

#ClosingTheGap Mekong

# Executive Summary Cambodia

Entrepreneurial Ecosystem Assessment



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### Entrepreneurial Ecosystem Assessment

#### Commissioned on behalf of:

The Dutch Good Growth Fund, part Investment funds for local Small and Medium Enterprises (SMEs), is a “fund of funds” investment initiative from the Dutch Ministry of Foreign Affairs. The initiative aims to improve financing for the “missing middle” – i.e. entrepreneurs who have outgrown micro-finance but do not yet have access to regular financial services. The Seed Capital and Business Development (SC&BD) program was established to increase the impact of the DGGF by providing technical assistance, seed capital and business support services to intermediary investment funds and local SMEs. The program incorporates a knowledge development and sharing component that supports research, tests assumptions and shares insights into financing SMEs in developing countries and emerging markets - fostering industrywide knowledge exchange.

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#### Disclaimer:

#ClosingTheGap Cambodia has been commissioned on behalf of DGGF as part of the ClosingTheGap series of entrepreneurial ecosystem assessments. The findings and recommendations are at the discretion of the consultants – Emerging Markets Consulting - and do not necessarily reflect the opinion of DGGF and/or its partners



Ministry of Foreign Affairs





Of Cambodia's approximately 15 million people (2017), two-thirds of the population is working age, or about 10 million people in total. Phnom Penh, Cambodia's capital city, accounts for 1.5 million people (10% of population). The capital sits at the center of Cambodian political and economic life, with government offices and business headquarters clustered in Phnom Penh. Cambodia stands out amongst the #CTGMekong countries for its enduring market-based economy – having adopted these principles since the early 1990s, not long after Vietnam (1985).

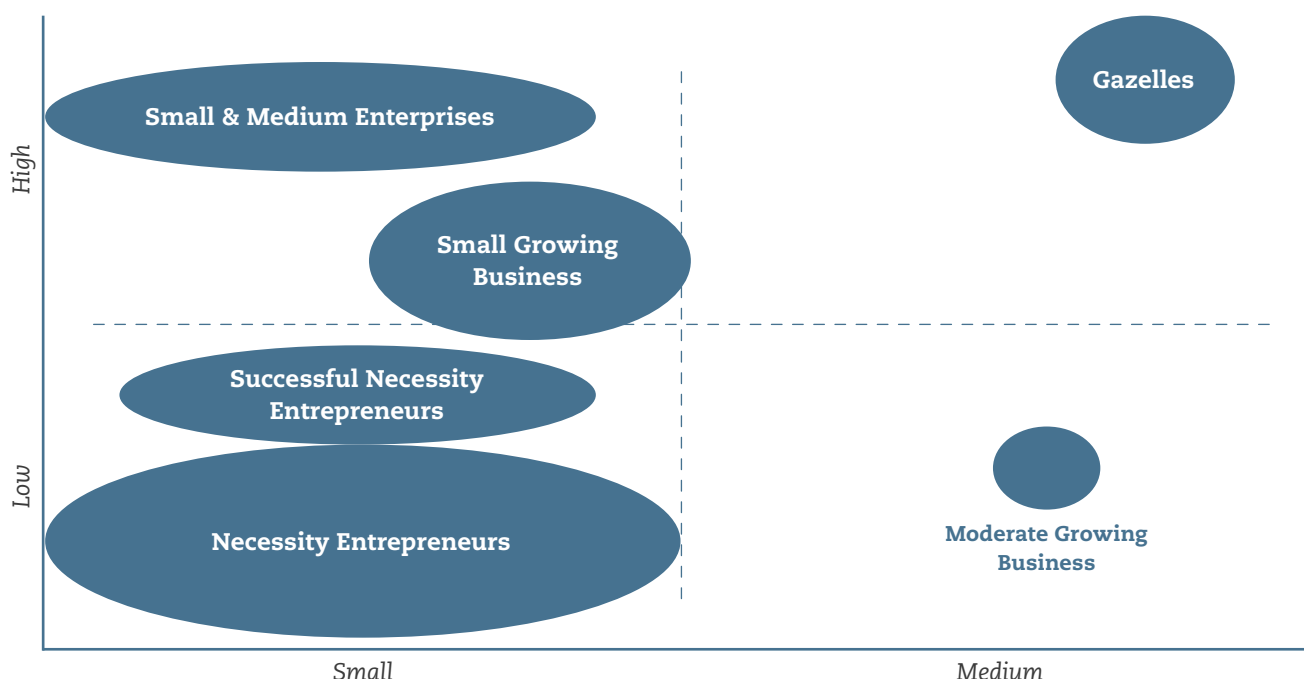
It's a relatively small and compact country, with more than double the population of Lao PDR within three-fourths the land area, and considerably smaller than both Myanmar and Vietnam. The country doesn't enjoy substantial natural resources endowments, other than its location between the significantly larger and also fast-growing economies of Thailand and Vietnam. GDP per capita is US \$1,485, considerably lower than Lao PDR (US \$2,552) and Vietnam (US \$2,690) and only slightly higher than Myanmar (US \$1,279).

Much current analysis of the economy focuses on the need to transition from a factor-based economy to an efficiency-driven economy<sup>1</sup> that is increasingly competitive, with more efficient production processes and increased product quality. In this context, promotion of entrepreneurship and SMEs are moving up the Royal Government of Cambodia's policy agenda.

### Cambodia is an SME Oriented Economy

Segmentation of the World Bank Enterprise Survey (WBES) from 2016 shows that half of registered SMEs in Cambodia are small, low-growth firms, with 5-19 employees and growth rate between 0-10% per annum. According to WBES 2016, women-owned firms (>50% women ownership) constitute about 43% of all small and medium sized firms, however this was higher for smaller firms, and lower for medium-sized firms. Cambodian SMEs are generally innovative compared to their counterparts in #CTGMekong, according to WBES data. In particular, high growth businesses – small & growing businesses (SGB), small & high-growth businesses (SHG) and Gazelles – are generally more likely to have introduced a new or improved product or service within the past three years, or to have spent on R&D.

Figure 1: Sub-segments as proportion of total



Source: Author's analysis of the 2007 and 2016 Enterprise Surveys

<sup>1</sup> World Economic Forum Classification

## SMEs Face a Challenging Business Environment

Historically, public investment has been weak, and consequently SMEs struggle to acquire human resources and adapt to infrastructural constraints. Pro-business policies and regulation also have not improved significantly, reflected in Cambodia's six years of static rankings in World Bank Doing Business reports. Across all categories of constraints self-reported by SMEs, 'Practices of competitors in the informal sector', 'Political instability', 'Inadequately educated workforce', 'Tax rates', 'Transport' and 'Corruption', all presented greater challenges than 'Access to Finance'.

However, recent Government initiatives include more incentives for SMEs, commitment to ongoing improvements to education, as well as the presence of the expectation of Chinese financial support for major infrastructure investments.

## Finance Remains a Concern

While access to credit remains a popular concern for SMEs, Cambodia stands out amidst Lao PDR, Myanmar and even Vietnam, for its competitive banking and MFI sector. The sector has had a credit bureau and a secured transactions law for a long time, which contribute to very high Doing Business ranking in 'getting credit'. However, much of SME borrowing still requires land or real estate collateral, and SMEs currently do not use credit to invest in productive assets. With respect to risk capital, there has been a proliferation of new investment platforms since 2017, albeit from a very low starting point. Investment in the emerging tech sector has expanded recently, and during late 2018 two Cambodia based tech startups closed US\$ 2.0 and 2.8 million funding rounds with substantial overseas participation.

Sector development has been encouraged by relatively benign market and innovation oriented regulation, and the current Financial Sector Development Strategy outlines the Government's plans to address needed improvements in credit information, secured transactions and service diversification.

## Business Support Services are Focused in the Capital

In Business Support Services, Cambodia has a diverse 'entrepreneur ecosystem' motivated by Cambodian and expatriate 'ecosystem builders' who are themselves highly entrepreneurial. In recent years, there is a lot of activity around building awareness in youth, tech and social impact oriented entrepreneurship, however alongside these, new initiatives are emerging, which address larger segments of micro and small businesses with traditional business models in main economic sectors. The BSS ecosystem is still fragmented and focused in the capital, Phnom Penh, though collaboration between stakeholders and activity in the provinces is increasing.

The key issues affecting the development the Cambodia ecosystem, are summarised in the following SWOT.

Figure 2: SWOT analysis of the Cambodia ecosystem



## Recommendations

In addition to implementing pro-business, regulatory reform agenda, we identify two opportunities to advance SME growth: improve business services support and early stage finance to growth-oriented SMEs. In particular, there is significant scope to mobilise domestic capital.

According to WBES, approximately 40% of registered SMEs are growing at an annual rate of 10% or more, yet lack access to appropriate support that can address expansion-related challenges: e.g. formulating a growth strategy, acquiring finance to grow, scaling operations and accessing growth markets, either geographic or via product/service innovation. As they get larger, these diverse requirements entail attracting and retaining staff with expertise and delegated authority. High growth businesses and Gazelles are more likely to export than other sub-segments and thus require support to develop business relationships with potential suppliers and customers in ASEAN and regional markets. This includes support for international networking and trans-border platforms where growth-oriented SMEs can access buyers and suppliers, and thereby forge strategic relationships.

Additionally, there is an absence of early-stage finance for domestic entrepreneurs. There are currently no functioning angel investment networks, and outside the tech sector, there is a very weak offering below US \$500,000 and SMEs have yet to list on the Cambodian Stock Exchange. For even smaller quanta of seed capital, existing accelerators do not incorporate a 'seed finance offer' and do not consistently graduate investible firms in sufficient quantity to stimulate the supply of angel capital. The key to sustainably increasing the availability of risk capital to entrepreneurs is unlocking wealth in Cambodia: domestic would-be investors have a greater familiarity with local conditions and greater tolerance for country-specific risk. However, platforms that educate domestic angel and early-stage investors and aggregate capital are still themselves 'startups'. Specific recommendations to address this could therefore include support to:

- Scale up accelerators that aim to produce investible firms in order to generate deal flow.
- Establish a seed fund for accelerated graduates, helping stimulate supply of external early stage investors.
- Seek opportunities to capitalise locally managed funds that aim to invest in SMEs, starting around US \$100,000.

In summary, the Cambodian entrepreneur ecosystem has good foundations based on active participation of motivated 'ecosystem builders' and successful entrepreneurs. However, rapid progress is limited to the past few years. Consequently, there remain gaps where support for SMEs may be improved, and there is substantial scope to scale access across the board. Ultimately, to realise SMEs' collective potential for growth and contribution to a competitive and innovative economy, the Cambodian Government needs to sustain broad-based improvements to the overall business environment.