicator. By normalizing the scores around best economic governance practices already found in Cambodia and not against ideal and possibly unattainable standards of good governance, the PBES encourages sub-national governments to improve their performance. For each indicator, a ‘star’ or top-performing locality can be identified and any other province can conceivably attain a perfect score of 100 in future iterations by emulating these Cambodian best practices.

Second, the PBES is solely a measure of economic governance and regulatory policy. It does not assess initial conditions for development (that is, the fundamental underlying factors that contribute to economic growth in a province but that are virtually impossible to address in the short term, such as location, infrastructure, size of the domestic market, and human resources). In doing so, the PBES is able to rank all provinces on an equal basis without giving undue advantage to well-endowed locations. Thus, the PBES should not be confused with a measure of Total Investment Environment that includes both economic governance and measures of initial endowments (i.e. structural conditions).

Third, the indicators that comprise the PBES are actionable in the sense that they are specific items that provincial officials can target and monitor improvement upon, and they are action-worthy because they represent policies that private firms have identified as critical to their business success and that previous research has shown to be influential for firm performance.

The same 10 sub-indices used in 2006 PBES are used to allow for over-years comparison. They were designed to highlight private sector priorities as well as focus on the issues that can be influenced by local government.
Appendix A3 - Relationship between the 2006 and 2009 PBES results

For a comparative ranking such as the PBES, it is important to demonstrate that rankings do not change substantially from year to year. This consistency has important policy and methodological implications. In terms of policy, the stability of the rankings indicates that provincial reforms have long-lasting effects. They do not dissipate at the end of the calendar year; firms continue to benefit from them and recall their impact when questioned by interviewers.

Methodologically, the strong correlation with PBES rankings in 2006 indicates that ranking provinces against each other works quite well. The PBES can consistently identify top performers, while also identifying what lower ranking provinces need to do to improve their scores in future. Such stability is confirmation that the approach offers a consistent and accurate measure of provincial economic governance over time.

Figure 10 is a scatter-plot illustrating the relationship between the 2006 and 2009 PBES scores and rankings for the same 10 provinces. The first thing to notice about this figure is that it is very likely that past performance is an important determinant of future governance. The graph shows that past performance is an important determinant of future governance. The line shows, based on the 2006 PBES scores, what one would expect the province’s 2009 PBES score to be.

It is important to note that ‘stability’ in the scores does not mean that the scores cannot change. Over the past two years, a number of provinces climbed up the PBES ladder. These provinces can be identified immediately in Figure 10, as their actual 2009 PBES scores are above the prediction line.

14 The correlation coefficient, as a measure of the standardized covariance between 2006 and 2009 PBES, is 0.49 and is significant at the .05 level.
The shaded region shows a 95% confidence interval around that line. A confidence interval means that were we to repeat the PBES exercise and re-sample a new set of firms, 95% of the time, the true correlation line between the 2006 and the 2009 scores would lie within that region. The relationship may not be exactly the same, but we can say for certain that past performance would continue to be a strong and positive determinant of future governance.
### Table A2: Detailed Descriptions of Sub-Indices and Component Indicators

<table>
<thead>
<tr>
<th>1. Entry Costs</th>
<th>2. Property Rights</th>
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<tbody>
<tr>
<td>- % of firms registered with the Ministry of Commerce or Municipal Department of Commerce</td>
<td>- % of firms with land documentation</td>
</tr>
<tr>
<td>- Total number of registrations, licenses and permits firms need to operate</td>
<td>- % of firms with solid title to land</td>
</tr>
<tr>
<td>- Waiting period for Registration Certificate from Provincial/Municipal Department of Commerce (median days)</td>
<td>- % of firms that feel expropriation is a risk</td>
</tr>
<tr>
<td>- Official fee for Registration Certificate from Provincial/Municipal Department of Commerce (median $)</td>
<td>- % of firms that deem changes in rental contracts a risk</td>
</tr>
<tr>
<td>- Waiting period for One-Year Operating License (median days)</td>
<td>- Effective land prices (adjusted for differences in supply and demand) (mean $)**</td>
</tr>
<tr>
<td>- Official fee for One-Year Operating License (median $)</td>
<td></td>
</tr>
<tr>
<td>- Waiting period for Patent Tax registration from Local Tax Authority (median days)</td>
<td></td>
</tr>
<tr>
<td>- Official Patent Tax Fee from Local Tax Authority (median $)</td>
<td></td>
</tr>
<tr>
<td>- Provincial Revenue from Patent Tax *</td>
<td></td>
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<tr>
<td>- Provincial Revenue from Registration certificate *</td>
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</tbody>
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<table>
<thead>
<tr>
<th>3. Transparency</th>
<th>4. Time Costs of Regulatory Compliance</th>
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<tbody>
<tr>
<td>- Transparency of - and access to - local planning and decrees/decisions (10 documents/5-point scale)</td>
<td>- Management time during year spent dealing with requirements imposed by government regulations (% of firms less than 16 days)</td>
</tr>
<tr>
<td>- Firm’s knowledge of provincial budget (% not familiar)</td>
<td>- Total number of inspections per year (median)</td>
</tr>
<tr>
<td>- Relationship with a provincial official is necessary to obtain access to provincial documents (% always or frequently)</td>
<td>- Time it took a firm to receive its land title (median days)</td>
</tr>
<tr>
<td>- % of firms agreeing that favoritism toward firms with political connections is an obstacle to business.</td>
<td></td>
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<tr>
<td>- Regularity that representatives from the provincial governor’s office meet with firms to discuss changes in laws or polices (% seldom or Never)</td>
<td></td>
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<tr>
<td>- Firms are informed about new economic and finance regulations that affect their business (% uniformed or poorly informed)</td>
<td></td>
</tr>
<tr>
<td>- Regularity that a firm receives advance notice about new or changing central government laws (% Seldom or Never)</td>
<td></td>
</tr>
<tr>
<td>- Request to Provincial/Municipal Department of Commerce * (5-point scale)</td>
<td></td>
</tr>
<tr>
<td>- Request to Provincial/Municipal Departments of Industry, Mines and Energy * (5-point scale)</td>
<td></td>
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<tr>
<td>- Availability of infrastructure maps * (# offices with map available)</td>
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<tr>
<th>5. Informal Charges</th>
<th>6. Participation</th>
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<tr>
<td>- Giving gifts to public officials is sometimes required to pass customs, obtain licenses, receive public services, or meet tax requirements (% No)</td>
<td>- % of firms agreeing provincial government solicits advice from affected firms on new laws, rules, regulations or decrees</td>
</tr>
<tr>
<td>- Corruption is an obstacle (% of major or severe obstacle)</td>
<td>- There are business associations or clubs in the province (% Yes)</td>
</tr>
<tr>
<td>- Information regarding available public procurement contracts is transparent (% Always or Frequently)</td>
<td>- % of firms in sample that are members of associations or clubs in the province</td>
</tr>
<tr>
<td>- Importance of government connections for winning public procurement contracts (% Essential or Useful)</td>
<td>- Number of business associations per 10,000 firms in province *</td>
</tr>
<tr>
<td>- Firms believe firms in their industry often pay commissions when doing business with government (% of Seldom or Never)</td>
<td>- Business Forum held in 2007 *</td>
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<tr>
<th>7. Crime Prevention</th>
<th>8. Tax Administration and Burden</th>
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<tbody>
<tr>
<td>- % of firms that experienced losses due to theft, robbery, vandalism, or arson in last year (% No)</td>
<td>- % of firms that believe bribes to public officials to avoid taxes and regulations are a significant business obstacle</td>
</tr>
<tr>
<td>- Monetary value of firm’s losses caused by crime (median $)</td>
<td>- % of firms that do not pay taxes</td>
</tr>
<tr>
<td>- % of firms that believe negotiating with tax authority is part of business</td>
<td>- % of firms that believe negotiating with tax authority is part of business</td>
</tr>
<tr>
<td>- Tax administration is an obstacle (%)</td>
<td></td>
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<tr>
<td>- Tax rates as obstacle (%)</td>
<td></td>
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<tr>
<th>9 Proactivity of Provincial Authorities</th>
<th>10 Dispute Resolution</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Provincial government officials’ attitude toward private business (% positive)</td>
<td>- % of firms that are confident that the legal system will uphold contracts and property rights in disputes</td>
</tr>
<tr>
<td>- Provincial departments of line ministries tend to interpret in firms’ favor when central regulation lacks clarity (% agree)</td>
<td>- Possibility of going to another official to dispute unjust decision (% seldom or never)</td>
</tr>
<tr>
<td>- Provincial government is good at working within central laws to create a profitable business environment (% agree)</td>
<td>- Percentage of sales in 2008 for which firm did not receive payment in the agreed time (median)</td>
</tr>
<tr>
<td>- Provincial government is creative and clever about solving new business problems (% agree)</td>
<td>- Percentage of sales for which firm never paid by customers in 2008 (median)</td>
</tr>
<tr>
<td>- Provincial government willingly risks punishment from the central government to pass decisions to aid local businesses (% agree)</td>
<td>- Satisfaction with dispute resolution in province (% satisfied)</td>
</tr>
<tr>
<td>- There are no initiatives at the provincial level (%)</td>
<td>- Success at recovering money owed to it (% successful)</td>
</tr>
<tr>
<td>- % of firms in province that believe there is a fair process to dispute changes in rent contracts</td>
<td></td>
</tr>
</tbody>
</table>

* component uses hard data; ** Derived from factor analysis; all other indicators derived from perception data
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- Improving the business enabling environment
- Increasing access to financial services
- Improving environmental and social sustainability
- Increasing value added in specific supply chain linkages
- Increasing access to infrastructure

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