

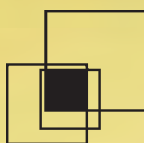


International
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Office



Easing the Barriers to Formality: Registration Procedures for Microenterprises and Handicraft Exports in Cambodia

Artisans' Association of Cambodia



Informal Economy, Poverty and Employment

Cambodia Series | Number 3

Informal Economy, Poverty and Employment

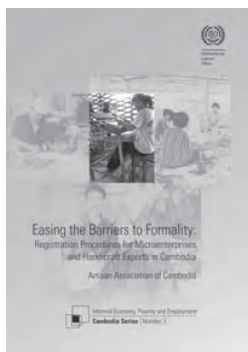
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Foreword

Cambodia's business environment has received considerable attention in recent years. A number of studies have shown that business registration processes remain inefficient and require greater transparency. Needless to say, investments cannot thrive when policies lack consistency. Foreign direct investments have fallen since 1996—a trend which has concerned the international and donor communities. Apart from foreign direct investments, potential local investments of entrepreneurial Cambodians are also inhibited. The absence of a proper regulatory environment prevents micro and small enterprises from doing business in a stable manner and limits their opportunity to service more established markets.

In response, Government has indicated its commitment to streamline the business registration process and create a more enabling business environment. The governments' development strategy aimed at meeting Cambodia's Millennium Development Goals, subsumed under its Rectangular Strategy, places good governance at its center and lists Private sector growth and employment development as one of its key operational priorities.

The International Labour Organization shares this concern for the development and growth of small and medium enterprises. In 1998, the International Labour Conference (ILC) adopted Recommendation No. 189, General Conditions to Stimulate Job Creation in Small and Medium-sized Enterprises, which sets guidelines for national policies and action. It identifies common constraints to the efficient growth of SMEs, among which are inappropriate, inadequate or overly burdensome registration, licensing, reporting and other administrative requirements.

This concern is furthermore reinforced by ILO's mandate, emphasized in the 1999 and 2002 International Labour Conferences, of reducing decent work deficits in the informal economy. ILO's approach, as elaborated in the conclusions following the ILCs consists of eliminating the negative forms of informality at the minimum and gradual integration of the informal economy into formal systems of protection and support. This would include access to legal form and to the protection it provides.

This study on business registration process in Cambodia was prepared in 2004 under the ILO Sub-regional project, Informal Economy, Poverty and Employment, funded by the UK Department for International Development (DFID) and implemented by the ILO Subregional Office for East Asia. The

project covered Mongolia, Cambodia and Thailand. This project, implemented in 2004-2006, aimed at reducing poverty by improving the quantity and quality of decent work opportunities for men and women in the informal economy. It seeks to achieve this broader goal by promoting (i) organisation, representation and voice, (ii) improved productivity and market access, and (iii) reduced vulnerabilities.

Among other initiatives in Cambodia, the Informal Economy Project promoted the work of handicraft producers. The handicraft industry supports the livelihoods of thousands of Cambodian families. It provides off-farm incomes in rural villages and opens a link between the villages and the growing tourism and urban economy. While there are no accurate statistics on the level of employment and revenue generated by this sector, this study infers that its total sales can go well in excess of US\$3 million. While small compared to other sectors, such as garments, this sector appears to be growing at least at 10 percent annually. Its role in export trade, employment and small enterprise development is worthy of note. Again, one of its constraints to growth is the regulatory environment, including export and importing processes, which is found to be complex and time consuming.

The present study is a result of a collaboration between the International Labour Organization (ILO) and the Artisan's Association of Cambodia (AAC). It examines business registration procedures, import and export processes, and current legislative and legal situation surrounding micro and small businesses, NGOs and associations. Recommendations are presented for the improvement of the regulatory environment for micro and small businesses and handicraft-related enterprises. It must be noted that one of the most important recommendations of this study is the formation of one or more industry associations that could continuously research and advocate for their members' interest.

We would like to thank the team which prepared this study, led by Mr. Curtis Hundley, private sector development analyst and team leader. Mr. Men Sinoeun, Director of AAC, provided coaching support to the team. The team members were Mr. Sok Vichet, marketing and business development specialist, who concentrated on the importing and exporting processes; Mr. Lun Yeng, financial analyst for AAC, who concentrated on the business, NGO and association registration processes.

This study was presented in a validation workshop in October 2004. Among the participants were ILO social partners and handicrafts industry stakeholders, including all the surveyed handicraft enterprises. The discussions further served as input to the finalization of this paper.

We would like to acknowledge Mr. Tun Sophorn, National Project Coordinator of the Informal Economy Project, who actively supported this research as well as other components of the collaboration with AAC on handicraft sector development. Ms. Sandra O. Yu, Chief Technical Adviser of the Informal Economy Project, technically backstopped the research and broader collaboration with AAC. Ms. Ginette Forgues, Senior Specialist on Local Strategies for Decent Work, provided valuable technical advice to the project as a whole.

We hope that this study will contribute to the current deliberations towards creating an enabling environment for micro and small businesses. We hope as well that this study would lead to the recognition of the handicraft sector of Cambodia where much economic potential lies, and yet where many marginalized producers and entrepreneurs are found.



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Definitions

Certificate of Origin

A document certifying the country in which a product is manufactured at and, in certain cases, may include such information as the local material and labour contents of the product. Some importing countries require a Certificate of Origin to establish whether a preferential import tariff is applicable.

Facilitator

As used in this document, a facilitator is an agent hired to complete a task for the hiring party. A facilitator may be a lawyer who registers an entity, a freight forwarder who facilitates a delivery through the customs import or export processes, or an employee of a government agency who ensures the proper authorisations are received, approvals are obtained for various processes, or provides other professional services.

Handicrafts

Products manufactured with the skill of hand and manual occupation. Many handicrafts use low-technology manufacturing capability.

Official fees

Fees paid to a government agency that are accompanied with a receipt of payment for the full sum paid.

Unofficial fees

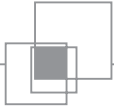
Fees paid to a government agency that are not accompanied with a receipt for payment, either in whole or in part of the full sum paid. Also referred to as corruption tax, tea money, incentive, or other euphemism. The RGC has not enacted the Anti-Corruption Law, which would outlaw such fees.

NGO

NGO is a legal entity that usually provides services for the betterment of a society, such as a charity, medical care, education, or training. In Cambodia, NGOs are entitled to privileges, such as duty-free import of goods used in service. The Law on NGOs and Associations, which will define them in Cambodia, has not been enacted, but has been under consideration since 1999.

List of abbreviations

AAC	Artisans' Association of Cambodia
ADB	Asian Development Bank
ASEAN	Association of Southeast Asian Nations
C/O	Certificate of Origin
CCC	Cambodian Craft Cooperation
CDC	Council for the Development of Cambodia
COM	Council of Ministers
EU	European Union or European Commission
FDI	foreign direct investment
GMAC	Garment Manufacturers Association of Cambodia
GSP	General System of Preferences
GTZ	Deutsche Gessellschaft fur Technische Zusammenarbeit
IFC	International Finance Corporation
INGO	international non-government organisation
JICA	Japan International Cooperation Agency
LDC	least developed country
LNGO	local non-government organisation
MEF	Ministry of Economy and Finance
MFN	Most Favoured Nation
MIME	Ministry of Industry, Mines and Energy
MOC	Ministry of Commerce
MOEF	Ministry of Economy and Finance
MOFA	Ministry of Foreign Affairs
MOI	Ministry of Interior
MOSALVY	Ministry of Social Affairs, Labour, Vocational Training and Youth Rehabilitation (now divided into the Ministry of Social Affairs, Veteran and Youth Rehabilitation and the Ministry of Labour and Vocational Training)
MOU	Memorandum of Understanding
MPDF	Mekong Private Sector Development Faculty
MSE	micro and small enterprises
MWVA	Ministry of Women's and Veterans' Affairs



NGO	non-governmental organisation
RGC	Royal Government of Cambodia
SME	small and medium enterprises
VAT	value added tax
WB	World Bank

Executive summary

Through a collaboration of the International Labor Organisation (ILO) and the Artisans' Association of Cambodia (AAC), this study was undertaken to examine the business registration processes, import and export processes, and current legislative and legal situation for micro and small businesses, NGOs and associations relative to these topics. The research included an interview of 15 Cambodian entities involved in the production, sale, and/or export of Cambodian handicrafts and a presentation to stakeholders to discuss the findings.

The study findings are presented in this report, along with recommendations for entities involved in the handicrafts sector to improve their businesses and the business environment in which they operate with an objective of improving exports of Cambodian-made handicrafts. There are no accurate statistics for either the level of employment generated by the sector or the level of revenue from domestic or export sales. From the small sample population used for this study, it can be estimated that the handicrafts industry supports the livelihoods of thousands of families and promotes total sales well in excess of US\$3 million. Relative to other sectors, such as the garment industry or agriculture, the handicrafts industry is small. It appears to be growing at least at a 10 percent annual rate and is worthy of attention for the value it provides to export trade, employment and cottage industry development.

Cambodia's enabling business environment and the business registration process has received considerable attention from donors in recent years, especially since foreign direct investment (FDI) has fallen dramatically since 1996 and in 2004 will approach only US\$50 million. Committed contributions to develop an enabling business environment from donors such as the World Bank (WB), Asian Development Bank (ADB), International Finance Corporation (IFC), European Union (EU), Germany, Japan, and others are estimated to exceed US\$6 million in technical assistance alone. Analysis has shown the business registration process to be inefficient and typified by requests for unofficial fee payments to facilitate public services. At the policy level, recent announcements by the Royal Government of Cambodia (RGC) indicate a willingness to streamline the business registration process and create a more business-enabling environment.

At the operational level, this willingness has been difficult to translate into actionable achievements. Corrupt practices appear to be endemic in the

functioning of the public sector. As a result, businesses continue to focus on locating “corruption agents” rather than concentrating on more important issues, such as increasing productivity and improving quality, developing markets, and acquiring necessary business skills. A recently released report by the United States Agency for International Development contains considerable information on the problems associated with Cambodia’s business environment.

One statement from the report provides some insight into the situation, “corruption has become part of everyday life in Cambodian, in fact it has reach ‘pandemic’ proportions”.¹ In this type of operating environment, one can expect that business as usual will include corrupt practices in nearly all aspects of business.

The importing and exporting processes are typified by non-transparency and negotiation for services. Handicrafts-related entities interviewed for this study indicated that the importing and exporting processes are so complex and time-consuming that most entities choose to use a freight forwarding company to perform the negotiations with customs and other agencies and to pay the resulting high fees. Freight forwarding firms have existing, long-term relationships with the importing and exporting agencies, which allow them to have a better negotiating position than individual entities. Still, freight forwarding firms interviewed for this study indicate their frustration with the time-consuming processes and constant demands for facilitation fees.

The 15 Cambodian handicrafts-related entities interviewed are generally upbeat about the potential for the production and improved market for handicrafts products, both at retail and export levels. The business environment for the 15 entities varies considerably; some entities are observing sales volumes doubling each year, while others are witnessing significant declines. Overall, the professional management capabilities within these entities are weak, with minimal experience in business development or exporting. Due to the complexity and corruption involved in the business registration, importing, and exporting processes, most of these entities choose to remain as NGOs with the intended purpose of operating at lower cost and avoiding income, salary, and other taxes. Anecdotal reports obtained during the course of research indicated that many for-profit entities are registering as NGOs for similar purposes. It appears from the research that anyone willing to pay the necessary facilitation fees can obtain NGO status.

Possibly as a result of their desire to maintain a low profile, handicraft entities receive almost no recognition from the donor community and have little or no representation as an important sector of the economy. Improving the profile of the industry, obtaining technical and financial support from donors, and representing their interests in government decision-making circles should improve their long-term sustainability, improve their opportunities to create viable employment, increase exports, and transition to profit-making businesses that pay reasonable taxes and contribute to the wealth of the nation. In this regard, one of the most important recommendations of this study is for the individual businesses, NGOs, and associations to form one or more industry associations.

1 Cambodia Corruption Assessment, USAID, May-June 2004.

Findings

Registration processes

Task 1 involves a review of registration procedures for micro and small businesses, NGOs and associations. The research into the registration process demonstrated that it is reasonably simple to register if one is willing to pay the facilitation fees.

The ADB and WB have invested considerable effort at identifying the constraints in the registration process and recommending changes to streamline applications. To obtain a full discussion of this topic, please review copies of the ADB's *Private Sector Assessment for the Kingdom of Cambodia*, issued in December 2003, and *Preparing the Small and Medium Enterprise Development Programme*, issued in August 2004.² The following constraints and recommendations are covered in detail in these two ADB documents, but we have tried to tie many of those comments with findings from this research study in the following list.

Lack of a coordinated registration framework

The legal framework and institutional structures that exist to register small and micro businesses, NGOs, and associations do not appear responsive to most business interests. There are few incentives for private businesses that are not involved in exporting or importing to pay the official and facilitation fees and encourage scrutiny that results from formal registration, such as visits by ministry personnel who invariably seek unofficial fee payments, and the requirement of expensive external audits. NGOs and associations have a much simpler process to follow and, for the most part, are not bothered by ministry staff once they have obtained permission to operate.

1. Enterprise registration lacks transparency

The lack of transparency and the complicated documentation requirements result in high financial and administrative costs, and a disincentive for businesses to formalise registration. Most applicants for registration interviewed for this report relied on facilitators to assist them to navigate through the registration process. While this saves time in processing the application, it adds unnecessary costs. Improved access to information on business registration, combined with simplified documentation requirements, would allow entities to facilitate most of the registration process on their own. Even with the recently revised Ministry of Commerce (MOC) registration procedures, the expectation for facilitation services continues.

2. Lack of legal framework and service provision for registration

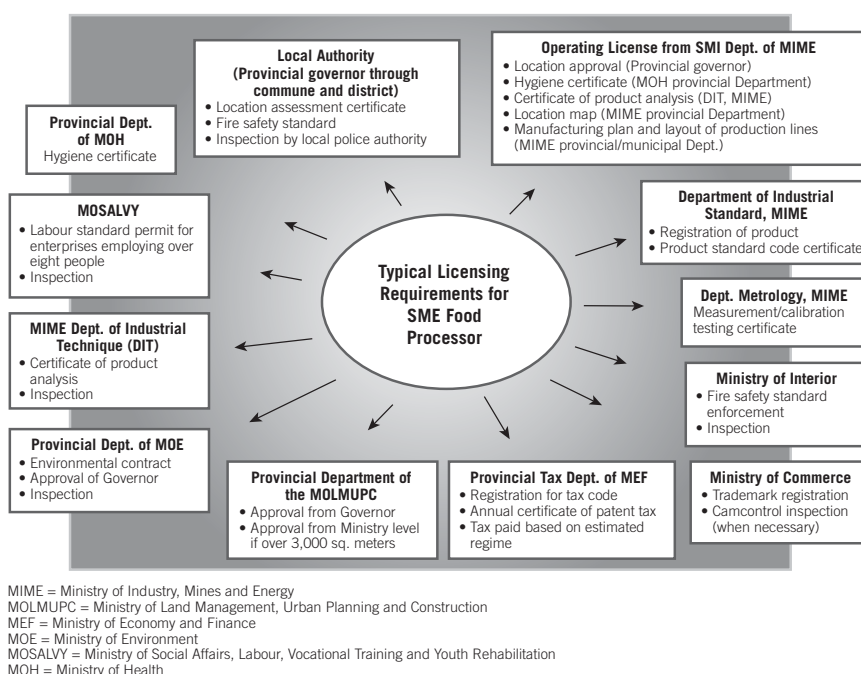
There is currently no requirement and little incentive for sole proprietorships, the mainstay of Cambodia's micro and small enterprises (MSEs), that earn less than \$1,500 per year in profits, to register at the MOC and formalise their businesses. Until the MOC and the RGC begin to provide value-added services or some benefit for registering businesses, there will be little justification for most businesses that are not interested in exporting or importing to formalise their registration.

² These documents are available at the ADB website, www.adb.org.

The MOC has drafted the Law on Commercial Enterprises, which replaces Instructional Circular No. 360 by providing for the creation of four types of legal entities, namely general partnership, limited partnership, private limited liability company and public limited liability company. The draft law has no provisions pertaining to sole proprietors. A provision of services must be developed that makes it attractive for sole proprietors to register.

3. Non-transparent and high-cost registration process

The lack of a transparent and efficient registration process significantly discourages enterprises from formalising due to complicated procedures and high costs. The flow of the company registration process is illustrated in the diagram below. This example of an SME (small and medium enterprise) food processor highlights the overly cumbersome procedures.



4. Lack of incentive to register

Development of a low cost registration system alone may not result in a significant increase in registered companies. By continuing to operate in the informal sector, businesses are demonstrating that the costs of formalising outweigh the benefits of operating in the formal sector. For the average Cambodian private firm, this means that the future tax burden of entering the tax system and the cost of increased regulatory scrutiny outweigh the benefits of improved access to finance and markets, improved enforcement of contracts and other public goods. This cost-benefit calculation is based on the view of the enterprises that weak contract enforcement mechanisms, property rights and delivery of public goods provide little benefit to formalised entities relative to the costs they might incur.

5. Licensing and inspection

Many ministries are involved in regulating enterprises. Line ministries are responsible for issuing operating licenses for businesses under their jurisdiction. For example, Ministry of Industry, Mines and Energy (MIME) issues operating licenses for manufacturers while the Ministry of Tourism provides operating licenses for hotels and tour operators. Ministries also provide licenses to regulate the quality of goods, sanitation, environment and safety. With so many ministries involved in business regulation, an effective institutional framework for supporting businesses is needed to ensure proper coordination of policies and regulations.

Laws and regulations including sub-decrees, prakas and procedures concerning licensing are not adequately disclosed to the public, and business applicants have limited understanding of how licensing and approval can be granted to them.

Business licenses in Cambodia

- Line ministries are responsible for issuing operating licenses to firms under their jurisdiction
- Most ministries also provide regulatory licenses
- High burden of licensing (more than 70 licenses have been identified)
- Firms are subject to multiple and overlapping inspections
- No process for reviewing necessity and cost of licenses

This can lead to the process being handled in a non-transparent manner. When accumulated, the formal and informal payments for obtaining operating licenses are very burdensome for businesses, NGOs, and associations, particularly given their small size and limited financial capacity. The short duration of licenses adds more costs due to the frequent need for renewal and additional payments. Durations range from one to three years depending on types of enterprises and ministries/institutions for which the licenses are applied. Longer durations and more reasonable scheduled fee structures would benefit Cambodian businesses, NGOs, and associations in the longer term.

Importing and exporting processes

Task 2 was fairly broad in its coverage of issues. One of more interesting findings is that within the import and export processing systems, few fees are scheduled, meaning that almost every transaction is negotiated and not accompanied by a receipts for money paid. It took the team considerable effort to locate accurate information on these processes. One freelance customs facilitator was kind enough to provide the team with considerable insider information and one of the most popular freight forwarders filled in many of the other details.

As a result of the less than transparent import and export processes, it was not surprising to learn that all handicrafts entities use the services of freight forwarders to facilitate their shipments rather than to attempt negotiations themselves. It was interesting to learn that none of the handicrafts entities

could identify either the steps or costs involved in the export or import processes and that customers are willing to assume the full costs of the shipping transaction.

The fact that almost any private firm, NGO, or association can export goods without being officially registered indicates several problems with the trade facilitation process. The complexities of the export process, combined with the informalities available to entities wanting to export goods create an operating environment where unofficial fees are an expected part of doing business, corrupt government agents exploit every opportunity, a corruption partner is required, and there is little incentive to promote business practices in a manner that improves the business environment, encourages business investment, or provides reasonable business profits.

Preferential treatment of handicrafts by developed nations has been available to Cambodian entities as a result of its least developed country (LDC) status for some time, but few entities are aware of the processes involved. In addition to understanding the complexities of the export procedures in Cambodia, obtaining duty-free import status in the developing countries that have granted preferential treatment to Cambodia requires exporters to understand complex rules and regulations that vary by importing country. The many constraints include marketing problems related to quality and price, and certification problems related to obtaining certificates of origin, identifying distinct product codes in the importing country, and meeting a host of other certification requirements imposed on imports.

Experts, while optimistic about the long-term prospects for Cambodia's handicrafts sector, caution handicrafts producers and exporters to go slow. They suggest that producers first develop the quality of the products and ensure an ability to consistently supply high-value products and only then to develop market linkages with buyers in developing countries. In most cases, a facilitating agent in the foreign importing country is needed to identify requirements, assist in the importation process, and guide the Cambodian exporters to higher-value markets. Expert advisers indicated that while export markets are important in the long-term, in the short- to medium-terms, Cambodian producers may be best served by concentrating on improving quality, developing a Cambodian brand, and concentrating on the tourist and expatriate markets.

Finally, after several years of encouragement from donors and private businesses for improvements to the government's Byzantine regulatory structures that generally inhibit business development activities and encourage informality, the RGC, specifically the MOC, has stated its commitment to promoting exports of Cambodian-manufactured goods. In addition to several speeches by government officials, recent prakas have provided an avenue for micro and small enterprises, NGOs, and associations to obtain the Certificate of Origin and to export tax free from Cambodia.

Still, the prakas leave many unanswered questions as to the costs involved in obtaining the necessary status and of the process itself. Much discretion in the decision-making process remains, which, experience demonstrates,

usually means requests for and payments of unofficial fees. Conversations with handicrafts producers and exporters indicate significant skepticism.

The benefits that could be obtained from the formation of an industry association are evident, especially if one examines the examples of services provided by Garment Manufactures Association of Cambodia (GMAC) for its members. GMAC's value-added services demonstrate how effective voluntary and semi-voluntary organisations can be in promoting the interests of their members. Due to the scale of Cambodia's handicrafts entities, few can afford business development services, training in business management, marketing advice, or development of adequate accounting systems. More importantly, as a group, the handicrafts sector lacks political voice, has difficulty importing high-quality material inputs, and are unable to solve common problems and promote their collective interests. There is a need for a client-responsive organisation to lead an effort to develop a handicrafts industry association.

Current and proposed legislation

Task 3 was concerned with existing and proposed legislation. It is evident from the work of the WB, ADB, the German, Canadian, and Japanese governments, and the EU, that considerable effort has been started on the legislative and procedural reform process, mostly directed at creating a business environment conducive to investment.

With the exception of limited donor funding, which has supported business development support agencies such as AAC and Mekong Private Sector Development Faculty (MPDF), few technical or financial resources have been directed toward the handicrafts sector in general or the development of Cambodian handicrafts exports in particular.

The large financial and technical resources provided by the large donors should create a helpful business environment for handicrafts producers and exporters, but the timeframe for this change could be five to 10 years. In the meantime, it would behove the industry participants to form an alliance, association, working group, or other functional body to collectively draw recognition to the importance of the industry, its ability to create jobs and develop the economy, reduce poverty, and build a skill base. Only by working together, collectively, will the proposed changes to the regulatory or legal frameworks be applicable to the handicrafts sector stakeholders.

Survey of 15 Cambodian entities and business case study

The survey of a mix of firms types resulted in an improved understanding of the problems faced by Cambodian entities relative to business registration, as well as the importing and exporting processes. Most NGO-registered entities have few problems producing, selling, or exporting handicrafts. Formally-registered private businesses have a difficult time competing with the subsidised NGOs and are not as active in exporting, possibly due to the need to pay income taxes and Value Added Tax (VAT) on exports. The business case study clearly identified how many firms need to operate outside or under the radar of formal business

organisation. These two research exercises identified how businesses adapt to the legal regulatory environment.

Final recommendations

The final recommendations are organized by task and were presented during the workshop.

Registration processes

- For NGOs, use the existing registration processes as long as it is advantageous, and create formally registered subsidiaries only when absolutely necessary.
- For private business firms planning to formally register their enterprises, document each and every step of the process and provide a written summary to the Minister of the Ministry of Commerce when the registration process is complete; present all costs in both time and financial terms.
- Solidify your “special” partnerships with ministry staff and use these partnerships when advantageous.
- Form a handicrafts industry association and use the association as a political voice to improve transparency in registration, exporting and importing, and all other matters involving the government.
- Engage the donors and their consultants to reduce the costs of registration. Expose corruption within the framework of an anonymous association.
- Discourage efforts to collect unreceipted fees by unscrupulous government agents.
- Identify ways to collectively export products, if that is advantageous.

Importing and exporting handicrafts

For imports into Cambodia

- Use freight forwarders whenever possible because they can facilitate shipments most efficiently.
- For small shipments, hire a facilitator at the port site.
- For large shipments, hire a freight forwarder to facilitate both the import permit and customs clearance.

For exports from Cambodia

- Given the current business environment, for the facilitation of exports, it is better for NGOs exporting handicrafts to remain as NGOs and not to become formal registered businesses.
- For formally registered businesses, NGOs and associations, it is better to hire a freight forwarder to facilitate the export process.

Overcoming marketing and manufacturing constraints

- Concentrate on productivity to reduce prices, and improve quality and the ability to produce consistent quantities of deliverable handicrafts.

- Encourage political pressure to decrease export costs and increase ease of importing.
- Form an association and be represented at public donor-funded workshops, presentations, and other public events.
- Honor any donor supports for the handicrafts industry.
- Develop the Cambodia quality brand.

Overcoming certification constraints

- Focus on the marketing and manufacturing-related issues foremost because this will be required before one can compete effectively, but do not lose sight of the foreign markets for the mid- and long-term.
- Form an industry association that represents the too-small-scale entities as well as the large ones and encourage technical and financial support from donors.
- Specialise in products, such as silks and silvers in the short- to mid-terms and establish relationships with fair trade groups in the USA and EU.
- Engage with the EU, Japan International Cooperation Agency (JICA), Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) trade facilitation consultants and do not let all their efforts become concentrated on the garment and agro-processing industries.

Survey of 15 Cambodian handicrafts-related entities

The survey of Cambodian handicrafts entities highlighted several problems. This report identifies some of the most crucial weaknesses, and the team recommends the following to begin to rectify those most relevant to the study.

- Establish a strong and independent handicrafts association; perhaps more than one.
- Due to the peculiarities of the business environment, continue to “play the game” as long as possible, but prepare for the future by concentrating on competitive exports rather than compassion exports.
- Concentrate on quality; import quality materials for inputs.
- Concentrate on market segments such as upscale tourists, silk handicrafts, silver figurines, the Asian market, and so on.
- Improve business and marketing skills.
- Obtain as much support from donors to “build up” the handicrafts industry and request them to support the industry; follow the example of the garment sector.
- Concentrate on developing the entire supply chain for the industry.
- Concentrate on creating a Cambodia brand with one or two products to begin with and then expand.
- Develop an industry vision; a compelling, driving vision that puts fire in the belly of every handicrafts producer, seller, and exporter.
- Continually concentrate on the Certificate of Origin problems at the Ministry of Commerce; use the current change-oriented environment to the advantage of the handicrafts industry and encourage donors to support this effort.

1

Introduction

This report consists of seven sections that link together to provide an overview of how the handicraft sector operates to register their businesses and export products.

Section 1: Introduction

Section 2: Registration procedures for micro and small businesses, NGOs, and associations

Section 3: Exporting from and importing into Cambodia

Section 4: Legislative and procedural reforms

Section 5: Case study of a handicraft NGO

Section 6: Survey of 15 Cambodian handicrafts entities

Section 7: Recommendations

Section 8: Appendices

There were five primary tasks involved with this research report.

1. Study the registration procedures for micro and small businesses, NGOs, and associations, identify constraints, and make suggestions for changes.
2. Examine the procedures for exporting and importing goods and describe General System of Preferences (GSP) requirements.
3. Research existing legislation and identify procedural reforms to facilitate handicraft exports.
4. Survey 15 Cambodian entities involved in the export of handicrafts to determine their registration process, their exporting and importing process, and details that could provide insight into their business operations and improve the operating environment for handicraft exporting entities, in general.
5. Facilitate a half-day forum to present research findings and enlist discussions with survey participants and other interested parties about improving exports of Cambodian-made handicrafts.

Related donor-funded projects in progress

Considerable financial and technical effort is being provided to the RGC by the WB, ADB, EU, GTZ, and JICA, among others, to improve the business registration and trade facilitation processes, increase the efficiency of the MOC and Customs Office, expedite the flow of exports, especially for the EU and

decrease the debilitating forms of corruption that pervade all trade and business in Cambodia.

In recognition of the sizable investments these organisations are making in research, analysis, and technical support, a note is necessary to understand that this research complements the significant efforts of these other donor projects. An estimated US\$6-\$7 million in technical assistance is expected to be invested through these projects over a period of a few years to address business registration and trade facilitation issues. Where beneficial to understanding, the efforts of these donor-funded projects are recognised in this report. Businesspersons are encouraged to be patient as the RGC implements the broad, long-term changes to the business environment.

Corruption's toll on Cambodia's businesses

On July 2, 2004, at the beginning of this research project, an interesting article appeared in the *Phnom Penh Post* that had bearing on the research. The article, which follows, appeared next to a story entitled, "Why FDI has

"The basis of enterprises set up in a corrupt society is to pursue corrupt business decisions. They are not trying to compete fairly in the market; the business is structured to maximise the corruption effect rather than economic efficiency."

This was the parting remark from Mr. Torush Lather, a former economic analyst with the Australian Department of Foreign Affairs and Trade, who left Phnom Penh on June 29, where he had been teaching English for 12 months.

He said for well-intentioned entrepreneurs, corruption was a disincentive from entering the market. "They can see that unless they are connected to a corruption agent, chances are they will only get a very small piece of the pie, and any business decisions will have to factor in the cost of servicing their corruption agent. If someone starts an enterprise, they very quickly find out there is little incentive to pursue productivity improvements. Profit then arises out of improvements in your position in the corruption chain."

Lather, who did his honours degree thesis on financial flows from Japan to South-east Asia, said there was little incentive in Cambodia for creating business, compared with developed countries, which had low corruption.

"At any time a new corrupt player can enter the market which may have been a legitimate enterprise, and simply cruel the market. All your investment, your energy is finished. "Small-to-medium enterprises are the largest employers; if they are not pursuing economic efficiency they will not have rational hiring strategies and individuals will not have career paths or incentives to succeed. There are many people trapped in these situations, most without knowing it."

"The impact of this is to degenerate the value system in society. It diminishes the relative financial value of productive labour. In other words, someone who is prepared to work hard and take risks is not rewarded as they would be in a free uncorrupt market system. The rewards go to those who make and then cement their corrupt contacts."

"The incentive to work hard and invest in productive skills is decreased. Very quickly people see the financial benefit of an opportunistic outlook rather than the established path of going through the process of increasing efficiency and expanding your market position."

(Excerpt from The Phnom Penh Post, 2 July 2004)

Plummeted”, which was written by Cambodian scholars and discussed issues related to the corrupt business environment. The author articulates how business is often conducted in Cambodia.

Research objectives and issues

The objective of this study is to assess government policy and regulations related to the registration of micro and small private businesses, NGOs, and associations, with the intent to identify and explore (a) the nature of existing constraints to registration and (b) their impact on the creation, development and growth of formal business organisations.

The research began with a hypothesis that the inability of organisations to register and assume legitimate status as business organisations, NGOs, and associations creates obstacles to the maintenance, development, and growth of formal private businesses, for-profit NGOs, and the need for value-adding business associations. The hypothesis led to the question, “If these entities receive undue harassment and are prevented from conducting business with parties interested in buying their products and are, furthermore, ineligible to access government incentives and other resources, then what is their ability to compete on a level playing field and generate economic growth?”

A special focus of this study is the review of processes and regulations in Cambodia affecting import and export of goods and raw materials. These regulations will be assessed in respect of their policies, procedures and costs, vis-à-vis the level of capacity of micro and small businesses.

Primary research tasks

Task 1. Review registration procedures for micro and small businesses, NGOs and associations required for conducting business in Cambodia. This research identifies the different types of registration, maps processes at the key agencies, and identifies obstacles to registration.

Task 2. Review registration procedures for exporting and importing goods and raw materials by organisations in the informal economy such as NGOs, micro businesses, and associations. This research briefly describes the GSP, lists Cambodia’s main legislative and regulatory instruments related to export formalities, and identifies and assesses costs related to export formalities of handicrafts.

Task 3. Provide recommendations for legislative and procedural reform to facilitate registration and exports of small handicraft producers, such as AAC members, in Cambodia. Due to the recent and extensive analytic effort by donors in this topic area, this study presents the findings and proposals for process re-engineering already being developed through technical assistance provided by ADB, WB, and EU consultants.

Task 4. Interview 15 Cambodian handicraft NGOs or private businesses, including members of the AAC, Silk Forum, and Cambodian Craft Cooperation (CCC). A cross section of NGOs, associations, micro and small enterprises was included.

Task 5. Facilitate a discussion in a half-day workshop for AAC members and other interested parties to address problems and propose solutions.

Task 6. Prepare a concise report on the research project.

Methodology

The methodology varied for each of the four research tasks as identified below.

Task 1. The review of the registration procedures was initiated through interviews with the primary business and NGO registration departments in the various government ministries, arranging verification meetings with them, and then including this information in the interviews with the Cambodian handicraft entities.

Task 2. The review of procedures and costs for importing and exporting goods was initiated through interviews with freight forwarding firms and others in the importing and exporting business, government agencies that facilitate trade, a freelance customs facilitator, and discussions with handicrafts businesses currently engaged in importing and exporting goods.

Task 3. The review of existing and proposed legislation to facilitate and improve export trade was initiated first through a desk study of existing documents, and followed by discussions with consultants from ADB, WB, EU, and GTZ, as well as through interviews with government staff located at the MOC.

Task 4. The survey of 15 Cambodian entities was initiated by first identifying a list of local and international NGOs, associations, and private businesses primarily involved in the handicrafts business, then selecting and contacting 15 of them and arranging an interview. The selection of the participants was not random, but we tried to select a variety of entities of varying sizes among the local non-government Organisation (LNGO), international non-government organisation (INGO), and private business categories.

Survey questionnaires and structured interviews

The team designed one survey questionnaire to use with each of the 15 Cambodian entities. In addition, structured interview questions were designed for interviews with regulatory agencies and businesses involved in import and export related trade, such as freight forwarding firms and shipping companies. Due to the limited number of businesses surveyed, some adjustments to the questions were required after the first couple of interviews to better capture the reality of the business environment.

Interviews with entities

The term “entities” is used to indicate NGOs, associations, or private businesses that produce and/or sell handicrafts. Interviews were conducted primarily by Cambodian team members, Sok Vichet and Lun Yeng, and where possible, in the Cambodian native language at the location of the firm. Each interview lasted an average of one hour and included a tour of the facilities.

For the handicrafts entities, we selected eight LNGOs, four INGOs, and three private businesses. For the ministries, we interviewed the primary registration agencies, MOC, Ministry of Interior (MOI), and Ministry of Foreign Affairs (MOFA), two coordinating agencies, Council of Ministers (COM) and Council for the Development of Cambodia (CDC), and three technical ministries, Ministry of Social Affairs, Labour, Vocational Training and Youth Rehabilitation (MOSALVY) and MIME. We attempted to interview Ministry of Women's and Veterans' Affairs (MWVA), but after several efforts to organize an interview and realising that none of the NGOs or private businesses registered with MWVA, we concluded it was unnecessary.

Collating, analysing, and presenting the survey results

An analysis of the collected information is included in the report under the heading for Task 4 and, where appropriate, information gathered during interviews is included throughout the report.

Project scope

The limited scope of the project and the approach of the study are not adequate to develop a full understanding of the “universe of Cambodia's handicrafts-oriented NGOs or private businesses”, in any systematic or statistical manner.

With only 15 entities selected, 14 located in Phnom Penh and 1 in Battambang and most being members of AAC, the approach has its limitation. However, the approach does provide insights to why companies choose to register as NGOs and operate as they do, identify the problems involved in firm registration and import-export processes, and lists existing and proposed legislative solutions directed at solving the problems involved in Cambodian commerce.

Project team

The project team consisted of three persons with administrative and coaching support from Mr. Men Sinoeun, Director of AAC. The team members were Mr. Sok Vichet, marketing and business development specialist, who concentrated on the importing and exporting processes; Mr. Lun Yeng, financial analyst for AAC, who concentrated on the business, NGO and association registration processes; and Curtis Hundley, private sector development analyst and team leader, who assisted in all areas of the research.

2

Registration procedures for micro and small businesses, NGOs and associations

Introduction

Cambodia's business registration process is complicated by a lack of comprehensive and completed regulatory and legal structures. The development of these structures is currently in process and improvements are gradually being implemented, such as the recently announced streamlining of business registration at the Ministry of Commerce. Current business registrations are governed by the 1995 Law on Commercial Rules and Registration, its amendments of 1999, and the MOC Instructional Circular on Commercial Registration of 1997. The Law on Commercial Rules and Registration pertains only to companies required to pay profit tax, which are enterprises that earn more than \$1,500 in annual profit. This law does not pertain to informal enterprises. Because the commercial registration and the accompanying rights and obligations affect only medium and large enterprises, a very small percentage of Cambodian enterprises are affected, or required to register formally.^{3,4}

The relationship of business registration and the tax system are intertwined. The Cambodian tax system has been undergoing a reform process for several years. The system divides taxpayers into two regimes, the real regime and the estimated regime, based on the form of enterprise, its activity, and the level of sales turnover. All limited liability companies fall under the real regime with profit taxes calculated on the basis of audited financial statements. Other forms of enterprises with smaller turnover pay an estimated profit tax, which is often discretionary and open to negotiation.⁵

Many constraints affecting the operations of enterprises are the result of having several ministries involved in licensing and regulatory oversight. Manufacturers of all sizes face many inspections from several ministries, some of which overlap. The average Cambodian enterprise is subject to 16 inspections per year. The application of regulations is discretionary and often corrupt. The most common and time consuming inspection for most registered companies, as reported in a World Bank study, is by tax officials, the next most common are visits by police. Policy reforms to reduce formal and informal fees of all aspects of businesses, including licensing, inspections, import and export processing and transportation are needed. These fees create a disincentive for investment and formalisation of businesses by increasing the cost of production and reducing competitiveness of Cambodian products.

3 Private Sector Assessment for the Kingdom of Cambodia, Asian Development Bank, December 2003.

4 Preparing the Small and Medium Enterprise Development Programme, ADB, August 2004.

5 Financial Sector Blueprint for 2001-2010, Royal Government of Cambodia and ADB, 2001.

Limited companies are required to register with the Legal Affairs Department of the MOC. Sole proprietorships are advised to register with the provincial-municipal trade divisions of the MOC, but this registry provision is generally disregarded on a formal basis and normally a business will pay an unofficial fee to allow it to conduct business. In practice, sole proprietorships do not normally register with an agency. Because only taxable enterprises, businesses with an annual profit of more than \$1,500, are required to register, the majority of SMEs are not registered. In practice, this \$1,500 threshold is not observed and registration is based on whether the enterprise intends to carry out import or export activities, or needs to register to do business with large enterprises or foreign enterprises.

Therefore, registration processes for micro and small enterprises, NGOs and associations are relatively simple and generally only require payment of reasonable facilitation fees. Most micro and small enterprises are not required to register as businesses with the MOC because their profits are less than \$1,500 per year and there are no audit requirements in place to expose those with sales above this amount. NGOs and associations are required to register with various ministries, as described in this report, but are not required to register with the MOC or Ministry of Economy and Finance (MOEF).

In the World Bank's Investment Climate Survey of 2004, being informal was advantageous in respect to suffering fewer impacts from corruption, weakness of the legal system, tax administration, and every other manifestation of public control of the economy.⁶ The top constraints listed for the 500 formal businesses interviewed in the survey, in order of priority, were:

1. Corruption
2. Crime, theft, and disorder
3. Economic and regulatory uncertainty
4. Anti-competitive behavior and unfair practices
5. Legal system and conflict resolution
6. Customs and trade regulations
7. Tax administration
8. Macro-economic instability
9. Tax rates
10. Electricity rates and service delivery

Registration processes and procedures

Since most micro and small enterprises are not involved in importing, exporting or need to be registered to contract with international enterprises or organisations, they can register with their local, provincial MOC and meet all necessary registration requirements. Most micro and small enterprises, in practice, don't bother with any registration, and are unhindered in conducting their business.

The processes and procedures of most ministries and agencies are similar, and differ primarily by the client population they serve, the amount of facilitation charges required, and the long-term relationship to which an enterprise, NGO, or

6 Cambodia Investment Climate Survey, World Bank, Andrew Stone, 2004.

association desires. The chart below identifies the primary registration ministries. A more detailed matrix appears in Appendix 1 that lists the official fees to be paid and the estimated timeframe for obtaining the registration or MOU.

Chart 1 Business, NGO, and Association Registration Matrix

Small enterprise, NGO, and association registration matrix									
Ministry or Agency	Ministry of Interior	Ministry of Foreign Affairs	Ministry of Commerce	Ministry of Commerce-Domestic Trade	Ministry of Industry, Mines and Energy		Council for Development of Cambodia	Council of Ministries	Line Ministries
INGO		R						O	R
LNGO	R							O	R
Non-Profit Association	R							O	R
For-Profit Association				R	O				R
SME			R	O	O				O
Large Enterprise			R				O	O	O

R - Required

O - Optional

Notes: CDC registration is required for enterprises to obtain investment and tax-free import or export privileges, and for INGOs to obtain tax-free imports for vehicles and goods.

COM registration is not required, but can facilitate registration for some enterprises, NGOs, and associations.

Obtaining MOUs with line ministries is usually required for NGOs and associations, but not for small private businesses. For example, NGOs developing human resources may desire an MOU with the Ministry of Social Affairs, Labor, Vocations, and Youth to facilitate information exchange.

Discussions with businesses, NGOs, and associations indicate that in addition to the official fees required, additional fees are required to pay for a registration facilitator. It is rare that a firm registers without a facilitator, usually a person who moves the registration or MOU process through the ministry. Only two entities interviewed for this report stated that they paid no fees. In both of these cases, the entities had an existing relationship with an employee of the ministry and were steadfast in their commitment not to pay fees, no matter how long it took. In the latter case, the processing took one year to complete.

Facilitation services and timeframes

There are no official fees for obtaining a license, except at the MOC, which formerly charged \$30, but now charges \$177. Facilitation fees for businesses, NGOs, and associations interviewed for this report varied depending on the expediency required and the ministry involved. Facilitation for small businesses to register at the MOC in the past ranged from \$1,000 to \$2,000. More recently, in response to the significant decrease in FDI and as a result of several studies identifying the business registration process as too expensive and cumbersome, this figure has decreased to a range of \$250 to \$300, in addition to official fees. Typical facilitation fees for NGOs and associations at the MOI or MOFA ranged from \$350 to \$500. Interviewees reported that requests for fees required for obtaining an MOU or permission letter from a line ministry, such as the MOSALVY ranged from \$10 to \$350 with the average being \$100, which included an agreement signing ceremony.

In most cases, ministries are mandated to provide their services in a relatively short timeframe of 15 to 30 days, but normally, the timeframe for obtaining licenses, letters of permission, and MOUs from the various ministries is a reasonable 30-day to 60-day timeframe if the businesses, NGOs, or associations pay the normal facilitation fees. Entities that desire registration in less time normally have to pay considerably more in facilitation payments. One NGO that had a lawyer obtain a business registration for one of its private sector divisions reportedly paid \$5,000 to complete the process in a relatively short timeframe. Entities that link with agencies such as the Council of Ministers before registration, usually obtain registrations more promptly.

Multiple choices available to LNGOs

There appear to be two processes that are acceptable for LNGOs, for the time being, although discussions indicated that the alternatives may not be tolerated by government authorities in the long-term. Eventually, all LNGOs may be required to register with the MOI as well as obtain an MOU with a line ministry.

There is currently no law on NGOs, which sets forth specific procedures for local and NGO registrations. The standard practice is for LNGOs to register at the MOI and for INGOs to register at the MOFA. Most also obtain an MOU with a line ministry, depending on their area of technical interest, but this option or requirement is not always enforced. For example, a local health-related NGO might obtain a letter of permission to operate from the Ministry of Interior and an MOU from the Ministry of Health. In effect, the registering LNGO becomes a partner with that ministry. A handicraft-related NGO working with land mine victims might obtain a letter of permission from the Ministry of Interior and an MOU from MOLSA.

We did have discussions with LNGOs wherein they stated that they only obtained an MOU with a line ministry and have not registered with MOI. In some cases, these LNGOs are very large organisations and export substantial volumes

of handicrafts. The MOU is enough for them to obtain locally-priced utility rates, avoid most police-based harassment, avoid obtaining a tax ID and paying profit taxes to the MOEF, and avoid paying VAT on their exports. To export, these LNGOs still negotiate with customs, the government import export inspection organisation, CamControl, and other agencies. We found no instance where INGOs were allowed to operate outside these regulations of obtaining a letter of permission from the Ministry of Foreign Affairs and an MOU from a line ministry.

Registration and MOU processes

Most micro and small businesses, LNGOs, INGOs, and associations register with one of six ministries and/or two agencies. The following information includes a brief description of regulatory mandate and mechanism of each agency, types of organisations registering with them, administrative processes and procedures for registration (although these are very brief), including the procedure, duration, costs, and problems likely to be countered by those registering.

With no law on NGOs, the legal framework for the registration of NGOs and associations is unclear. According to information received from the Office of Associations and NGOs, Department of Political Affairs, in the MOI, there is no enacted law, decree, sub-decree, or circular on the registration of associations and NGOs.

The MOI drafted a Law on NGOs and Associations in 1999 and submitted this draft law to the Council of Ministers (COM), but it has not been approved. The approval process for a law would normally take an estimated 18 months after the COM has approved it. In 1994, the MOI issued a notice to governors of provinces and towns banning them from registering associations. Associations are to only be registered at the MOI in Phnom Penh.

There are no official fees to be collected for the LNGO, INGO, or association registration process, although some ministries do charge \$2 to \$3 for the registration forms. The timeframe for registration depends on the payment of facilitation fees for persons who are usually employees of the ministry itself or maintain a close working relationship with employees of the ministry and understand the registration process.

Discussions with all organisations interviewed suggest that ministries avoid documenting the official process and make registering unduly complex. We could find no ministry or agency that could produce a document outlining a step-by-step process. One entity interviewed for the report stated that, “They keep us running in circles telling us to do this and that, but when we do this and that, we return to be told this is wrong and we need to do something else.” Conversations suggest that most managers in the business, NGOs, and associations surveyed are unwilling to experience the frustration involved in “doing it by oneself” and opt to pay a reasonable facilitation payment.

Ministry of Commerce (MOC)

All limited liability enterprises are required to register with the MOC. Sole proprietorships that have profits of more than \$1,500 are required to register with the MOC in Phnom Penh or at one of its provincial offices. Sole proprietorships with profits of less than \$1,500 are not required to register. In practice, most limited liability companies register, but few sole proprietorships register. Sole proprietorships normally register only if their activities include importing, exporting, or contractual agreements with international enterprises or (donor) organisations, which require that the firm is registered. None of the NGOs or associations interviewed for this report were registered with the MOC.

Enterprises registered with the MOC must also pay an annual patent tax of \$300, to obtain a tax identification number, and obtain a VAT number from the MOEF. For registering entities, there are other licenses and permits, depending on the type of business activity. For example, if the enterprise employs persons, it will require an approval of its labour management rules from the MOL; if the enterprise operates a production process, it will require a license from the MIME; if the firm creates environmental waste, it may require a license from the Ministry of Environment (MOE).

Previous process for registering at MOC

The MOC obtains its mandate for registration from the 1996 Law on the Establishment of the MOC and implementing sub-decree passed in 1997. In the past, cost of the MOC registration process ranged from \$1,000 to \$2,000, with an average of \$1,050 and average timeframe of 94 days, including the time needed to obtain permission letters from the provincial, commune, and district authorities, processing the registration application at the MOC, and obtaining additional required licenses from other ministries. The MOC was allowed to charge an official fee for registration of \$30. Another \$30 was required to include the registration information in the Weekly Business Bulletin published by the MOC's Domestic Trade Department. The remaining fees were for unofficial payments to government authorities, facilitators, or ministry staff to prepare and process the registration documents.

In 2004, the ADB formulated a loan for the Government of Cambodia that required a redesign of the business registration process at MOC, including the development of new procedures. As a result, a recent ministry decree has revised the registration procedure and reduced the cost of registration from an estimated average of \$1,050 to a more reasonable \$177 to \$240.

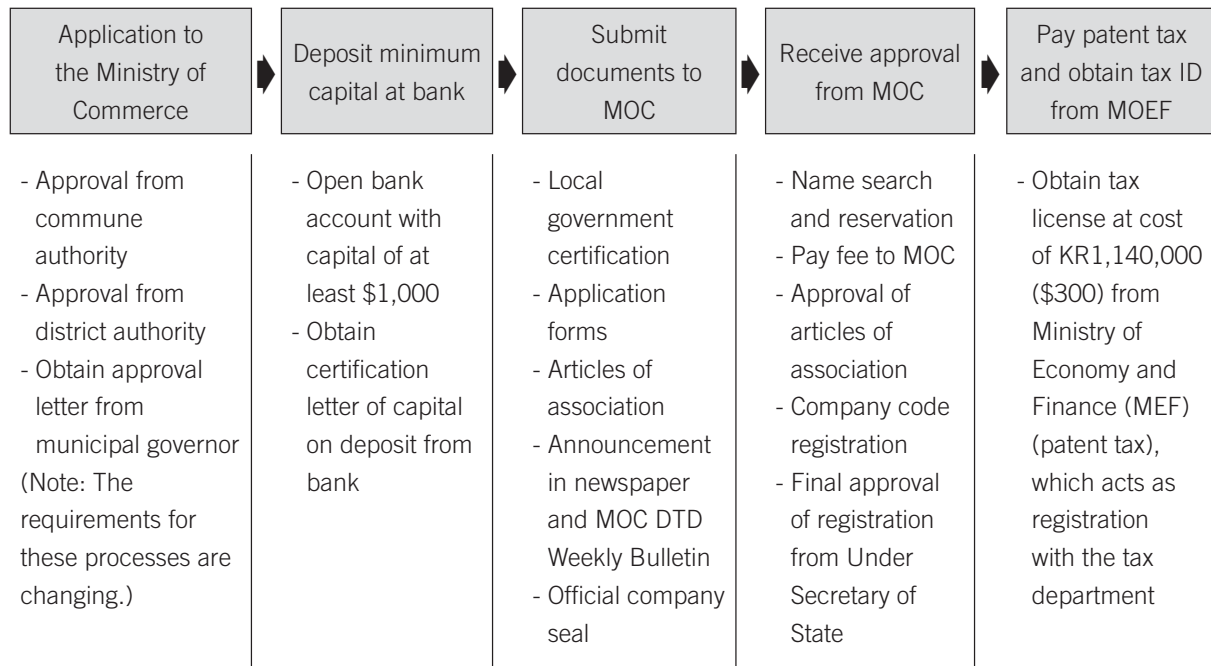
New process for registering at the MOC

According to the prakas issued by the MOC on August 23, 2004, the redesigned process for company registration in Ministry of Commerce will include the following fees.

1 Fee for treasury	US\$70
2 Cost of formats for company registration.....	30
3 Search the information-reservation name	5
4 Registration number	5
5 Chamber of Commerce.....	20
6 Publication in bulletin	10
7 Seal.....	12
8 Service	5
9 Department of Municipal Commerce.....	20
Total costs for registration	US\$177

The ADB’s project consultant indicated that the process change was intended to create a one-stop-shop for processing business registrations. Included in the proposal are the elimination of the need to obtain advance approvals from the district, commune, and provincial authorities, a streamlined business charter process and a decrease in capital required from \$5,000 to \$1,000. The consultant stated that he was not confident that the suggested one-stop-shop process would eliminate all of the unofficial fees. Conversations with one firm that recently registered under the redesigned process indicated that the ministry continues to suggest facilitation services of \$250 fee to complete the registration process for the applicant.

Diagram 1 Business registration process at MOC



Estimated cost of registration: \$240 to \$490.

Estimated length of time to register: 15 to 30 days.

Ease of registration process: Very difficult without facilitator.

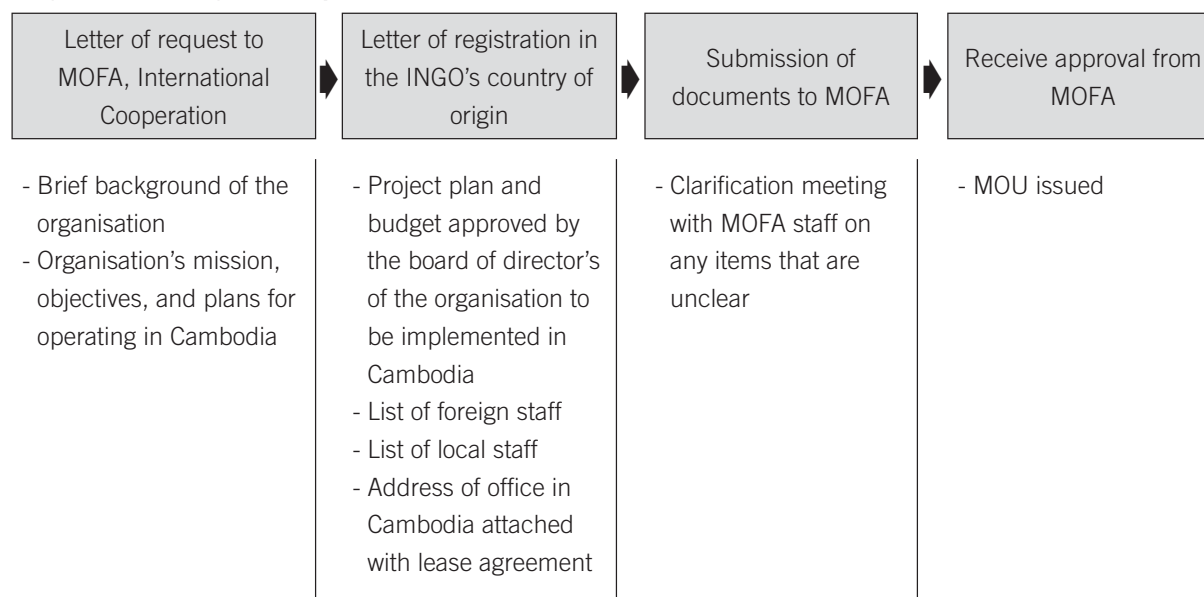
Ministry of Foreign Affairs (MOFA)

The MOFA registers only non-profit INGOs and associations. The MOFA obtains its mandate for registration from the 1996 Law on the Establishment of the MOFA and implementing sub-decree passed in 1999. The MOFA issues a MOU for a period of three years, which can be renewed for an additional three years with the payment of a negotiated fee after the MOFA evaluates the project or programme of the INGO and find no objection.

There is no formal license or certificate, since there is no Law on NGOs or Associations, so MOFA issues an MOU to the firm, which allows the entity to operate and receive benefits such as no payment of salary tax or profit tax, the ability to obtain local-rate utilities, and export products. The MOU also allows the organisation to import equipment tariff-free with additional permission of the CDC. This permission is obtained with payment of a negotiated fee and by presenting a copy of the MOU to CDC.

There is no official fee for registering with the MOFA and obtaining an MOU, but facilitation services are usually required at a cost of \$350 to \$500. These services are typically provided by someone employed at or well-connected with the MOFA. The normal timeframe for obtaining the MOU is 30 to 60 days. The current procedures are shown below.

Diagram 2 INGO registration process at MOFA



Estimated cost of registration: \$350 to \$500

Estimated length of time to register: 30 to 60 days.

Ease of registration process: Difficult without facilitator.

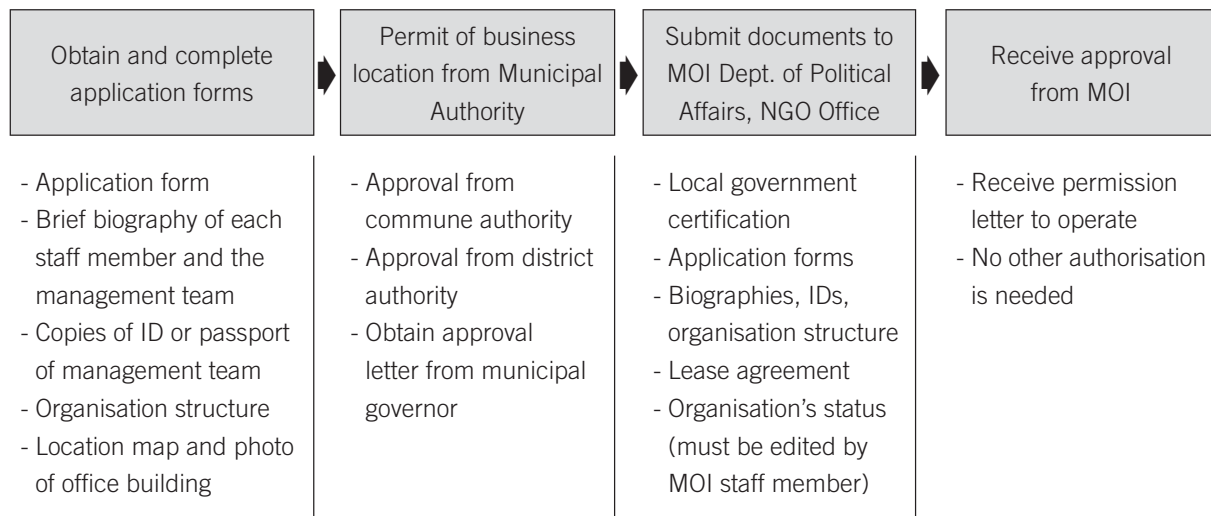
Ministry of Interior (MOI)

The MOI registers only non-profit LNGOs and associations, but discussions with businesses and LNGOs indicated that some profit-oriented Cambodian businesses also register as NGOs to avoid taxation and obtain related benefits. The MOI obtains its mandate for registration from the 1996 Law on the Establishment of the MOI and implementing sub-decree passed in 1995. The governing mandate contains a declaration from the co-minister of the ministry to line level authorities to confirm the location of LNGOs.

The registration process normally takes 30 to 60 days, if facilitated, and requires one or two meetings with MOI staff. The registration results in the issuance of a permission letter rather than an MOU that allows for legal operation of the LNGO or association for the intended purpose. Official fees are \$1 or \$2 for the purchase of the required forms. Normally, registration facilitation is required at a cost of \$350 to \$500. Interviews with several LNGOs indicated that the “reason one requires facilitation is because ministry staff will invariably identify a nebulous reason for not recognising the organisation’s status”. It was never fully explained to the team in any clearer manner than this. Each LNGO must negotiate with the MOI for its status to be recognised. This normally requires a payment of an unreceipted fee, which is included in the facilitation charge.

Staff at the MOI could provide no information on how the registration could affect importing or exporting of goods into or out of Cambodia. Even though the research team heard that handicrafts can be exported free of all charges and fees if registered at the MOI, no LNGO or association is doing so, choosing instead to pay negotiated customs clearance charges. The current procedures are shown in the following diagram.

Diagram 3 LNGO registration process at MOI



Estimated cost of registration: \$350 to \$500.

Estimated length of time to register: 30-60 days.

Ease of registration process: Very difficult without facilitator.

Ministry of Industry, Mines and Energy (MIME)

The MIME is supposed to provide businesses and some NGOs involved in manufacturing production with operating licenses, production line certificates, and Quality Standard Certificates. MIME obtains its mandate for registration from the 1996 Law on the Establishment of the MIME and implementing sub-decree passed in 1999.

Any business with a production process, including NGOs and associations, are supposed to obtain an operating license from MIME. Obtaining a license entails first applying at the MIME, after which a MIME official visits the factory to ensure processes are safe and meet minimum requirements, then the factory owner pays a fee and is issued the license. The same process is followed for a production line certificate, but normally these are issued only to garment manufacturers. Most handicrafts businesses and NGOs do not now obtain operating licenses, but as MIME becomes more capable, all types of entities will be required to file and obtain an annually license.

The issued licenses allow the firm to legally operate. Many businesses and NGOs operate inconspicuously and avoid licensing; this may be especially true in provincial areas. Unless an entity wants to export goods, there would be no obvious need to voluntarily license the production facility.

The Quality Standard Certificate is produced by MIME, primarily for garment manufacturers to complete the export process. The certificate does not certify quality, but does certify that the products were produced in Cambodia, which assists garment companies to meet exporting requirements. None of the handicraft entities interviewed stated that their customers have requested a Quality Standard Certificates, but if firms hope to export more handicrafts to the EU in the future, this may become a requirement.

Official costs are \$50 to \$60 and it takes 10 to 15 days to receive the license to operate. It is unclear if receipts are provided, but the fees appear reasonable. The current procedures are shown in the following diagram.

Diagram 4 Licensing process at MIME



Estimated cost of licensing: \$50 to \$60.

Estimated length of time to register: 10 to 15 days.

Ease of registration process: Easy without facilitator.

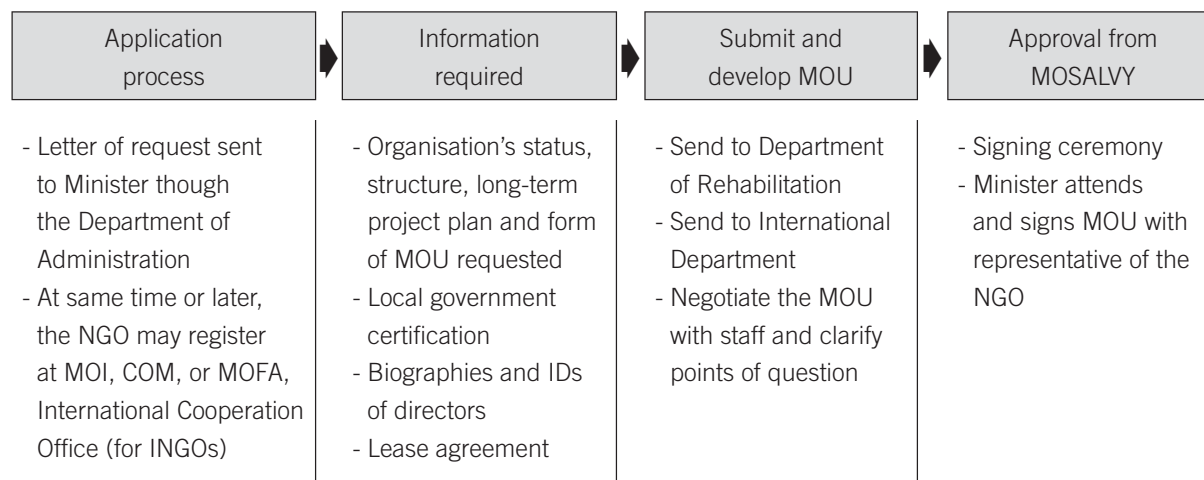
Ministry of Social Affairs, Labour, Vocational Training and Youth Rehabilitation (MOSALVY)

The MOSALVY is a line ministry that provides MOUs and letters of permission to LNGOs and INGOs. Neither MOUs or letters of permission are required for private businesses. MOSALVY obtains its mandate for registration from the 1996 Law on the Establishment of the MOSALVY implementing sub-decree passed in 1999.

Organisations that have activities related to social improvement, labour development, vocational training, or youth can “partner” with MOSALVY and obtain an MOU that allows them to operate for an indefinite time. There are no official fees to for the MOU, but an unofficial payment of \$70 to \$100 is normally requested for a signing ceremony that includes flowers and refreshments. Obtaining the MOU is reported as easy to do without a facilitator. The MOU process takes one to two months.

It is unclear if the MOU allows duty-free imports or exports. No one we spoke with in the ministry could answer this question and it is not documented in the MOSALVY mandates. To obtain these privileges, the INGO would also need to register at the MOFA and CDC. No LNGO interviewed for this report had requested duty-free exporting and chose instead to pay normal export facilitation fees negotiated by the agent, which was usually a freight forwarder. The current procedures are shown in the following diagram.

Diagram 5 MOU process at MOSALVY



Estimated cost to develop MOU: \$70-100.

Estimated length of time to develop MOU: 30-60 days.

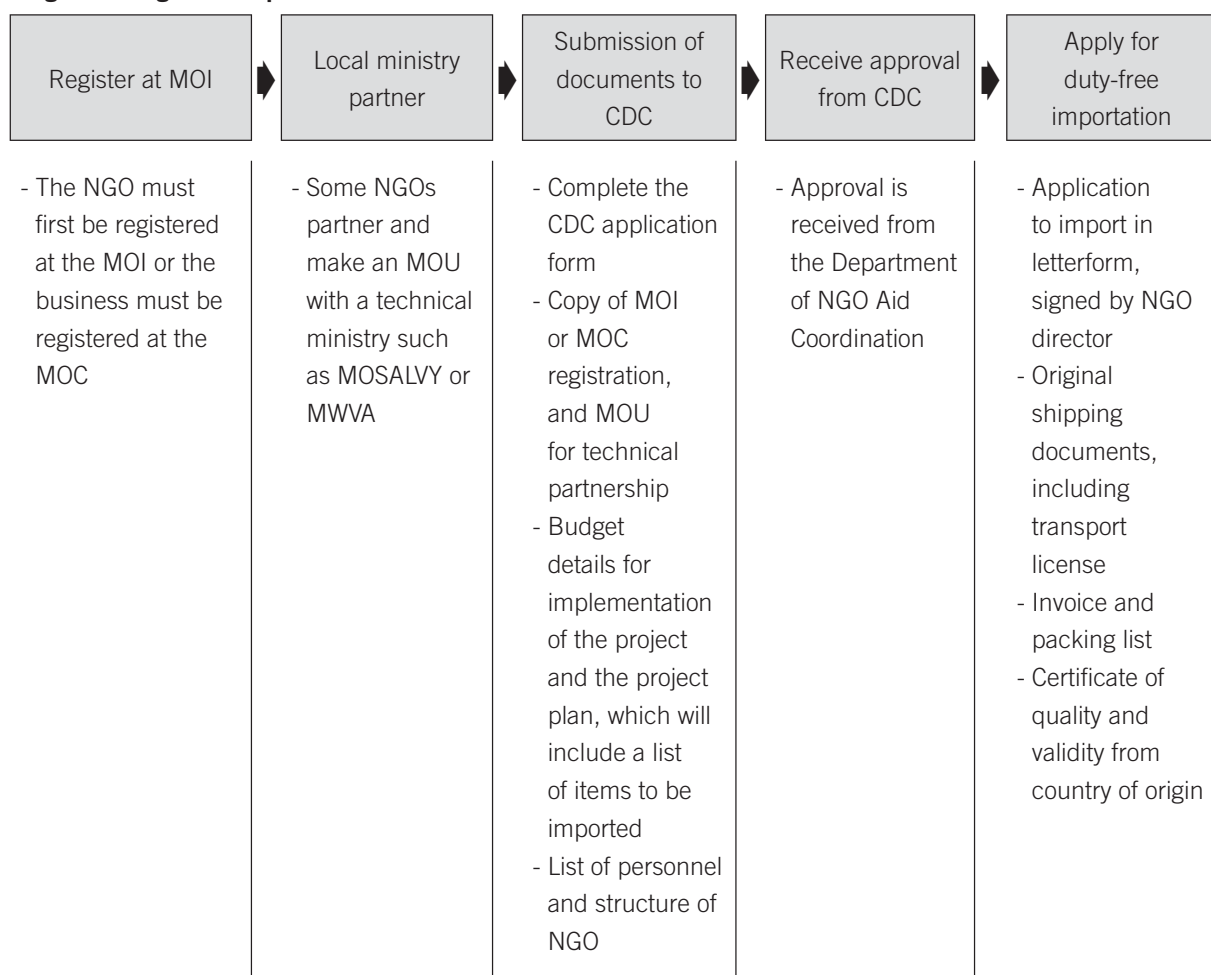
Ease of registration process: Easy without facilitator.

Council for the Development of Cambodia (CDC)

The CDC does not provide authority for businesses or INGOs to operate in Cambodia. INGOs that plan to import goods into Cambodia duty-free need to register their project with the CDC to obtain duty-free import privileges. Businesses and INGOs that register with the CDC are usually either large for-profit businesses, such as garment firms who import-process-and-export, or INGOs that need to import motor vehicles to serve their needs or foods to be distributed. Most garment manufacturers register at the CDC. Manufacturers importing goods for production and then to export obtain import licenses from CDC and have to meet several other quota-related and accounting requirements. CDC obtains its mandate for registration from a 1995 sub-decree on implementation, which has been revised numerous times.

The cost of registration for INGOs is \$10 for the application form and \$2.50 for the administration process. The only registration criterion is that the INGO must be registered at the MOFA, MOI, or MOC and have authority (registration, MOU, or permission letter) to operate. The INGO must also prove it has \$10,000 in operating funds, identify its source of funds, location, and timeframe of operations. The current procedures are shown in the following diagram.

Diagram 6 Registration process at CDC



Estimated cost to register: \$12.50.

Estimated length of time to register: 30 days.

Ease of registration process: Easy without facilitator.

Council of Ministers (COM)

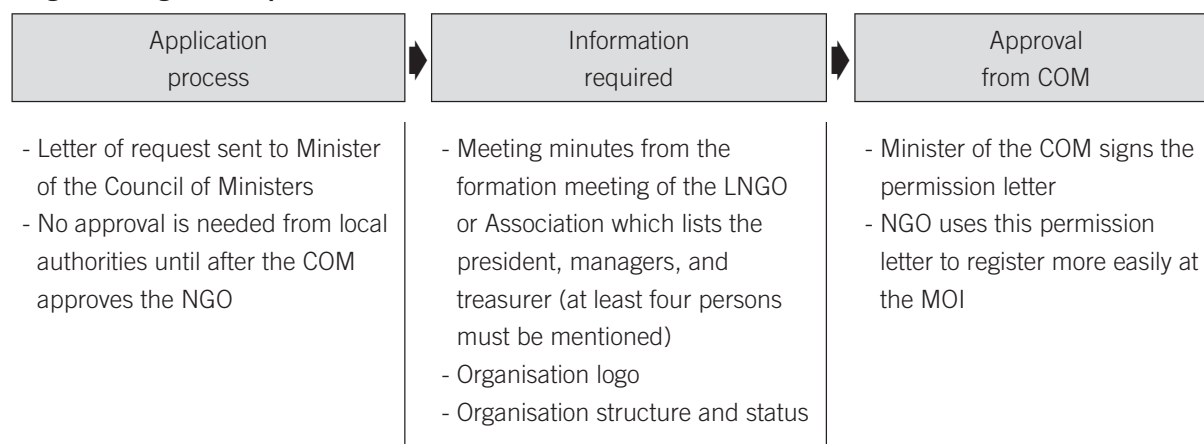
The Ministry of the Council of Ministers issues permission letters only to LNGOs and non-profit associations. Small and micro businesses would rarely, if ever, seek facilitation support from the COM. Medium and large businesses, those that need partnerships with well-placed government officials, do seek facilitation support from COM, as it can provide status to the business. The COM obtains its mandate for registration from a 1994 sub-decree on implementation.

The COM issues only a temporary permission letter. It is expected that after the Law on NGOs and Associations is enacted, the COM will be able to issue permanent permission letters. None of the NGOs or associations interviewed for this report registered at the COM, but the team was informed that there have been some in the past. There are no standard application forms; the applicants are required to locate another NGO or association that previously applied and make copies of forms.

There are no official costs, but normally, registration requires the assistance of a facilitator at a cost of between \$350 and \$500. It is very difficult to obtain registration without a facilitator. The process normally takes 10-15 days.

The permission letter allows for legal operation of the LNGO or association for the intended purpose until the NGO law is passed. The permission letter does not allow duty-free imports or exports through the MOC or CDC. To obtain these privileges, the NGO would also need to also register at the MOFA or MOI. The current procedures are shown in the following diagram.

Diagram 7 Registration process at COM



Estimated cost to obtain permission letter: \$350 to \$500.

Estimated length of time to develop MOU: 30-60 days.

Ease of registration process: Difficult without facilitator.

Conclusions from Task 1

The research into the registration process for small and micro enterprises, NGOs, and associations demonstrated that it is reasonably simple to obtain registration if one is willing to pay the facilitation fees. The registration matrix shown at the beginning of this section lists the required and optional registering ministries.

The ADB and WB have invested considerable effort at identifying the constraints in the registration process and recommending changes to streamline applications. To obtain a full discussion of this topic, please review copies of the ADB's *Private Sector Assessment for the Kingdom of Cambodia*, issued in December 2003, and *Preparing the Small and Medium Enterprise Development Programme*, issued in August 2004. The following constraints and recommendations are covered in detail in these two ADB documents, but we have tried to tie many of those comments with findings from this research study in the following list of constraints and recommendations.

1. Lack of a coordinated registration framework

The legal framework and institutional structures that exist to register small and micro businesses, NGOs, and associations do not appear responsive to most business interests. There are few incentives for private businesses that are not involved in exporting or importing to pay the official and facilitation fees and encourage scrutiny that results from formal registration, such as visits by ministry personnel who invariably seek unofficial fee payments, and the requirement of expensive external audits. NGOs and associations have a much simpler process to follow and, for the most part, are not bothered by ministry staff once they have obtained permission to operate.

2. Enterprise registration lacks transparency

The lack of transparency and the complicated documentation requirements result in high financial and administrative costs, and a disincentive for businesses to formalise registration. Most applicants for registration interviewed for this report rely on facilitators to assist them to navigate through the registration process. While this saves time in processing the application, it adds unnecessary costs. Improved access to information on business registration combined with simplified documentation requirements would allow entities to carry out registration on their own. Even with the recently revised MOC registration procedures, the expectation for facilitation services continues.

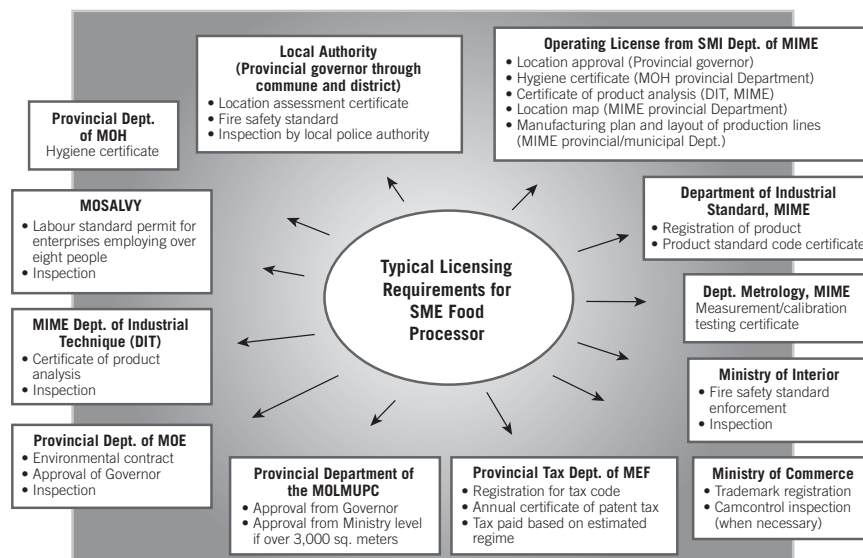
3. Lack of legal framework and service provision for registration

There is currently no requirement and little incentive for sole proprietorships, the mainstay of Cambodia's small and micro enterprises, those that earn less than \$1,500 per year in profits, to register at the MOC and formalise their businesses. Until the MOC and the RGC begin to provide value-added services or some benefit for registering businesses, there will be little justification for most businesses that are not interested in exporting or importing to formalise their registration.

The MOC has drafted the Law on Commercial Enterprises, which replaces Instructional Circular No. 360 by providing for the creation of four types of legal entities, namely general partnership, limited partnership, private limited liability company and public limited liability company. The draft law has no provisions pertaining to sole proprietors. A provision must be developed that makes it attractive for sole proprietors to register.

4. Non-transparent and high-cost registration process

The lack of a transparent and efficient registration process significantly discourages enterprises from formalising due to complicated procedures and high costs. The flow of the company registration process is illustrated in the diagram below. This example, of an SME food processor, highlights the overly cumbersome procedures.



MIME = Ministry of Industry, Mines and Energy
 MOLMUPC = Ministry of Land Management, Urban Planning and Construction
 MEF = Ministry of Economy and Finance
 MOE = Ministry of Environment
 MOSALVY = Ministry of Social Affairs, Labour, Vocational Training and Youth Rehabilitation
 MOH = Ministry of Health

5. Lack of incentive to register

Development of a low-cost registration system alone may not result in a significant increase in registered companies. By continuing to operate in the informal sector, businesses are demonstrating that the costs of formalising outweigh the benefits of operating in the formal sector. For the average Cambodian private firm, this means that the future tax burden of entering the real regime tax system and the cost of increased regulatory scrutiny outweigh the benefits of improved access to finance and markets, improved enforcement of contracts and other public goods. This cost-benefit calculation is based on the view of the enterprises that weak contract enforcement mechanisms, property rights and delivery of public goods provide little benefit to formalised entities relative to the they might incur.

6. Licensing and inspection

Many ministries are involved in regulating enterprises. Line ministries are responsible for issuing operating licenses for businesses under their jurisdiction. For example, MIME issues operating licenses for manufacturers while the Ministry of Tourism provides operating licenses for hotels and tour operators. Ministries also provide licenses to regulate the quality of goods, sanitation, environment and safety. With so many ministries involved in business regulation, an effective institutional framework for supporting businesses is needed to ensure proper coordination of policies and regulations.

Laws and regulations including sub-decrees, prakas and procedures concerning licensing are not adequately disclosed to the public, and business applicants have limited understanding of how licensing and approval can be granted to them.

Business licenses in Cambodia

- Line ministries are responsible for issuing operating licenses to firms under their jurisdiction
- Most ministries also provide regulatory licenses
- High burden of licensing (more than 70 licenses have been identified)
- Firms are subject to multiple and overlapping inspections
- No process for reviewing necessity and cost of licenses

This can lead to the process being handled in a non-transparent manner. When accumulated, the formal and informal payments for obtaining operating licenses are very burdensome for businesses, NGOs, and associations, particularly given their small size and limited financial capacity. The short duration of licenses adds more costs due to the frequent need for renewal and additional payments. Durations range from one to three years depending on types of enterprises and ministries/institutions for which the licenses are applied. Longer durations and more reasonable scheduled fee structures would benefit Cambodian businesses, NGOs, and associations in the longer term.

3

Exporting from and importing into Cambodia

Introduction and summary of findings

According to records published by the MOC, Cambodia exports about US\$2 billion of goods each year. An estimated 96 percent of these exports are fabric-related and associated with the garment and footwear industries. The balance of official exports are mostly agriculture-related products such as rubber, cattle, and other crops. Agriculture and trade experts estimate that even larger shares of agriculture-related crops are exported unofficially through porous borders with Thailand and Vietnam.

Research for this task examined formal export channels, primarily for the handicrafts industry, and primarily through air freight, since that is the manner in which handicrafts entities currently export goods. At least one handicrafts firm interviewed used informal means (i.e., smuggling) to export goods in an effort to reduce shipping costs and ensure on-time deliveries. The research indicated that handicrafts entities found exporting and importing processes not transparent and intentionally complex. When interviewed, an entity noted that, “Every step involved in the export transaction, it seems, allows for the collection of unofficial fees and each step requires negotiation, since scheduled charges are either ignored or don’t exist.”

The WB recently conducted a comprehensive trade facilitation study, parts of which were released on August 12, 2004 in a publication entitled, *Seizing the Global Opportunity: Investment Climate Assessment and Reform Strategy*. The purpose of the study was to identify trade facilitation constraints and propose solutions to overcome them. According to the publication, “Trade facilitation practices in Cambodia stand out in the high costs of corruption and long delays for clearances procedures.”⁷

The WB study was primarily focused on the garment sector and sea freight shipping. Among the findings from the study were the following:

1. Boundaries between the responsibilities of agencies involved in control over importation are ambiguous and lead to overlaps.
2. Arriving ships are placed under the control of numerous agencies, yet their roles are not clearly identifiable.
3. Procedures are unclear and superfluous.

The study confirmed these findings to be true in the handicrafts sector and applicable to air shipments as well. The study also identified that most

⁷ Seizing the Global Opportunity: Investment Climate Assessment and Reform Strategy, World Bank, August 2004.

handicrafts entities are not hindered in their exports by excessive corrupt practices because all enterprises, NGOs, and associations interviewed hired freight forwarders to negotiate for them and ensure delivery of goods to customers. Importing customers are normally willing to pay the higher fees incurred as long as on-time delivery is certain.

How the garments industry benefit from collective representation

A good example of the value of collective representation is the garment industry. The garment industry, due to its scale, scope, and need for official documentation, uses official and formal export and import channels. Due to their value to the economy and decisions by the RGC to provide preferential treatment and investment incentives for importing raw materials and exporting finished goods using Cambodian labour, the garment industry receives special recognition. Investment incentives in the past have included long-term income tax holidays, low-cost leases on state-owned land and buildings, tax-free imports of machinery, and tax-free import of goods processed for export.

The politically powerful Garment Manufacturers Association of Cambodia (GMAC) facilitates the relationship between factory owners and the RGC. GMAC also provides substantial facilitation support services to its members, including facilitating the acquisition and authentication of the Certificate of Origin, managing quota allocations, verifying compliance with labour standards, verifying compliance with duty exemptions, and managing quality.

The collective impact of garment firms on the economy is tremendous. It's estimated that the garment sector provides between 200,000 and 300,000 jobs with an average annual payroll of approximately US\$8 to \$18 million per month. Yet, even with the considerable economic and political influence, GMAC continues to be hindered by the excessive collection of unofficial fees in the trade facilitation process and repeatedly lambastes the government's inability or unwillingness to correct chronic problems.

How the handicrafts industry could benefit from collective representation

Collectively, the handicrafts industry is small and economically inconsequential relative to the garment industry. No accurate estimate of handicraft exports is available. MOC export records indicate less than \$250,000 of handicrafts are exported. From the research conducted for this study, it could be reasonably estimated that somewhere between \$1.5 and \$3 million of handicraft products are exported annually. This would include some tourist purchases at handicrafts shops.

Compared to the garment sector, estimated handicrafts exports are probably less than two-tenths of one percent of garment exports. The handicrafts industry does employ a considerable number of persons, especially vulnerable working classes such as single mothers and war victims. With Cambodia's burgeoning tourism market, much potential exists for handicrafts to contribute, especially the rural economy.

Unlike the garment sector, the handicrafts industry has no major trade association representing the industry's general interests. Individually, handicrafts entities possess little political or economic influence to promote change in the official trade facilitation channels or reduce facilitation fees. As demonstrated by GMAC, which has been successful at representing their members' interests and promoting change, a handicrafts sector membership association could assist individual entities to obtain a collective voice and promote improvements in importing and exporting of goods and services.

A caveat is worth mentioning. The research for this report indicates that the informality of the sector may actually be increasing the ease by which exports are facilitated. No LNGOs, INGOs, or associations interviewed for this report are formally registered with the MOC, pay income tax, 10 percent VAT, and except for relatively few complaints related to the cost of exports, no firm experiences difficulty exporting if they use freight forwarders to facilitate the exports.

On the other hand, many of the handicrafts exported are what one could term "compassion exports". The buyers are more interested in "helping" poor or handicapped Cambodians than in purchasing high quality handicrafts. Although no survey has been conducted on how much this segment of buyer contributes to handicrafts exports, the research for this report indicates it is substantial. Yet "compassion exports" could actually be inhibiting the transition to higher quality production and investment.

A representative association could add value in assisting the promotion of higher quality Cambodian handicrafts and link a broader segment of buyers to handicrafts producers. This would be in addition to promoting the handicrafts producers' collective interests and operating as the collective voice with government, much as the GMAC does. The research did not inquire if handicrafts entities would be willing to pay for this service, but if value-added services could be developed by the representative association, such as additional services to those being offered currently by the AAC, it is reasonable to assume that many entities, NGOs, and associations would be willing to contribute financially to support a collective representation of their interests. Further research is needed on this matter.

Importing raw materials and input supplies

Research indicates that few handicrafts entities import goods through formal import channels, and none of the interviewed enterprises, NGOs, or associations are planning to import, choosing instead to purchase goods in the local markets and to let existing businesses supply their needs. Some enterprises and NGOs have imported materials in the past, but state that it is "too time-consuming and expensive to use the formal channels".

Most handicrafts entities source their supplies from local markets and let others manage the importation process. The unwillingness of handicrafts entities to import supplies results in an inability of most entities to control quality, which results in lower quality production. The two most common examples provided by interviewees were zippers and dyes. Most entities are not of proper scale

and scope to order minimum quantities of quality zippers from foreign suppliers and are left to purchase substandard quality zippers in local markets. Also, inconsistent dye quality is regularly mentioned as a problem, yet higher quality German dyes appear to be either in relative short supply or too expensive for most entities. Again, a representative association could promote more efficient, regular delivery of supplies at reduced prices.

Exporting handicrafts

The 15 handicrafts-exporting entities interviewed for this report indicated that exporting goods is relatively easy, although expensive. Existing customers have been willing to pay for the high costs of air shipping and most handicrafts entities appear to be unconcerned with export shipping costs. As mentioned, many buyers to date have been more interested in “compassion” than quality. Developing a more sustainable and growing handicrafts industry may be difficult unless costs can be reduced and buyers can be encouraged to become more interested in quality than compassion exports.

All handicraft exporting entities interviewed used air freight and the services of freight forwarding firms, such as Transpeed, OCS, or Federal Express to facilitate their shipments. A rare few occasionally use the parcel post services at the Phnom Penh post office for very small shipments. For a fee, the freight forwarding companies use formal channels to export packages and negotiate fees and transaction costs for their customers. Although these services provide a value-added service, shipping costs are excessively high. None of the handicrafts entities could identify the costs involved in shipping and most were unconcerned, since the buyers are picking up the costs. There appears to be little recognition by handicrafts exporters of the potential sales and profits being lost as a result of these high fees.

Process and costs of importing and exporting goods

The following two diagrams identify in simplified terms the processes for exporting goods from and importing goods into Cambodia by air freight. A more detailed spreadsheet is provided in Appendix 2 that outlines the processes and costs involved in both air cargo handling and ocean cargo handling.

Although no handicrafts exporter interviewed for this report is using containerised shipments by ocean-going vessels, it is believed that an entity named Baskets of Cambodia, a relatively large bamboo and rattan basket manufacturer with production facilities located in Siem Reap, is shipping several containers a year through the sea port in Sihanoukville. This information could not be confirmed, as the firm’s manager would not grant an interview.

All handicrafts exporters interviewed for this report use air freight and hire the facilitation services of freight forwarders. In most cases, negotiated fees are not itemised on the exporter’s bill. Instead, the forwarders simply add a customary charge to the bill that covers the negotiated unofficial fee and the expenses to negotiate. Where receipts are provided by government agents, they are itemised and included on the customer’s invoice.

Diagram 8 Process for exporting goods from Cambodia

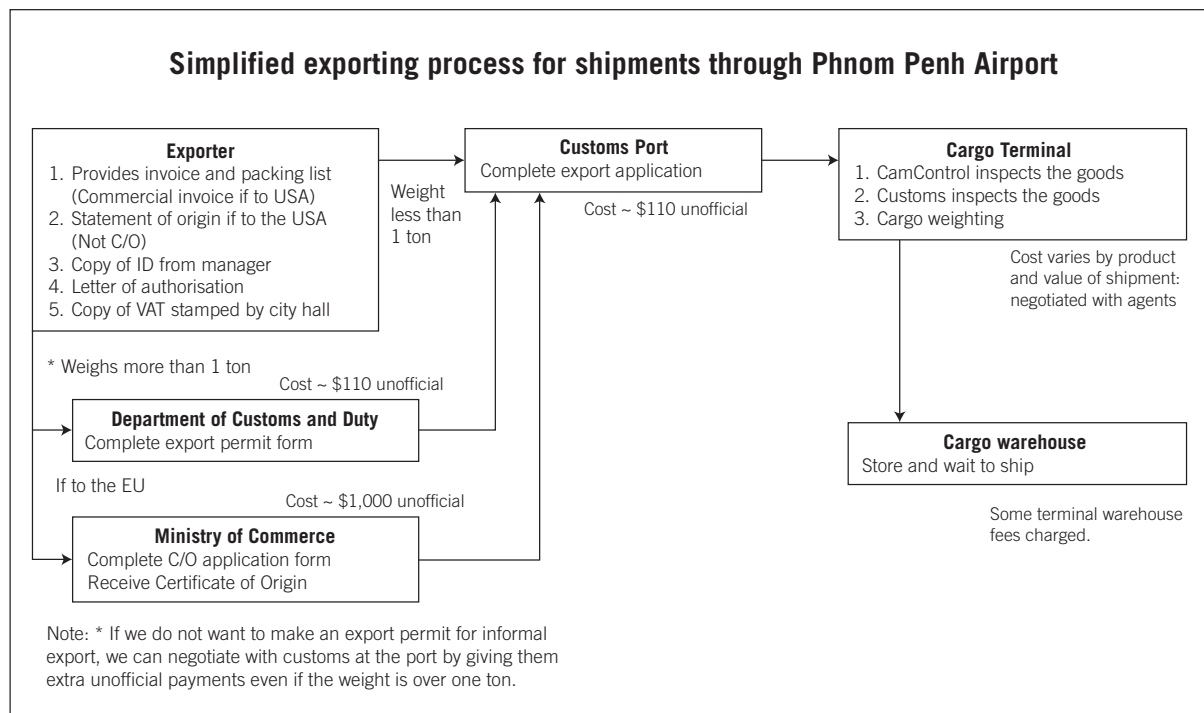
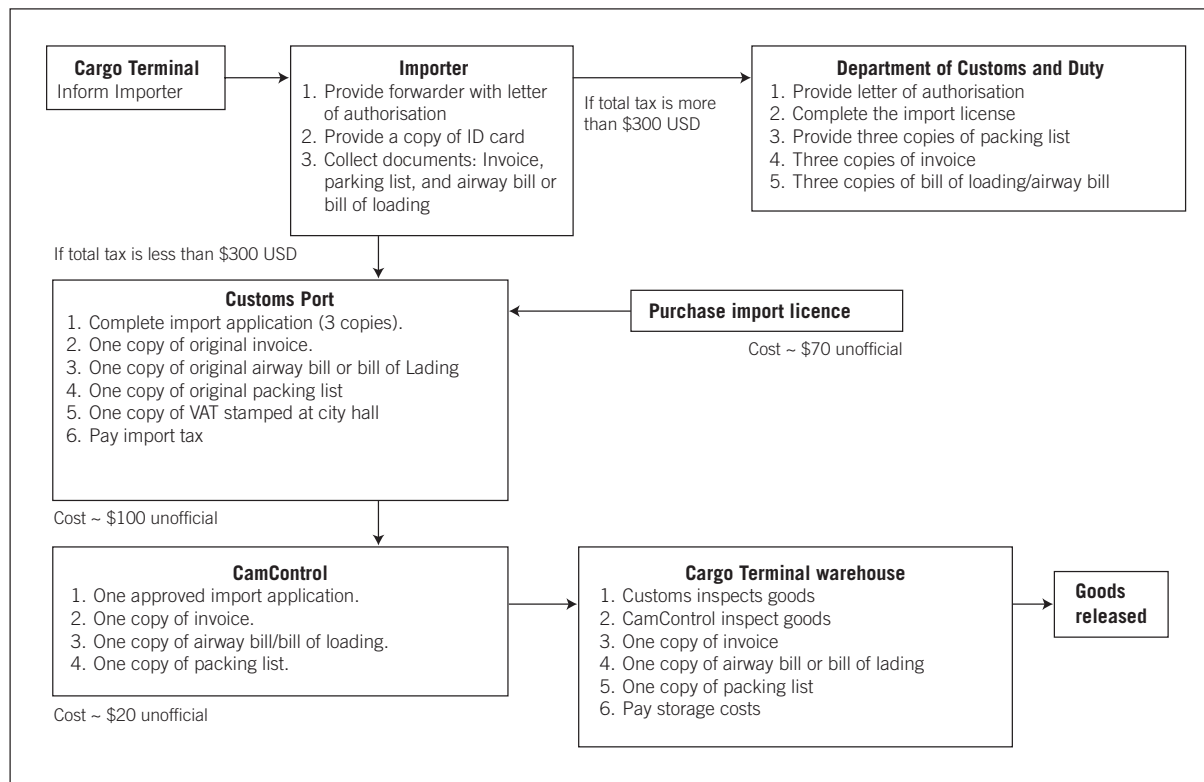


Diagram 9 Process for importing goods into Cambodia



How registration affects the process and costs of exporting

Linking the registration of a micro or small business, NGO, or association to costs of exporting is difficult, if not impossible, because there are many methods used to avoid taxation and formal procedures. Although this research is by no means a comprehensive compendium of all experiences by micro or small businesses, NGOs, or associations, anecdotal discussion and observations are worth noting and are included herein.

For micro and small businesses that are not registered with the MOC and therefore do not possess a tax identification number or VAT certificate, exporting through formal channels is difficult. Informal options for relatively small quantities are available for regional countries, but official or large-scale exports of handicrafts would be nearly impossible to accomplish informally. For businesses registered with the MOC, in addition to the normal export costs shown in the previous diagrams, a 10 percent VAT charge would also be required, in addition to profit taxes. The shipping process could be as simple as contracting a freight forwarder or negotiating through customs brokers located throughout the country. One way that some private businesses avoid charges is to ship the goods as “samples”, thereby avoiding taxation. This entails shipping relatively small quantities.

For NGOs and associations, the only required documentation appears to be a copy of the MOU or permission letter the NGO or association received from either the MOI, MOFA, or line ministry. In at least one instance, large quantities of handicrafts, primarily silks, are being exported by an NGO that is only registered with a line ministry. In many instances, the freight forwarder is not asked about the registration of the exporting NGO and no documentation is required.

The fact that everything is negotiable, at least for the time being, may mean that almost any entity could ship relatively large quantities of handicrafts without being registered with any ministry. In this way, the costs involved in registration could be avoided entirely. Eventually, if the RGC implements the recommendations promoted by recent WB and ADB trade facilitation projects, the government will gain the capability to control the export process and reduce the ability of government agents to negotiate for unofficial fees. At that point, businesses, NGOs and associations will be required to prove that they are properly registered and to follow stricter export and import procedures.

General System of Preferences (GSP)

The terms of reference identified the need to research the GSP with specific application to the EU. Additional research was conducted for the US, Canada, Korea, and Japan, but not at a similar level of detail, since many of the conditions apply equally to all countries.

GSP is the most extensive and explicit expression of an attempt to use trade preferences as a tool for economic development. There are a number of other schemes, such as the African Growth and Opportunity Act and Everything But Arms initiative, limited to subgroups of developing countries, with varying product coverage and preferential arrangements. Preferences for the 49 Less

Developed Countries (LDCs are countries with GDP less than \$900), such as Cambodia, form a subset of GSP, while other unilateral preferences depend on explicit waivers of WTO rules.⁸ GSP, a concept started in the 1970s, includes reduced tariff rates and documentation requirements for importation of Cambodian handicrafts into the markets of developed countries, such as the United States and EU.

As a member of the WTO, the possibility for Cambodia to export more competitively priced products, other than garments, to the United States and Canada should improve. The research did not include analysis of the Association Southeast Asian Nations (ASEAN) agreements, which was outside the terms of reference, but anecdotal evidence suggests that the requirements to ship goods to ASEAN countries are much less complicated than exporting goods to the EU, USA, or Canada.

In 2002, only about 36 percent of the Cambodian products exported to the EU requested GSP privileges. The remaining 64 percent paid full duties of 15 to 20 percent of value. The majority of Cambodia's exports to the EU are garments and shoes. The total value of handicrafts currently exported to the EU is estimated to be relatively small. The value of handicrafts exported to the US, Australia, and ASEAN nations is considerably higher. The reasons for this may relate to GSP privileges, but more likely relate to the fact that buyers from these countries have established working relationships with Cambodian handicrafts producers and exporters.

A large proportion of these handicrafts exports appear to be compassion-related and promoted by religious cults, non-profit, or for-profit businesses promoting Cambodia as a LDC with significant disadvantaged and war victim populations. In addition, the EU certification requirements appear to be overly-rigorous. Combining the overly-rigorous requirements with the fact that most Cambodian entities are very small in scale means there are severe limits on the ability of Cambodian handicraft entities to import to the EU.

8 "The EU's Everything But Arms Initiative in Least-Developed Countries," Lucian Cernat, et. al., UNCTAD, June 2003.

9 "Integrating the Least Developed Countries into the World Trading System: The Current Impact of the EU Preferences under Everything But Arms," Paul Brenton, International Trade Department, The World Bank, April 2003.

What is the Everything But Arms (EBA) initiative?

In 2001, the European Commission granted, as a sub-component to GSP, unrestricted duty-free access to all products (except arms) manufactured from all LDCs.⁹ The programme was called the Everything But Arms initiative and it granted duty-free access to all products from LDCs without quantitative restrictions and, more importantly, the EBA is granted for an unlimited time period. The practical effect of the EBA has been to provide for the import to the EU of a few remaining agricultural products that had not already been granted unrestricted import privileges.

One research report stated that EBA is "only about agricultural products" and that "the previous GSP cleared the way for duty-free imports of manufactured goods", such as handicrafts from Cambodia.

The EU still maintains stringent requirements to import goods duty-free into its member countries. These requirements include the Certificate of Origin, vessel transport and accumulation certification, which are explained below.

With the exception of relatively large garment exports, GSP and EBA privileges, which allow unrestricted imports of Cambodian handicrafts to the EU, have not provided much benefit to the handicrafts sector. The following information is concentrated on the EU in particular, but the changes required to remove the constraints are applicable to most export markets. These changes include, among others, the need to improve overall product quality and meet ever-changing customer requirements, decrease manufacturing costs, dramatically improve marketing relationships, and decrease shipping costs. Individual entities do not normally have the capabilities to meet these requirements.

A more effective approach is needed if Cambodia's handicrafts producers hope to compete in international markets and begin exporting quantities of handicrafts to the EU, USA or other high-value markets. These issues are discussed further in the remainder of the report.

Why have GSP and EBA failed to improve exports to the EU?

Analysis performed on the EBA programme by trade experts showed that changes initiated between 2001 and 2003 had only minor impacts on the ability of LDCs to import more products into the EU. The reason for the limited impact was that 99 percent of the EU imports from the LDCs had already been liberalised by previous GSP regimes; the only exceptions left to be covered were rice, sugar and bananas. By 2001, the majority of imports from LDCs were already entering the EU duty and quota free. These were primarily food imports.

Constraints to the export of handicrafts

Analysis suggests that there may be a range of factors to blame for the failure of Cambodian products to be exported to the EU and other non-ASEAN nations. These factors fall into two general categories: 1) marketing and manufacturing constraints and 2) certification constraints. Examples of each are listed below:

1. Marketing and local manufacturing constraints
 - Price and quality of goods are not competitive
 - Exporting costs are too high relative to competitors
 - Export processes are not transparent and unduly complex
 - Exporting entities cannot meet customer delivery requirements
 - Quality inputs are difficult to obtain
 - Designs do not keep pace with trends; Cambodian entities lack the skill to develop and market new designs
 - Few marketing linkages between Cambodian handicraft entities and international buyers
 - Scale of Cambodian entities inhibits investment to develop market linkages with international buyers
 - Image of low quality products and no national branding
2. Certification constraints
 - Certificate of Origin (C/O) rules, especially for the EU, combined with an onerous and expensive C/O process at the MOC

- Strict product coding requirements which need importing countries to have additional certifications depending on product category
- Product quality restrictions, especially for the EU, such as the prohibition on the use of toxic dyes in silk handicrafts or requirements to certify that products do not contain elements of endangered tree or plant species
- Inability of the RGC to provide product Quality Standard Certificates. Cambodia does not have a certification laboratory

Reducing export constraints

Interviews with handicrafts producers, exporters, and buyers repeatedly identified general low quality and high price of Cambodian handicrafts as a fundamental problem. Silk handicrafts and miniature silver animal figurines were the two items consistently ranked by buyers as competitive based on their existing quality and wholesale price. The entity named Baskets of Cambodia would not grant the team an interview, but this entity is reported to be exporting quantities of handmade baskets to the United States. These examples demonstrate that Cambodian businesses, NGOs, and associations can meet international standards for quality and price and do not need to stay in the low quality and high price “compassion” export segment.

Many of Cambodia’s exports appear to be “compassion-related” exports. This term means the exports are predominantly purchased by persons and organisations interested more in the economic development of a class of craftsman, than in the products themselves. These classes include disabled war veterans, destitute village women, landmine victims, and similar categories. From conversations with handicrafts entities and buyers, there seems to be a very large and perhaps expanding market for compassion exports internationally, although no estimate of the market size has been determined. Cambodia, due to its increasing poverty status and significant number of disabled veterans and citizens, seem well-placed to benefit from compassion exports. Some handicrafts producers and exporters are especially keen at identifying and marketing to these special interest groups, such as churches and veterans organisations.

Anecdotal information suggests that most handicrafts produced for compassion export are of lower to moderate quality and not competitively priced relative similar products manufactured in Vietnam and Thailand. One buyer lamented that Thailand has all but priced itself out of the export market and is now focusing more exclusively on developing demand among domestic consumers and the 10 million annual tourists. Vietnam appears to be more market savvy and better able to meet customer quality and quantity requirements. If Cambodia is to compete in the long-term, it must develop products that do not depend on compassion and can compete head-to-head with high quality products on the international market.

Reducing marketing and local manufacturing constraints

Compassion export customers seem willing to pay above market price for lower quality products. This has certainly helped a subset of Cambodian entities to manufacture and export volumes of handicrafts. In the long-term, one problem with developing an industry dependent on compassion imports is that market price and quality signals received by producers indicated that low quality and high price are acceptable conditions. These market signals actually inhibited the development of higher quality and higher value handicrafts, improved customer focus, and better regionally competitive pricing. Thus, compassion exports have indirectly impeded handicraft industry development and, especially, national branding initiatives intended to enable Cambodian handicrafts to be internationally recognised.

Most of the handicrafts entities interviewed for this research either concentrate on the low-end, high-profit compassion trade or on the Phnom Penh walk-in tourist trade, which appears to be seeking low quality and reasonable prices. Few entities are concentrating on high quality or high priced products or night markets. Siem Reap handicraft entities appear to be more attuned to the higher quality market, but were not interviewed for this report.

As a result of the low-value concentration, most Phnom Penh-based shops, especially those operated by NGOs or associations, fail to maintain clean and attractive showrooms, fail to recognise the need for constant design innovation, and are witnessing stagnant or declining annual sales. Some of the shops visited during the research were quite appalling, with sticky food products aligned next to fine silks, dusty displays and stained clothing, and a general disregard for product marketing. On the other hand, the few shops that did appear to concentrate on high quality and high value had spacious showrooms, well-designed displays, and smiling, helpful staff. Most private enterprises were of this later category.

Several business development-related agencies and entities are promoting improved quality handicrafts products and working hard to improve productivity. Higher productivity should translate to more competitive prices. Organisations such as Traidcraft in the UK and Cambodia House in Australia have provided design and marketing experts to Cambodia free-of-charge to improve design, marketing, pricing, and product mix. MPDF, a donor-funded development agency, has supported several NGOs in developing their product lines and is set to improve market linkages between some Cambodian handicrafts producers and buyers in the EU, US, Canada and other developed nations. In the medium-term, these agencies will help to build the human resources and institutional capabilities that should reduce the constraints identified as market and manufacturing based.

Concentrating on tourists

During an interview with a well-respected EU-sponsored consultant with a long-term contract to promote and facilitate trade between Cambodia and the EU, the research team was counselled not to promote the export of handicrafts too strongly.¹⁰ The consultant believed that in addition to poor quality and high

10 Interview with Jean-Marc Bonnamy, Institutional Support Programme for Trade Facilitation at the Ministry of Commerce, June 2004.

prices, Cambodia's handicrafts entrepreneurs lacked the necessary marketing and sales skills and this was the primary reason they were unable to develop new market linkages with the EU and other developed countries.

He explained, "Cambodia has almost one million tourists a year and there seems to be little focus on them as an export market. Handicrafts marketing should be directed to local shoppers, expatriates in Cambodia, as well as tourists. It is much more expensive and takes much greater skill to export and compete with dozens of foreign businesses for international customers than it does to sell locally to people in your backyard."

The case made by the consultant may be accurate, but there has to date been no research to indicate the size of the tourist-handicraft market or how large the expatriate or Cambodian market potential may be for handicrafts for either of these segments.

Reducing certification-related constraints

Several constraints inhibit handicrafts exports to the EU and other developed nations. The most recognised constraints are the Certificate of Origin constraint, product coding requirement constraint, and product quality restrictions, which are related to the product coding requirements. A fourth, but inconsequential constraint is the inability of businesses or other entities to obtain a Quality Standard Certificate. However, this constraint cannot be overcome until the RGC initiates a certification laboratory. During the research we identified additional constraints, such as vessel transport and accumulation rule constraints that will decrease the likelihood of exporting to the EU and create significant barriers for Cambodian entities to export handicrafts to the EU market on a preferential duty-free basis.

More constraints may exist and it is beyond the scope of this project to identify each and every one. What is apparent is that there are considerable constraints to exporting goods duty-free from Cambodia to developed nations and considerable effort must be expended to develop these markets. It is unlikely that Cambodia's small entities can effectively develop these market linkages with international buyers without assistance either in the form of a collective association or significant support from donors or the government.

Certificate of Origin. In addition to strict adherence to cumbersome Certificate of Origin rules by the EU customs authorities, research indicates that even the most well-connected and fair-sized small Cambodian business has great difficulty obtaining Certificates of Origin in a timely manner and at reasonable expense in Cambodia.

The situation is further described later in this report, but briefly, the cost of obtaining a Certificate of Origin is so high relative to the value of goods exported, that handicrafts entities are either choosing to avoid the EU market entirely, or ship custom orders for which the EU importer has to pay duties and tariffs amounting 14 or 20 percent. For small shipments to the US, Canada, Japan, and Australia, exporters are choosing to 1) provide their own certificate or origin, which is simply a self-written document verifying the document originates from

Cambodia, 2) willingly reducing the product price to one that encourages the importer to pay the minimal duty, or 3) shipping through alternative means, such as through carry-on luggage of visiting tour groups, which appears to be a common practice for exports and imports.

One analysis of export trade to the EU identified the rules of origin as the primary reason for the lack of utilisation of trade preferences.¹¹ A recent discussion with the manager of the powerful GMAC included a confirmation that the EU's rules of origin were inhibiting garment sales to the EU and resulted in a substantial loss of revenue to exporters that were required to negotiate lower prices to compensate for the import duties applied against garments and footwear that could not meet EU's rules of origin.

Product coding. The product coding requirement (also referred to as customs codes) constraint was mentioned by two trade experts as a primary limitation to exporting to the EU. Ms. Jose Vahl and Mr. Jean-Marc Bonnamy both mentioned that improving exports to the EU will require exporters to identify the correct product code used on the Certificate of Origin and other import documents and to learn the complex process the various EU states use to import goods. Mr. Bonnamy was more direct, "small Cambodian exporters just don't have the horsepower to manage the EU importation processes. The process is complex and time-consuming. It takes an expert to do it right. Product codes are listed in an enormous document and it is up to the exporters to know the codes for their products and be prepared to defend their code selection with customs officials in the EU."

The product coding concept is very simple, but when put into practice, is quite complex. Every product imported to the EU must be coded with a specific product code. Depending on the code for a product, the exporting task can be especially simple or very complex. There are many regulations that can apply to any particular product depending on the code of the product you export.

As Mr. Bonnamy stated and as Ms. Vahl agreed, "Small exporters cannot know this information without paid administrative support, usually sourced from the EU. It is expensive and time-consuming to identify all the codes. One needs to hire a mediator to manage this process." He advised that, "for the time spent and money invested to grow the handicrafts export market to the EU, it would be far better to focus on the local and regional markets and as product quality and prices become more competitive, the EU buyers will begin to seek out the products that are interesting to them."

"Being a small firm and trying to export to the EU is very difficult. It would be much better to create, within the MOC, an office that operates as a mediator to discuss with producers how they can export to the EU. The mediator should be able to facilitate exports out of the country on behalf of manufacturers." This appeared to be sound advice, except that research indicates that the MOC is a bottleneck in the current Certificate of Origin process, as will be explained later in the report.

Product quality. Restrictive rules on product quality also inhibit Cambodian exports, such as requiring the use of non-toxic dyes in silks and cottons.¹² In

11 "Making EU Trade Agreements Work: The Role of Rules of Origin," P. Brenton and M Manchin, *The World Economy*, 2003.

12 Use Restrictions on Certain AZO Dyestuffs in the EU, EU Directive 2002/61/EC., Informational literature provided by DyStar Textiles Company, Germany, February 14, 2003.

the case of silk handicrafts, these rules are especially difficult to meet given that Cambodia has no product certification facilities. Cambodia producers are required to import expensive dyes from abroad which entails international sourcing and high importation costs, in addition to the fact that no government-approved certification is available.

Quality Standard Certificate. The Quality Standard Certificate that will meet EU import requirements is not available in Cambodia. A donor-funded laboratory and testing facility is under construction at MIME and should be completed in late 2004 or early 2005. When asked about the process and cost of certification, the spokesperson for MIME stated that these have not been ascertained yet, but will be determined in the near future.

It was stated that although the donors paid for the testing facility, the costs to maintain and administer it will be considerable, so the fees charged may be high. If obtaining the Quality Standard Certificate goes the way of the Certificate of Origin at the MOC, and the EU requires this for importing Cambodian silk handicrafts to ensure the proper non-toxic dyes are used, then a new, expensive problem may be developing that will rival the Certificate of Origin constraint.

Accumulation rules. Accumulation rules can be quite complex. To export handicrafts to the EU, the exporter must prove that each product component either originates in Cambodia or has proof of origin. During interviews, it was suggested that the majority of high-quality silk used in Cambodian silk handicrafts actually comes from Vietnam. The best silks are exported to Thailand as buyers there are willing to pay a higher price and have a ready market. This situation is also true of the silver used in the miniature silver figurines. Accumulation rules for LDCs would allow silk or silver to be purchased from Vietnam, zippers from Thailand, and dyes from Germany as inputs to the final product and still be considered to have originated from Cambodia, but the origin of all goods must be clearly identified and they cannot exceed 75 percent of total value.

According to one article on this subject, all product inputs must be accompanied with a Certificate of Origin from the originating country and included in the documentation provided to the EU to certify that accumulation meets requirements for duty-free import. That means for each button, zipper, cut of cloth, or other input to a product, one has to have a Certificate of Origin and include it in the documentation sent to the EU for import approval.

The basis for these rules is to ensure that the products produced by Cambodian's have value added in Cambodia and are not just manufactured in Vietnam or Thailand and exported through Cambodia. The certification of the value added, proving that the input by Cambodians is at least 25 percent of the total value of the imported product, may be difficult in many instances and impossible in others. Many of the inputs purchased in Cambodia are smuggled across the borders without documentation or customs clearance. This is a costly and nearly impossible task for small-scale producers in Cambodia. Requiring Certificates of Origin in the current market environment is not practical for most Cambodian handicrafts producers or exporters.

Vessel transport certification. The costs of documentation related to the rules of origin are compounded by the requirement that “goods for which duty-free preferences are requested must be shipped directly to the EU from the country of origin”. If the exported goods transit through another country, which will be the case for almost all of Cambodia’s exports, then documentary evidence must be provided to show that the goods remain under the supervision of the customs authorities of the country of transit, did not enter the domestic market there, and did not undergo operations other than unloading and reloading. In practice it may be very difficult to certify transportation and obtain the necessary documentation.

Improving exports of handicrafts—experts’ concerns

It was presented during discussions with trade experts Ms. Jose Vahl of Traidcraft and Mr. Jean-Marc Bonnamy of The Institutional Support Programme funded by the EU, that it will be very difficult in the short-term to improve exports to the EU without 1) considerably improved administrative support from the MOC in facilitating acquisition of the Certificate of Origin and the MIME in acquiring the Certificate of Origin and the Quality Standard Certificate, and 2) substantial improvements in the productivity and quality of Cambodian handicrafts.

Mr. Bonnamy planned to work with MOC administrative staff to streamline the export process and develop a one-stop-shop for exporting goods from Cambodia. The emphasis of his effort, like that of the WB’s Private Sector Development Strategy, in general, is to continue promoting increased garment exports, not increased handicrafts exports. Mr. Bonnamy commented candidly that from his international experience, Cambodia’s handicraft’s industry is a long way from being competitive in the international market. In his opinion, “neither the quality nor quantity of goods is sufficient from which to build an industry.”

Traidcraft’s Jose Vahl, who returned to Cambodia in late 2004, was quite positive on Cambodia’s potential to develop its handicraft sector, but was realistic in her views that considerable technical assistance is needed for the industry to develop; short-term improvements have looked promising. She noted that improved business development skills of handicrafts business operators, improved consistency of product quality, and improved product design should be of more short-term concern. Once these issues are effectively tackled, then exports should be promoted.

A likely solution for Cambodian handicrafts entities is to solidify a business relationship with fair trade-oriented and businesses such as Traidcraft from the United Kingdom, or Cambodia House from Australia and steadfastly concentrate on improving quality and price. In addition, a voluntary industry association could help to promote the interests of the industry with buyers, voice concerns with government, and assist in consolidating the importation of higher-quality input supplies.

Exporting to the USA, Canada, Korea, and Japan

All countries require similar procedures for importing goods, including a Certificate of Origin. Most countries exempt carry-on luggage to a specific amount and product samples from taxation.

New process implemented for acquiring the Certificate of Origin

Mr. Ney Sakal, Office Chief at the MOC's Domestic Trade Department informed the team that two ministerial declarations (prakas) had been issued in July 2004 to improve exports of Cambodian-made products, including handicrafts. Each declaration was signed by the Minister of Commerce. The certificate of origin has supposed to have been free to all Cambodian registered business, NGOs, and associations from its very beginning. The unofficial fees of \$500 to \$2,000, that were normally charged are corruption taxes. Discussions with GMAC indicate that they have been able to negotiate fees for their members to between \$200 and \$300 per shipment, "but if the member is in a hurry, these charges can increase substantially".

There is no indication within the prakas of the timeframe between application and disbursement of the C/O. The research team was informed that it should be 48 hours, but Mr. Sakal believed it would take two weeks or more to fulfil the requirements of the new process. This would not meet the needs of those members of the handicrafts industry interviewed as part of this study.

Free Certificate of Origin for NGOs

There were two prakas issued. The first prakas is a declaration offering the Certificate of Origin to NGOs. The English-translated prakas states:

1. In order to provide the right to NGOs to receive the C/O from the MOC to export products overseas, NGOs have to establish a sole proprietorship company, limited to capital from the NGO's funds, but with profits returning to the NGOs fully.
2. After registering at the Regulation Department of the MOC, NGOs then need to register at the Trade Preference System Department within the MOC to have the right to export through the MFN/GSP system.
3. The C/O will be issued free-of-charge, including all fees.
4. The Director of the Cabinet Office, Director of Technical Department, Director Administrative and Finance Department, Chief of Trade Preference Department, Chief of Overseas Trade Department, Chief of Regulation Department, Chief of CamControl Department, and Chief of Administration Department must follow the intent of this prakas.

The prakas indicates that the NGO will be able to export goods without paying any government fees for the C/O. It does not make clear if the exporting NGO can avoid paying customs, CamControl, or other fees. It indicates that the NGO will need to establish a sole proprietorship and register with the MOC as a private firm. This may require a full registration, which is expected to cost about \$500 in official and facilitation fees, but Mr. Sakal expressed confidence that

the NGO would not be charged any fees. Capital limits are now set at \$1,000, but the capital required of the NGO may be less, according to the prakas.

The prakas does not indicate if the sole proprietorship will be required to obtain a tax identification or VAT certificate, which is confusing, especially given that the exports of handicrafts are supposed to be free. The prakas is vague and the MOC staff did not appear familiar with the process. They were also not confident that applicants could obtain the C/O free or avoid other charges. Experience would suggest that it would be difficult to avoid unofficial fees, but with recent comments by high-ranking government officials that the government is committed to form a process free of unofficial fees, there is hope. The study team has suggested that AAC facilitate, through one of its members, the process for at least one shipment to clarify the procedures and test the new process.

Free Certificate of Origin for registered businesses

The second prakas is a declaration offering the Certificate of Origin from the MOC, to, it is presumed, businesses already registered that want to export handicrafts or Cambodian-manufactured goods. The prakas states:

1. To provide the right of local producers to receive the Certificate of Origin from the MOC to export products overseas, handicrafts businesses have to register at the Trade Preference System Department, and present the Business Registration Certificate for Trade and Company received by the Regulation Department to obtain the right to export through the Most Favoured Nation (MFN)/GSP system.
2. In case the product is not in the quota system, the C/O will be issued free-of-charge, including no administration fees.
3. The Director of the Cabinet Office, Director of Technical Department, Director Administrative and Finance Department, Chief of Trade Preference Department, Chief of Overseas Trade Department, Chief of Regulation Department, Chief of CamControl Department, and Chief of Administration Department must follow the intent of this prakas.

This prakas indicates that registered businesses exporting Cambodian-made handicrafts (and other Cambodian-manufactured items) will receive the C/O free-of-charge. The enterprise must be registered with the Domestic Trade Department and the Trade Preference System Department, both within the MOC.

Taken together, the two prakas indicate, and Mr. Sokal confirmed, that all entities that export Cambodian-manufactured goods, which are not covered by quotas (primarily garments), can obtain the C/O free-of-charge. Unregistered private businesses would need to first register and obtain a tax identification number, and VAT certificate.

Two registered businesses have recently attempted to export Cambodian-manufactured products using this process. One was a cashew nut processing firm in Kampong Cham, who was successful in obtaining the C/O. The other was a palm wine manufacturer in Phnom Penh, who it was reported, was not successful. No clear reasons were provided as to why the second firm was unsuccessful.

The new MOC-DTD Certificate of Origin process

For entities interested in exporting through the newly implemented MOC-DTD process, it would be best to first call Ney Sokal at the Domestic Trade Department, phone 012-843-220 and request a meeting for him to discuss the process. Before beginning the process, the entity must register with the MOC departments mentioned in the prakas. The process, which takes an estimated two weeks to one month to complete, is as follows:

1. Obtain a copy of the prakas and keep it with you.
2. Compose a letter to the Director of the Domestic Trade Department (DTD) requesting a Certificate of Origin free-of-charge and explain that the firm meets the criteria identified in the prakas.
3. The Director of the DTD may request a meeting to verify the information.
4. After confirmation that the information is correct, the Director of the DTD will compose a letter indicating that the firm meets the criteria required by the prakas.
5. The letter from the DTD will be sent to the Technical General Director of the MOC requesting the firm be granted a C/O free-of-charge.
6. The Technical Director General at the MOC will call the firm to come to his office to discuss some things, such as the product being shipped, to whom, and for how much.
7. After the meeting, if the Director General is satisfied that the goods are Cambodia-made, he/she will sign the letter sent to him by the Director of the DTD and request the exporting firm go to the GSP department to obtain the C/O.
8. The firm makes a normal application for the C/O and includes the letters in the required paperwork.
9. If there is a problem, then the DTD Director will contact the Secretary of State of the MOC and discuss the problem.

Conclusions from Task 2

Task 2 was fairly broad in its coverage of issues. One of the more interesting findings is that within the import and export processing systems, few fees are scheduled, meaning that almost every transaction is negotiated and not accompanied by receipts for money paid. It took the team considerable effort to locate accurate information on these processes. One freelance customs facilitator was kind enough to provide the team with considerable insider information and one of the most popular freight forwarders filled in many of the other details.

As a result of the less than transparent import and export processes, it was not surprising to learn that all handicrafts entities use the services of freight forwarders to facilitate their shipments rather than to attempt negotiations themselves. It was interesting to learn that none of the handicrafts entities could identify either the steps or costs involved in the export or import processes and that customers are willing to assume the full costs of the shipping transaction.

The benefits that could be obtained from the formation of an industry association are evident, especially if one examines the examples of services provided by GMAC for its members. GMAC's value-added services demonstrate how effective voluntary and semi-voluntary organisations can be in promoting the interests of their members. Due to the scale of Cambodia's handicrafts entities, few can afford business development services, training in business

management, marketing advice, or development of adequate accounting systems. More importantly, as a group, the handicrafts sector lacks political voice, has difficulty importing high quality material inputs, and are unable to solve common problems and promote their collective interests. There is a need for a client-responsive organisation to lead an effort to develop a handicrafts industry association.

The fact that almost any private firm, NGO, or association can export goods without being officially registered indicates several problems with the trade facilitation process. The complexities of the export process, combined with the informalities available to entities wanting to export goods creates an operating environment where unofficial fees are an expected part of doing business, corrupt government agents exploit every opportunity, a corruption partner is required, and there is little incentive to promote business practices in a manner that improves the business environment, encourages business investment, or provides reasonable business profits.

Preferential treatment of handicrafts by developed nations has been available to Cambodian entities as a result of its LDC status for some time, but few entities are aware of the processes involved. In addition to understanding the complexities of the export procedures in Cambodia, obtaining duty-free import status in the developing countries that have granted preferential treatment to Cambodia requires exporters to understand complex rules and regulations that vary by importing country. The many constraints include marketing problems related to quality and price, and certification problems related to obtaining certificates of origin, identifying distinct product codes in the importing country, and meeting a host of other certification requirements imposed on imports.

Experts, while optimistic about the longer-term prospects for Cambodia's handicrafts sector, caution handicrafts producers and exporters to go slow. They suggest that producers first develop the quality of the products and ensure an ability to consistently supply high-value products and only then to develop market linkages with buyers in developing countries. In most cases, a facilitating agent in the foreign country is needed to identify requirements, assist in the importation process, and guide the Cambodian exporters to higher-value markets. Expert advisers indicated that while export markets are important in the long-term, in the short- to medium-terms, Cambodian producers may be best served by concentrating on improved quality, developing a Cambodian brand, and concentrating on the tourist and expatriate markets.

Finally, after several years of encouragement from donors and private businesses for improvements to the government's Byzantine regulatory structures that generally inhibit business development activities and encourage informality, the RGC, specifically the MOC, has stated its commitment to promoting exports of Cambodian-manufactured goods. In addition to several speeches by government officials, recent prakas have provided an avenue for micro and small enterprises, NGOs, and associations to obtain the Certificate of Origin and to export tax free from Cambodia.

Still, the prakas leave many unanswered questions as to the costs involved in obtaining the necessary status and of the process itself. Much discretion in the decision-making process remains, which, experience demonstrates, usually means requests for and payments of unofficial fees. Conversations with handicrafts producers and exporters indicate significant skepticism.

4

Legislative and procedural reform to facilitate handicrafts exports

This section lists main legislative and regulatory instruments related to export formalities, especially those concerning handicrafts, and provides recommendations for legislative and procedural reform to facilitate registration and exports by handicraft producers, such as AAC members, in Cambodia. The legislative and regulatory structures in Cambodia are currently receiving considerable attention as a result of its recent membership in the World Trade Organisation. As part of its accession to WTO, Cambodia has made a large number of commitments in legal and judicial reforms, including the enforcement of the rule of law and establishment of a specialised commercial court.

The ADB, WB, and bilateral donors have invested and continue to invest millions of dollars in promoting legislative and procedural reform. Until relatively recently, handicrafts received scant attention by government authorities interested in improving exports. The RGC has concentrated its support on developing the garment sector, which represented 96 percent of exports in 2002 and 2003. There are more than 50 new laws and sub-decrees waiting to be promulgated into law. Meeting the WTO commitments will mean passing more than two laws and regulations per legislative working month. Based on past experience, however, the Cambodian parliament has, on average, only adopted one piece of legislation every three months.

The current interest in speeding up the legislative, judicial, and procedural reform process will be difficult due to institutional weaknesses, low-skill levels of government staff, and, most importantly, the endemic corrupt practices that pervade the regulatory institutions of Cambodia. There has developed during the past years a culture of expectation that unofficial fees are an accepted and normal practice and that civil servants have a right, if not duty, to extract rent payments from each and every financial transaction visible to them. Changing this “systemic” corruption will take considerable will by government staff at all levels, a constant vigil, and decisive actions against corrupt practices when they are exposed. There is considerable hope being generated by a host of government and donor officials, but from conversations with businesses, NGOs, and associations, it seems no one interviewed for this study is confident in the rhetoric.

Due to the fact that each ministry operates somewhat independently, obtaining up to date and accurate information on laws and regulations is difficult. The donor community has requested that the government prepare a regular

publication of prakas, laws, and regulatory changes, but the request has not systematically been recognised. The following information comes from many sources.

The WB and ADB have invested an estimated \$1-\$2 million in 2003 and 2004 identifying the legislative and regulatory changes required to facilitate improved export procedures. Although these changes are mostly directed at the garment industry, they have some applications to handicrafts as well. Therefore, the WB and ADB suggestions are included herein.

In the short- to medium-term, forming a formal handicrafts industry association will provide considerable value in keeping member producers and exporters informed of regulatory and procedural changes and is probably the best hope for improving the business operating environment and improving export performance.

Status of drafts of major commercial laws in Cambodia

The following table lists the most current list of commercial laws under consideration by the RGC. None of the laws, sub-decrees, or prakas directly concern export of handicrafts, but are intended to develop an enabling business environment for all enterprises.

Current draft law status			Timeframe for passage*
Ministry level	Council of Ministers	National Assembly	
Commercial Contract Law			As soon as possible
		Law on Commercial Enterprises	Early 2004
		Law on Commercial Arbitration	January 1, 2005
Law on Establishing a Commercial Court			Pass law by June 2005
	Civil Code and Procedures		2004
	Insolvency Law		As soon as possible
	Law on Secured Transactions		As soon as possible
Commercial Leasing Law			2005

* Deadline according to Work Plan for WTO Accession submitted to the Council of Ministers on 27 February, 2004.

Existing laws

The following is a list of relevant commercial laws, sub-decrees, and prakas with relevance to trade facilitation.

1. Sub-decree No. 64 ONKr.BK, “Determination and Management of Inspection Offices”, October 2001
2. Council of Ministers, “Draft Sub-decree on Plan Quarantine”
3. MEF, “Regulation on the Implementation of Pre-shipment Inspection Service”, August 2000
4. MEF/Custom, “Draft Law on Customs”, August 2002
5. MEF/SGS, Prakas No. 599 SHV. PRK, “The Implementation of the Pre-shipment Inspection Service”, August 2002
6. MOC, Prakas No.131 MoC/M2002, “The Correction on and Amendment of Establishment of Technical Working Groups of the National Codex Committee”, 2002
7. MOC/CamControl, “Law on the Management of Quality and Safety of Products and Services”, 2000
8. Declaration at MOC-Domestic Trade Department on NGOs and Associations to facilitate acquiring of the Certificate of Origin, 2004

Proposed laws or other procedural reforms

The following is a list of commercial trade-related laws that should be completed in the coming years, but as yet are not included in any timeline.

- Enterprise Law. Not yet promulgated.
- NGO Law. Not yet promulgated.
- Prakas on Streamlining Business Registration at MOC. Part of the ADB SME Development Programme to be completed in coming years.
- Prakas on Trade Facilitation. Part of the WB Private Sector Development Programme to be completed in coming years.
- Prakas for declaration to develop a one-stop-shop for exporting small shipments with Certificate of Origin at the MOC. Part of the EU-funded project to facilitate trade which is located in the offices of the MOC.

Trade agreements

The RGC has trade agreements with several governments. These trade agreements are available on the MOC website at www.moc.gov.kh/Trade_Agreement/index.htm

Agreements listed on the website include those with the governments of Brunei, Indonesia, Laos, Malaysia, Philippines, Thailand, Vietnam, India, Korea, and Canada.

Reform priorities to streamline trade facilitation

As part of WTO membership, Cambodia has committed to a new Customs Law. However, obtaining the benefits of WTO membership requires a comprehensive trade facilitation reform. The following are government commitments to improve the investment climate and trade facilitation in Cambodia.¹³

13 Cambodia Investment Climate Assessment, World Bank, August 2004.

1. Establish a cross-agency trade facilitation and investment climate reform team.
2. Establish a system of transparent performance measurements including private sector monitoring.
3. Re-engineer the trade facilitation process, including all licenses, procedures, and documents to remove overlaps and unnecessary approvals. Following the process re-engineering, a single administrative document will be implemented and other documents progressively eliminated.
4. Introduce an overall risk management strategy to consolidate and rationalise all examination requirements of the different control agencies.
5. Perform a strategic review of the role of CamControl to more productively deploy the organisation's unique knowledge of quality control processes and make optimised use of inputs and resources from other agencies.
6. Provide a single-window process to manage trade facilitation.
7. Introduce a WTO-compatible flat fee for service and provide a service-level agreement that defines the services offered, which includes a schedule of fees and no facilitation charges.
8. Streamline the licensing and registration process and reduce the cost of incorporating with the commercial register which is maintained at the office of the clerk of the commercial court.
9. Streamline the process notification of the Ministry of Labor to start hiring employees.
10. Harmonise registration for VAT, income tax, and company registration using the same form and resulting in the same identification number. This will allow a unique identifier and facilitate information sharing across agencies.
11. Implement a national award programme to promote good corporate citizenship and governance in the private sector.
12. Monitor, evaluate, and report, through business associations, progress toward reform objectives.

ADB-sponsored SME Development Programme objectives

The primary objective of the SME Development Programme is to support the Government's efforts in creating a conducive business environment, which will improve opportunities for the development of SMEs. The issues identified as most significant for improving the business environment include the following. Once again, few of these framework conditions directly concern the export of handicrafts or development of the sector, but are intended to develop an enabling business environment for all enterprises.

1. Establish an SME development framework
 - i. Providing a long-term strategic framework for SME development (road map).

- ii. Designing an institutional framework including a permanent secretariat to support the SME Working Group currently being set up by the Government.
2. Improve governance and regulatory reform related to SMEs
 - i. Improve the business registration process by:
 - a. Simplification of the process through streamlining of documentation requirements
 - b. Reduction of fees and clarification of the costs involved
 - c. Improving the transparency of the system
 - ii. Draft model Articles of Incorporation to assist companies to meet the requirements of the Law on Commercial Enterprises.
 - iii. Support the decentralisation of registration process to provincial authorities.
 - iv. Establish review process for evaluating the impact of regulation on the private sector by:
 - a. Setting up an inter-ministerial regulatory review process
 - b. Establishing a recourse mechanism for administrative decisions
 - c. Initiating a pilot review process for selected licenses
3. Enhance SMEs' access to finance
 - i. Assist in the development of a simplified system of financial reporting to suit SMEs' needs and capabilities
 - ii. Assist in developing leasing as an alternative financing mechanism for SMEs
 - iii. Further develop the credit information sharing system for the banking sector
4. Improve SME access to markets and support capacity building by:
 - i. Upgrade the MIME website to an SME portal
 - ii. Facilitate development and strengthening of business associations
 - iii. Facilitate business development services (BDS) for clusters through cooperation with donors and business associations

Conclusions from Task 3

It is evident from the work of the WB, ADB, the German, Canadian, and Japanese governments, and the EU, that considerable effort has been started on the legislative and procedural reform process, mostly directed at creating a business environment conducive to investment.

With the exception donor funding, which has supported business development support agencies, such as AAC and MPDF, few technical or financial resources have been directed toward the handicrafts sector in general or the development of Cambodian handicrafts exports in particular.

The large financial and technical resources provided by the large donors should create a helpful business environment for handicrafts producers and exporters, but the timeframe for this change could be five to 10 years. In the meantime, it would behove the industry participants to form an alliance, association, working group, or other functional body to collectively draw

recognition to importance of the industry, its ability to create jobs and develop the economy, reduce poverty, and build a skill base. Only by working together, collectively, will the proposed changes to the regulatory or legal frameworks be applicable to the handicrafts sector participants.

5

Growth Handicrafts Shop – Case study of a Cambodian enterprise

Task 4 involved interviews with Cambodian handicraft NGOs including members of AAC, Silk Forum, and CCC. A cross section of NGOs, associations, MSEs were included. To protect the identity of this firm, the names and some details were changed.

Discovering information about one's competitors in most developed countries is very difficult and time-consuming. Discovering competitive information on your competitors in Cambodia seems quite simple; just ask questions and most entities seem willing to share details about their businesses that should remain confidential; and so it was with Growth Handicrafts Shop. This story is just one of many similar descriptions about conducting business in Cambodia.

The enterprise

Growth's five owners work alongside employees to produce moderate to high quality silk handicrafts for export to the U.S. and for sale in local shops. Like most handicrafts business operators in Cambodia, Growth's owners learned the silk handicrafts trade through training provided by a local handicrafts NGO.

At the NGO training centre, Growth's owners learned how to sew, locate suppliers, locate buyers, and set up their business. To start Growth, the owners borrowed \$1,000 from an NGO, bought a sewing machine and other necessary equipment, and obtained a \$12,000 advance order from their first client, who was also a former client of the Wat Than handicrafts business incubator project.

There are few places in the world where starting a business is so easy, inexpensive, and immediately profitable, but in the Cambodia silk handicrafts business, at this stage of development, it seems very easy to make money.

Growth rented a shop house near a Phnom Penh tourist area and started producing silk products. To avoid taxes and keep costs low, they registered the business with the MOSALVY as an NGO intended to support the advancement of disenfranchised minority.

Growth never legally registered their business at the MOI as required by law, yet has been able to obtain the "protection" of the laws of Cambodia by simply obtaining an MOU from MOSALVY. The MOU cost them only \$5 because Growth was patient with the registration process and unwilling to pay unofficial fees. They started their business while awaiting the MOU.

Business model

Their business model is seductively simple, although, according to the laws in Cambodia, illegal. Growth has three basic and related business operations:

- 1) a simple, but well-located retail handicrafts shop where they sell a variety of handicrafts, mostly to tourists;
- 2) a thriving handicrafts export business based solely on two U.S. customers; and
- 3) a privately-owned and operated silk weaving business that operates solely to supply the silk fabric for Growth. The NGO also sells some products on consignment in other shops located in Phnom Penh, but these sales are not a major part of its business.

Organisation structure

The organisational structure is thin. It consists of the five partners operating as a de-facto board of directors, an astute business manager who handles all the business affairs while advising the owners, and five section supervisors: human resources, finance, quality control, stock control, and production, most of which are filled by the five owners.

The firm employs about 40 full-time sewing staff, all of whom suffer from physical disabilities. They outsource some sewing to another group of disabled persons when their own capacity is exceeded, which is often. Human resource management is the most critical and continuing problem for the firm.

The critical management bottleneck is trained sewing staff and experienced managers. It takes about six months to train sewers to meet Growth's high quality standards. Locating qualified managers who can lead and organize production is even more difficult.

Staffing strategy

Wages depend on the level of productive output; totally on an incentive basis. Growth pays 40 percent of the product's wholesale price to the producer, as long as the product meets stringent quality standards. This wage structure provides Growth's production staff with an incentive to stay with the firm, since competitors generally pay fixed salaries that limit the ability of the producer to earn more. Only when the 40 full time staff cannot meet order quantities, does Growth seek additional production from contracted production staff. Contract staffs earn the same 40 percent of wholesale price.

Business strategy

Growth produces silk handicrafts less expensively and at higher quality than most competitors do. Customer demand exceeds the ability to supply. Growth has wisely decided to concentrate on quality rather than improving revenue growth through production of lower quality goods. This choice has resulted in overall slower growth, but the quality advantage has encouraged more orders from their two very satisfied U.S. export customers.

Growth's product designs usually come from customers who purchase a competitor's product and then ask Growth to copy it. Growth, out of principle and respect for its competitors, will not make exact duplicates of another firm's design. Instead, Growth, like all interviewed entities, will make a simple, perhaps unperceivable, alteration to the design.

Sourcing strategy

Silk material comes from a related, but separately owned and operated silk weaving factor. The factory is not "registered" as a Growth enterprise and the 50 persons employed at the factory are not physically disabled. This private firm supplies most of Growth's production silk on a sole-source basis. In fact, the silk production factory is not registered with the MOI and operates illegally with the approval of village and district level authorities.

Although it is highly profitable, the factory pays no revenue taxes, salary taxes, or other government fees. The silk cloth factory's primary problems are also human resource based, which inhibit its ability to obtain a consistent quality and quantity of material.

The factory owner, a close associate of Growth Handicraft's, has plans to expand the silk weaving production to supply other silk handicrafts businesses in Phnom Penh and eventually to export silk fabric. The factory is actively seeking new local and export customers.

Operation undetected

Due to the growth of their export business, the owners sense that the day will eventually come when a government official, possibly from the Ministry of Economy and Finance (MOEF), will demand they register with MOI, or worse, register as a private business with the MOC. This may require them to begin paying required taxes and fees, which will increase their costs and, possibly, make them less competitive. Until that happens, Growth will be able to operate successful silk handicraft production, retail, and export businesses without application of Cambodia's laws.

Asked why the silk cloth factory owner didn't register with the MOC and MIME and conduct business legally, the owner stated, "then the factory will need to pay a one percent minimum gross revenue tax, \$300 dollar annual patent tax, 10 percent VAT tax on exports (although handicrafts exports are supposed to be tax-free), taxes on the factory lease and payments for factory operating permits".

Perhaps more importantly, once the factory is registered, the owners will be required to pay commercial rates for electricity, sewage, garbage removal, and other "unofficial" fees as they will likely be visited by a stream of government authorities constantly demanding an ever-escalating collection of fees for made-up inspections. Neither Growth Handicraft, nor the silk production factory, are required to pay these fees as long as they operate outside legal status. These costs are normal for MOC-registered enterprises. If Growth is eventually forced to register as a business due to its profit orientation, then it would seem reasonable that it would be required to accept these expenses.

Operating Growth as an NGO and obtaining silk products from a factory operated in secrecy, allows the firm to avoid many expenses and maintain high profitability. Profits are re-invested in production improvements and labour expansion.

Export strategy

Exporting finished products is easy. Total export shipments, which are in the low six figures, and all to the USA, have doubled each year and are expected to double again this year and next. If this occurs, Growth will be exporting close to \$500,000 of silk handicrafts each year.

Customers pay all shipping costs and shipments are facilitated by a freight forwarding firm at a cost of about \$4.50 per kilogramme. The forwarding firm handles all the administration fees and expedites export processing. Official and unofficial payments are negotiated with customs and CamControl. The export process requires Growth to provide only an invoice, packing list, and letter of authorisation for the forwarder to negotiate on Growth's behalf. After the export process is complete, the forwarder invoices Growth.

Growth wants to export to the EU, but business links are weak, and obtaining the required Certificate of Origin (C/O) is expensive and time consuming. Therefore, neither Growth, nor its related silk weaving factory, is marketing to EU customers.

Complicating exports are upcoming EU restrictions on silk fabric dyes that will increase the difficulty of exporting Cambodia-dyed silks. The government of Cambodia, primarily customs, makes it difficult to import approved German dyes.

Conclusion

Operating at full capacity, doubling exports annually, avoiding taxes and fees, satisfying customers, and growing at a steady pace is Growth's recipe for success. As handicrafts become more competitive, as government improves its ability to monitor, regulate, and tax businesses, and as the ability of entities to operate undetected deteriorates, Growth will need to consider other business options. For now though, it is summertime and the going is easy, at least for Growth Handicrafts and its sole-source silk production factory.

6

Survey of 15 Cambodian entities

The research team conducted 15 interviews with entities consisting of micro and small businesses, LNGOs, INGOs, and associations. The entities were not chosen randomly, but were instead a mix of AAC members, non-members, and independent enterprises involved in the production, sale, or export of handicrafts.

Two of the private businesses originally selected, failed to allow an interview due to the nature of the interview questions. Two additional, non-handicrafts-related trading companies were interviewed, but provided minimal value in identifying the fundamental problems faced by handicrafts-oriented entities, so these have not been included. All interviews were performed in a casual, business-like manner, allowing sufficient time for reflective questioning and story telling. This section presents survey results at a glance and a summary by general category.

Introduction

The interview questions were organized into four main categories of questions: company information, business registration process, export and import process, and export scale and location. The rather broad range of categories, combined with the relatively small number of companies surveyed, make it unadvisable to generalise the results to the entire small handicrafts business sector in Cambodia, especially given that only one surveyed entity was located outside Phnom Penh. The responses do provide good information about the sector's common problems related to registration and exports.

The handicrafts production and export situation in Siem Reap, a city with more than 500,000 annual international tourists may be quite different from Phnom Penh. Siem Reap was not included in the study. Anecdotal information suggests that the handicrafts sector is well-served by a well-managed voluntary association of handicrafts entities that concentrates on improving quality standards and the image of Cambodian handicrafts.

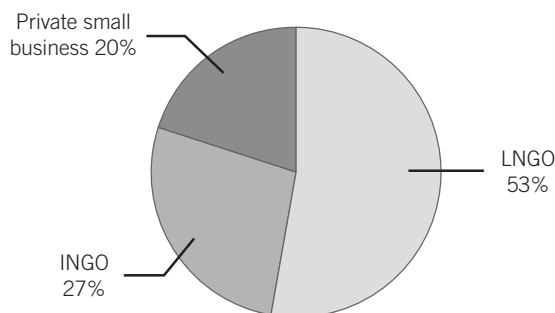
To provide some cross validation, conclusions drawn from the responses were casually discussed with the interviewees, regulatory agencies, and freight forwarding firms.

Company information

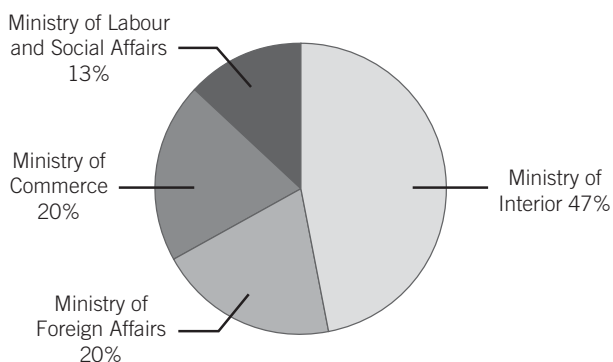
The survey sample consisted of eight LNGOs, four INGOs, and three private businesses. Of the local NGOs, which are prescribed to register at the MOI, only six had registered there. Two had only registered at the line ministry, MOSALVY.

The majority of companies interviewed had been in business between four and 10 years. Only three of the 15 companies had a history of more than 10 years. Several companies commented that competition is intensifying and the many new handicrafts shops opening in Phnom Penh are putting pressure on walk-in and export sales.

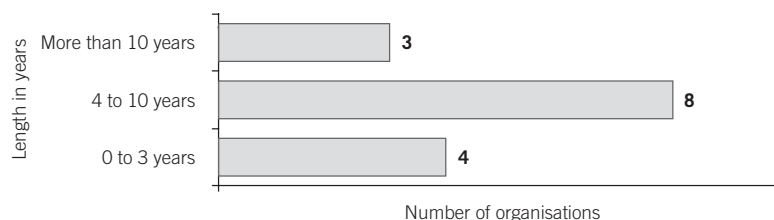
How is your organisation registered?



Where is your organisation registered?



How many years has your organisation been in Cambodia?



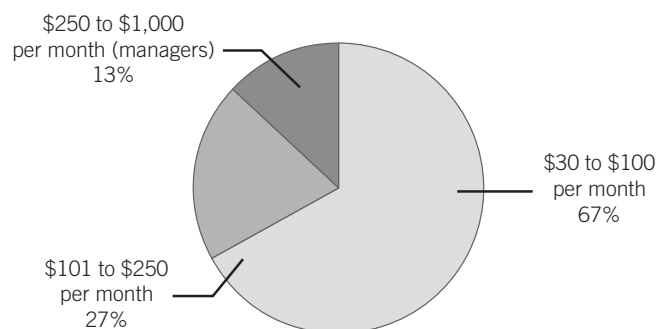
About three-quarters of the entities consider themselves to have 40 or fewer permanent employees. The term, “employee”, was confusing to most entities, since the vast majority of artisans produce handicrafts on a piece-rate basis. This basis, postulated on producers meeting increasingly more stringent quality standards and being paid only for acceptable production, seems to be the most popular model for handicrafts entities in Phnom Penh. It also reduces the obligation of businesses, NGOs, or associations to pay salary taxes or other benefits.

In addition to the regular full-time employees and artisans, a majority of entities have business linkages with large contingents of “freelance” handicrafts artisans. These artisans are paid only for products ordered or consigned to the entities. Some entities use these freelance producers as an overflow production set when orders exceed the capacity of the permanent workers to meet demand.

The average artisan can expect to earn between \$30 and \$100. Permanent staff and employees living in Phnom Penh, generally earn more than artisans living in rural areas, ranging up to \$250 per month.

What is the average artisan’s monthly salary?

Average monthly pay per artisan



Survey results at a glance

How is your organisation registered?	LNGO-53%, INGO-27%, Private Business-20%
Where is your organisation registered?	MOI-47%, MOFA-20%, MOC, 20%, MOLSA-13%
Why did you choose this ministry?	Advised by authority or lawyer-60%
Describe the registration process	Easy-47%, Confusing-30%
Did you require a facilitator?.....	Yes-67%
How long did it take to register?	1-2 months-53%, 3-6 months-27%
How much did registration cost?	\$50-\$300-60%
Can you provide step-by-step details of registration?	No-73%
Were you given receipts for payments?	No-80%
Did you encounter problems during registration?	No-80%
Were you offered facilitation services by the ministry?.....	No-67%
What has been the impact of registration?.....	Expect to pay lower tax and expenses-67%
Would you register with this ministry again?.....	Yes-60%
What types of products do you export?.....	Silks-87%, Silver-33%, Coconut shell-33%
To which countries do you export?.....	#1-Asia, #2-USA-Canada, #3-EU, #4-Australia
What certificates do you use to export?	Packing list and invoice only-67%
Describe the exporting process.....	Simple-87%, Expensive-13%
What is your primary exporting channel?	Freight Forwarder-80%, Informal-20%
Describe the typical costs you incur	Freight Forwarder Invoice-67%
How many of the export costs come with receipt (other than invoice)?.....	None-93%
What feedback do you receive from customers?	None-60%, Quality is poor-13%
How many years have you been exporting?	4 Years or less-67%
How much in USD value do you export per year?	\$200-\$10,000-49%, \$40-100,000-19%
What is the USD value of an average shipment?	Less than \$2,000-93%
What are the typical costs for exporting different-sized shipments?	Not sure-93%
Do you import materials?	No-87%
Describe the importing process.....	Informal process-100%
Describe the typical costs of importing	Not sure-100%
How long has your organisation been in business?	0-3 Years-27%, 4-10 Years-53%
How many workers do you employ full-time?	1-10-40%, 11-40-33%, 31-122-27%
How many workers do you employ part-time?.....	1-100-53%, 700-1,000-13%
What is the average worker's salary?	\$30-100 per month-67%
What is your anticipated annual rate of growth?	10% or less-47%, 30% or more-20%
Is it easy to locate new export customers?	No-80%
How do you locate new export customers?.....	Walk-in to the shop-53%, Trade fair-40%
What problems do you have obtaining materials?	Inconsistent colours for silk-100%
Where do you obtain new designs?	Copy other products purchased in the market-100%

Observations of the NGOs

The team observed that many of the smaller, subsidised NGO handicrafts entities, both the well-established entities as well as recently opened shops, are financially supported to such an extent that they discourage the development of competitive marketing skills. The management and technical capacities demonstrated by these staff indicate a critical shortage of business skills and customer focus.

The shortage of business development capabilities were demonstrated by poor merchandising, ineffective store locations far removed from tourist or expatriate walk-in traffic, ineffective advertising, and an observable lack of customer service. They appeared to stay in business because of the NGO support subsidies and the happenchance sale or export of a quantity of goods. A critical comment would be that these entities actually put a drag on the image and profitability of the handicrafts sector and probably do more harm than good. The informality by which they operate, their general focus on the compassionate buyer, and their inattention to quality tarnish the image of those entities concentrating on building a Cambodia brand.

Observations of private businesses

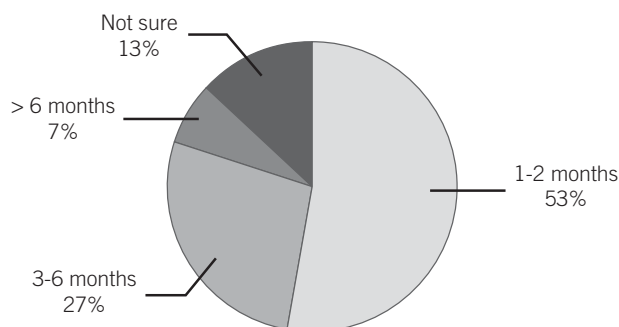
Privately-owned and operated businesses are typified by better locations, clean and well-designed showrooms, and a focus on customers. Every private business interviewed complained of low profitability and difficulty in competing against the NGO-supported entities. Most are struggling to stay in business and are consistently upgrading their product lines, seeking a better grade of customer, and working to build the Cambodia image as one of quality. As a result of the competition, some private businesses tend to specialise and try to maintain a competitive advantage by concentrating and specialising in a small range of handicraft products, while others have developed an additional service-related business, such as home and office decorating.

Business registration process

The range of entities in the survey allowed for a good overview of the NGO, association, and business registration process and an improved understanding of the difficulties encountered. Since most micro and small businesses are not required to fully register at the MOC, the team intentionally selected three businesses that had fully registered.

The business costs of obtaining registration should consider both monetary fees paid as well as time committed to “running the paperwork” and ensuring registration. All interviewees paid some unofficial fees to register. Only two of the 15 entities were so tenacious in their pursuit of low-cost or no-cost registration that they paid minimal fees. In these cases, the time commitments required to facilitate the process by oneself appeared to be high, considering that the fees one would have to pay to have the process facilitated averaged \$100 for line ministries and \$350 for the MOI or MOFA. It would depend, of course, on how one values their time.

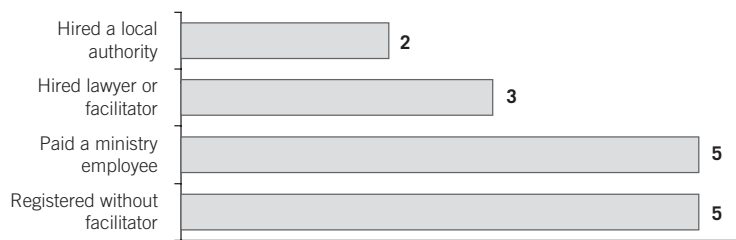
How long did it take to register the organisation?



Given the current regulatory environment, all local NGOs and associations are able to proceed with business as usual during the application process. Therefore, even though the time to obtain registration extended for a long period, there is little lost opportunity associated with the wait. Private businesses, especially those operated by expatriates would not be likely to have this luxury and would probably not be allowed to conduct business before the required licenses and permits were acquired.

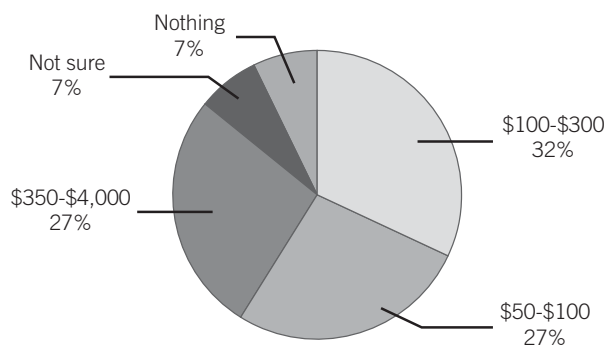
Although five of the interviewees stated that they registered without a facilitator, further clarification revealed that only two entities actually did register without paying for a facilitator. The “normal” process for registration is to pay a facilitator to “run the paperwork” and complete the process in a relatively short timeframe. When asked about the process of obtaining the registration, only two entities of the 15 could identify the steps taken; the others had hired someone to handle the registration process.

Did you require an attorney or facilitator?



Most registrants paid about US\$350 to register at the primary ministry, such as the MOI, MOC or MOFA, and then an average of \$100 at a line ministry for an MOU or permission letter. The line ministry agreement was usually considered to be free-of-charge, but in nearly all cases, ministry staff requested a signing celebration charge.

How much did the registration process cost your organisation?



None of the entities have experienced regularised visits by police or other officials seeking unofficial fees since registration. Unofficial fee collections for most business are transaction-based and occur when exporting, importing, or transporting goods between locations. All entities acknowledged, normally light-heartedly, the annual visits by fire extinguisher checking agents who request \$20 to \$50 annually to ensure fire extinguishers are properly charged. Few of the entities allow the checking agents into their shops or facilities.

LNGOs appeared to benefit most from registration, since once registered, they could obtain utility services at lower local rates. INGOs and private businesses paid higher expatriate utility and service fees and are much more visible to unofficial fee collectors. None of the international NGOs or private businesses interviewed considered these requests excessive.

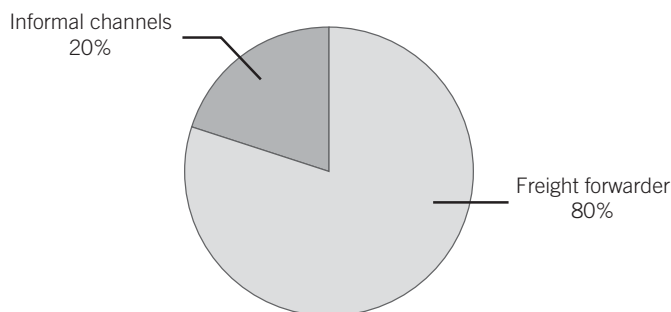
Export and import process

Responses related to the export and import processes were the most revealing as to how business is conducted and how engrained and accepted corrupt practices have become for Cambodian businesses.

Only two entities reported importing materials, but both have since decided to discontinue importing, choosing instead to purchase materials from local markets and to allow someone else handle the logistics, unofficial fee payments, and other difficulties involved. Both entities reported that they used informal and illegal means to import materials. In one case, a leather handicrafts producer decided to discontinue this line of business because the importing process was too expensive and time consuming.

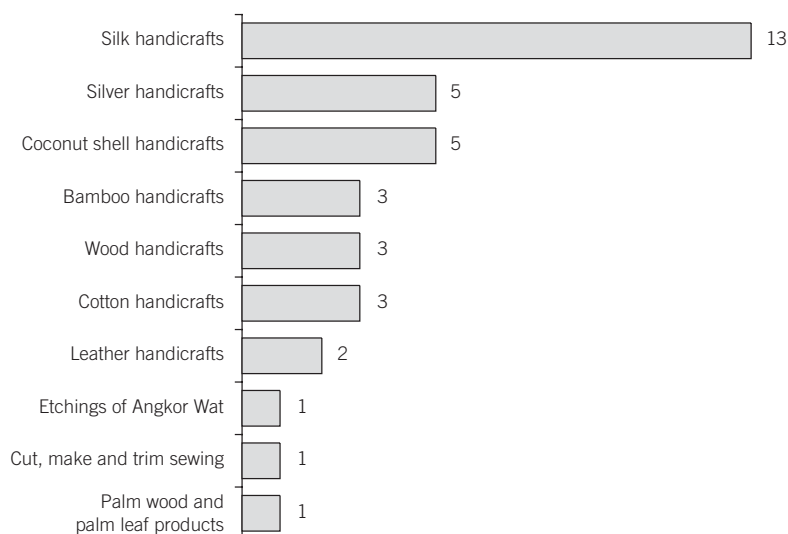
All exporters used freight forwarders and shipped their goods by air freight. Although the costs of air freight average \$4.50 per kilogramme, plus unofficial fees, the process is simple, less expensive than ocean freight, and more secure than postal services. Another common method of exporting is to use the carry-on baggage of customers. This was a common strategy for the most successful NGO, which is shipping about \$300,000 worth of product annually.

What is your primary export channel?



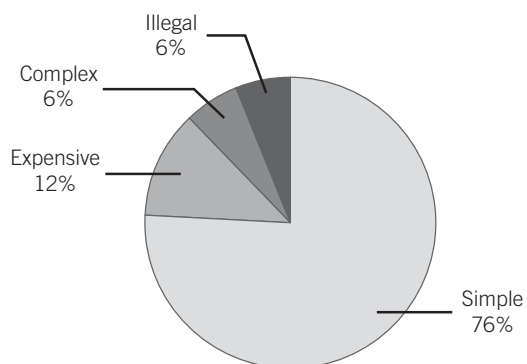
Freight forwarders indicated that ocean freight for any volume less than a full container load is cost-prohibitive compared to air freight. At least one firm, which denied an interview, reportedly exports full container shipments to the USA on a regular basis.

What types of products do you export from Cambodia?



High costs of exporting do not seem to be a deterrent for the exporters, primarily because most export costs are currently paid for by the buyers directly and do not have to be explicitly deducted from selling costs. The exporting firm pays a shipping invoice and is reimbursed by the buyer. None of the exporters could state the step-by-step process of exporting, although some exporters could list one or two steps, such as customs inspection.

One freight forwarder kindly provided the team with the full exporting process and explained the many steps where fees to government agents are negotiated.

Describe the exporting process.

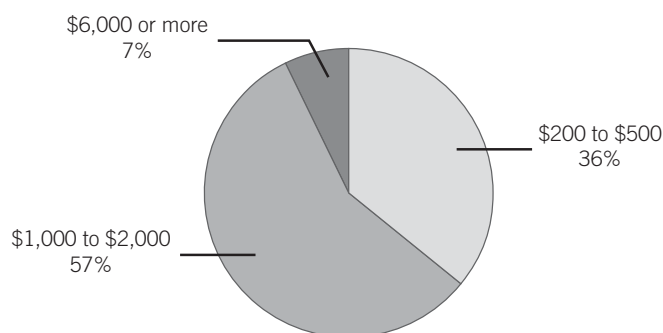
Most freight forwarders provide a complete one-stop export service wherein the exporting firm supplies a commercial invoice and packing list and the forwarder handles all the shipping negotiations for the client. Although this service expedites shipments, it also insulates the exporter from understanding the complexity and costs of the export process.

Export scale and location

According to statistics available from the MOC, the total value of handicrafts exports in 2002 was between \$60,000 and \$100,000. The value of exports in 2003 by the fifteen interviewees appeared to exceed \$1 million. Anecdotal evidence suggests more than \$2 million worth of handicrafts are exported from Siem Reap each year also.

It is likely that actual exports exceed these figures. There are more than 50 handicrafts-related entities in Phnom Penh and Siem Reap, most of which sell to tourists who “export” through their carry-on baggage.

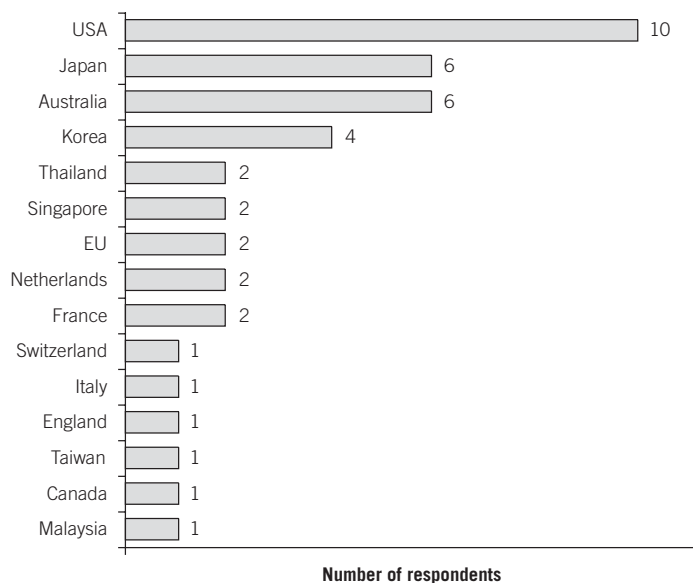
Most shipments are small, averaging less than \$2,000 per invoice and many private businesses avoid VAT and other taxes by shipping items as samples or by using the parcel services at the post office.

What is the value of an ordinary export shipment?

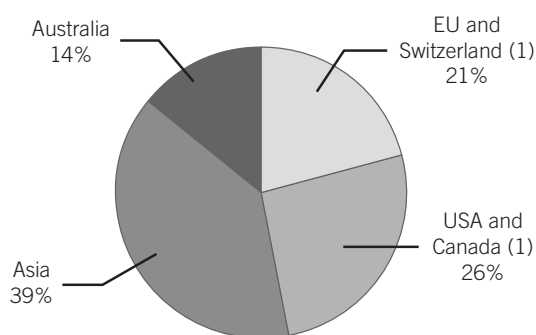
Collectively, the primary shipping location for the majority of exports is Asia, followed by the USA, Europe, and Australia. In terms of volumes, which were not categorised during the survey, most of the volume is shipped to the USA.

Although many exporters have shipped items to the EU, it is more difficult to do so because most EU customers expect the shipment to be accompanied by a Certificate of Origin, obtained from the MOC.

To which countries do you export products?



To which regions do you export?

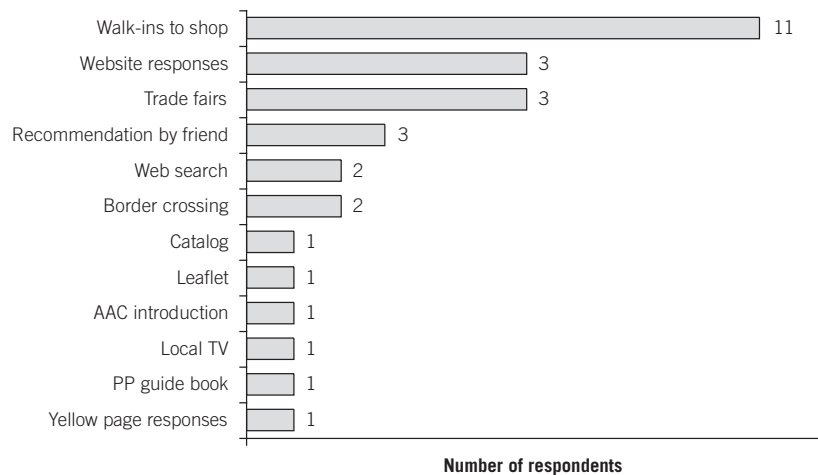


The process for obtaining a C/O is time consuming and expensive. One firm, a private company with solid links to a foreign government and the MOC, has obtained a C/O on four or five occasions and states that the NGO cum private business “refuses to pay any unofficial fees”. Instead of paying the unofficial fee, the NGO cum private business sends one of its senior managers to the MOC everyday for one week.

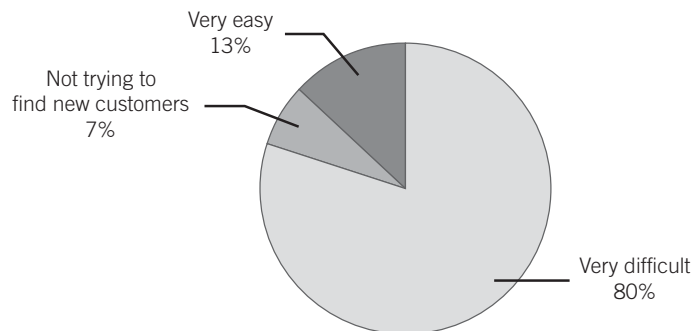
If problems occur, such as a refusal by MOC staff to provide the C/O without facilitation fees, the expatriate director of the entity travels to the MOC to discuss the problem with the MOC Secretary of State, who then berates the office staff who are holding up the process. This has happened several times already. Most other entities have determined that obtaining the C/O is not worth the frustration or the profit and, therefore, avoid a sale completely if the customer demands a C/O.

Locating new customers is becoming increasingly difficult as more entities open shops catering to walk-in tourists and expatriate residents. Few entities are well-linked with international organisations that can facilitate trade, such as fair trade organisations located in the EU or the United States. Anecdotal evidence suggests that because of the image of low quality of handicrafts in Cambodia, most fair trade organisations are avoiding Cambodia. A concerted effort to change this image could be the first order of business for a handicrafts trade association.

Where do you locate customers?



How easy or difficult is it to find new export customers?



7

Recommendations

This study puts forward the following recommendations.

Registration processes

- For NGOs, use the existing registration processes as long as it is advantageous, and create formally registered subsidiaries only when absolutely necessary.
- For private business firms planning to formally register their enterprises, document each and every step of the process and provide a written summary to the Minister of the Ministry of Commerce when the registration process is complete; present all costs in both time and financial terms.
- Solidify your “special” partnerships with ministry staff and use these partnerships when advantageous.
- Form a handicrafts industry association and use the association as a political voice to improve transparency in registration, exporting and importing, and all other matters involving the government.
- Engage the donors and their consultants to reduce the costs of registration. Expose corruption within the framework of an anonymous association.
- Discourage efforts to collect unreceipted fees by unscrupulous government agents.
- Identify ways to collectively export products, if that is advantageous.

Importing and exporting handicrafts

For imports into Cambodia

- Use freight forwarders whenever possible because they can facilitate shipments most efficiently.
- For small shipments, hire a facilitator at the port site.
- For large shipments, hire a freight forwarder to facilitate both the import permit and customs clearance.

For exports from Cambodia

- Given the current business environment, for the facilitation of exports, it is better for NGOs exporting handicrafts to remain as NGOs and not to become formal registered businesses.
- For formally registered businesses, NGOs and associations, it is better to hire a freight forwarder to facilitate the export process.

Overcoming marketing and manufacturing constraints

- Concentrate on productivity to reduce prices, and improve quality and the ability to produce consistent quantities of deliverable handicrafts.
- Encourage political pressure to decrease export costs and increase ease of importing.
- Form an association and be represented at public donor-funded workshops, presentations, and other public events.
- Honor any donor supports for the handicrafts industry.
- Develop the Cambodia quality brand.

Overcoming certification constraints

- Focus on the marketing and manufacturing-related issues foremost because this will be required before one can compete effectively, but do not lose sight of the foreign markets for the mid- and long-term.
- Form an industry association that represents the too-small-scale entities as well as the large ones and encourage technical and financial support from donors.
- Specialise in products, such as silks and silvers in the short- to mid-terms and establish relationships with fair trade groups in the USA and EU.
- Engage with the EU, Japan International Cooperation Agency (JICA), Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) trade facilitation consultants and do not let all their efforts become concentrated on the garment and agro-processing industries.

Survey of 15 Cambodian handicrafts-related entities

The survey of Cambodian handicrafts entities highlighted several problems. This report identifies some of the most crucial weaknesses, and the team recommends the following to begin to rectify those most relevant to the study.

- Establish a strong and independent handicrafts association; perhaps more than one.
- Due to the peculiarities of the business environment, continue to “play the game” as long as possible, but prepare for the future by concentrating on competitive exports rather than compassion exports.
- Concentrate on quality; import quality materials for inputs.
- Concentrate on market segments such as upscale tourists, silk handicrafts, silver figurines, the Asian market, and so on.
- Improve business and marketing skills.
- Obtain as much support from donors to “build up” the handicrafts industry and request them to support the industry; follow the example of the garment sector.

- Concentrate on developing the entire supply chain for the industry.
- Concentrate on creating a Cambodia brand with one or two products to begin with and then expand.
- Develop an industry vision; a compelling, driving vision that puts fire in the belly of every handicrafts producer, seller, and exporter.
- Continually concentrate on the Certificate of Origin problems at the Ministry of Commerce; use the current change-oriented environment to the advantage of the handicrafts industry and encourage donors to support this effort.

8

Appendices

Appendix 1 Agencies, costs and time for business registration

Appendix 2 Exporting and importing processes and costs for air and ocean cargos

Appendix 1: Agencies, Costs and Time for Business Registration

Agencies	Local NGOs or Not profit Association		International NGOs		Profit Organisation/Profit Association/Business firm		Remark	Requirement for registering
	Time	Cost	Time	Cost	Time	Cost		
Ministry of Interior (MOI)	Average is 1-2 months	\$1.5 for application form					Legal Entity Registration	<ol style="list-style-type: none"> 1 Provide 6 copies of application form ministry. 2 Provide 6 copies of brief biography of each staff and manager with 6"x4" photograph 3 Provide 6 copies of staff/management team ID card or passport. (The management and project staff must be Cambodia citizens, but advisors can foreign). 4 Provide 6 copies of organisation structure (must have at least 3 persons). 5 Provide 6 copies of location map. 6 Provide 6 copies of leased office. 7 Provide 6 copies of organisation's status. (The will to be edited by a specialist within the ministry.) 8 Provide 6 copies of legal lease agreement of the office building.
Ministry of Foreign Affair and International Cooperation (MOFA/IC)			15 to 30 days	\$100 for signing ceremony			Memorandum of Understanding	<ol style="list-style-type: none"> 1 Send letter of request to Minister of MOFA/IC for MOU along with organisation brief - background, mission, objectives and so on. 2 Provide copy of letter of registration for the organisation recognized by the authority in country of origin. 3 Provide project plan and budget to be implemented in Cambodia and approved by the organisation's Board of Directors. 4 Provide list of foreign and local staff, including ID cards or passports. 5 Provide address of Cambodia office location and attach lease agreement.

Agencies	Local NGOs or Not profit Association		International NGOs		Profit Organisation/Profit Association/Business firm		Remark	Requirement for registering
	Time	Cost	Time	Cost	Time	Cost		
Ministry of Social Affairs Labor Vocational training skill and Youth (MOSALVY) (Note: All technical line ministries operate in very similar manner.)	15 to 30 days	\$70 to \$100 for signing ceremony	15 to 30 days	\$70 to \$100 for signing ceremony			Memorandum of Understanding) For local NGOs or Associations after registering at MOI or COM and for International NGOs after signing the MOU with MOFA/IC)	Provide registration certificate from MOI or COM for local NGOs and Associations; or MOU from MOFA/IC for international NGOs.
Ministry of Industry, Mine and Energy (MIME)	10 to 15 days	\$50 to \$60 service charge			10 to 15 days	\$50 to \$60 service charge	Register to obtain production permission license for manufacturing enterprises.	<ol style="list-style-type: none"> 1 Provide application letter. 2 Provide biography of owner and a copy of ID card or passport. 3 Provide product sample, logo and company stamp. 4 Provide location of office (map). 5 Provide location of factory and production line (map). 6 Provide a list of shareholders and shares owned. 7 Provide a copy of a stock certificate, if available. 8 Provide a Certificate of Quality Standard, which is obtained in the MIME offices as well. 9 Provide hygiene certificate. 10 Provide a letter from the district and commune authorities approving the location of the factory, statement on environmental impact and so on. 11 Provide an investigation list.

Agencies	Local NGOs or Not profit Association		International NGOs		Profit Organisation/Profit Association/Business firm		Remark	Requirement for registering
	Time	Cost	Time	Cost	Time	Cost		
Council of Ministers (Minister of the COM)	10 to 15 days	No fee mentioned					Legal Entity Registration	<ol style="list-style-type: none"> 1 Send letter to Minister of COM requesting registration of the firm. 2 Provide meeting minutes from the meeting establishing firm, including names of the president, managers and treasurer. At least 4 persons must be in the firm. 3 Provide meeting minutes established and approve the status, accept regulation, structure and organisation logo. 4 Provide a biography of all people in the organisational structure.
Council for the Development of Cambodia (CDC)	One week after submitting	\$10 for the application form and guide book	One week after submitting	\$10 for the application form and guide book	Average is 1-2 months; depends on approvals	not mentioned	This is to register the business project and obtain investment privileges or for International NGOs who plan to export goods tax free. INGOs sign with CDC after signing the MOU with MOFA/IC.	<ol style="list-style-type: none"> 1 Provide the form from CDC, signed by representatives of the NGO in Cambodia. 2 Provide the memorandum of understanding for the project with any technical line ministry, and memorandum of understanding with representative of the Royal Government of Cambodia. 3 Provide budget details for the implementation of project and documents, including project implementation plan. 4 Provide a list of personnel and structure of the organisation.

Appendix 2: Exporting and Importing Processes and Cost for Air and Ocean Cargos

Exporting and Importing Cost for Air Cargo Handling									
Exporting					Importing				
Activity	Responsible Party	Unofficial Fees No Receipts	Official Fees Receipts	Notes	Activity	Responsible Party	Unofficial Fees	Official Fees	Notes
Purchase Forms	Exporter	\$1.25		Charge by Customs	Purchase Forms	Importer	\$1.25		Charge by Customs
Freight Shipping Cost	Exporter		\$3.80 to 4.50 per kilo	Charge by FF					
Document handling	Exporter	\$20		Charge by FF	Clearance Fees	Importer		\$45	Charge by FF
Pick up Charges			\$15 min. plus \$0.03 per kilo	Charge by FF	Pick up Charges	Importer	\$15 min. plus \$0.03 per kilo		Charge by FF
Certificate of Origin (EU) or Quota Visa (USA)	Exporter	\$250-\$1,000 per certificate		Charge by MOC. Can up to \$2,000. Takes one week to one month	CDC Import Permit**	Importer	\$600-\$1,000		Charge by CDC
Export permit	Exporter, but normally, Freight Forwarder handles this for the Exporter	\$40-\$100		Charge by Customs. At least one day. Negotiated by customs agent.	Normal Import Permit	Importer	\$60-\$70 min. charge for import permit, negotiated based on value.		Charge by Customs commodity specialist who negotiates value.
Terminal Handling Charge	Exporter		\$0.04 per kilo	Charge by CAMS	Terminal Handling Charge	Importer	\$0.08 per kilo		Charge by CAMS
Security Charge by Airline	Exporter		\$0.10 per kilo	Charge by Airline	Duty Payment	Importer	Tariff fees are scheduled		Some importers negotiate
Carrier Fuel Surcharge	Freight Forwarder		\$0.20 per kilo	Incorporated in Freight Charge	Carrier Fuel Surcharge	Freight Forwarder		\$0.20 per kilo	Already added into the freight charge

Exporting and Importing Cost for Air Cargo Handling									
Exporting					Importing				
Activity	Responsible Party	Unofficial Fees No Receipts	Official Fees Receipts	Notes	Activity	Responsible Party	Unofficial Fees	Official Fees	Notes
Customs Clearance Fees (airport warehouse)	Exporter	\$56-\$150 for loads < 1 ton. Minimum charge + \$17 per kilo additional tons		Charge by customs agent who negotiates value	Customs Clearance Fees (at airport warehouse)	\$66-\$120			Extra fees are based on value, not weight
CamControl Permit	Exporter	\$10-\$150	0.1% of value	Charge by CamControl	CamControl	Importer	\$10-\$150	See Tariff Schedule	Charge by CamControl
Payment Counting Fee		1% of total reil amount		Charged to count money					
VAT Stamp			10% of invoice	Tax Department	VAT Stamp	Importer		10% of invoice	

Exporting and Importing Cost for Ocean Cargo Handling									
Exporting					Importing				
Activity	Responsible Party	Unofficial Fees	Official Fees	Notes	Activity	Responsible Party	Unofficial Fees	Official Fees	Notes
Arrange Consolidator or Shipping Firm	Exporter	N/A	N/A		Arrange Consolidator	FF/C Releases Container to Shipper			
Customs Export Permit	Exporter	\$300 (LCL/FCL)					\$300 (LCL/FCL)		
LCL - Send goods, Invoice, Packing List, Authorisation Letter*	Exporter				FF/C Releases Container to Shipper				
FCL - Release Container to Shipper - Include Invoice, Packing List, Authorisation Letter, VAT, C/O*					CDC Import Permit			(Free)	
FCL - obtain factory inspection from CamControl and Customs									
Bill of Lading	Exporter	\$15			Import Duty	\$150			
Customers Clearance	Exporter	\$90 LCL \$150 FCL 20'			Customs Clearance	\$150			
Fuel Adjustment Charge	Exporter	\$5 per CBM \$30 per FCL 20'			SGS Inspection	\$210 per shipment			

Exporting and Importing Cost for Ocean Cargo Handling									
Exporting					Importing				
Activity	Responsible Party	Unofficial Fees	Official Fees	Notes	Activity	Responsible Party	Unofficial Fees	Official Fees	Notes
Pack into Container	Exporter								
Transport to/from Sihanoukville or PP Port	Exporter	\$120 per FCL 20'							
Ship to Destination Per cbm	Exporter	USA-Long Beach \$60, UK \$21, Japan \$105, Korea \$8							
Facilitation Fees		\$25 LCL \$35 FCL			Facilitation Fees		\$25 LCL \$35 FCL		
Terminal Handling Charge		\$6 per CBM \$70 per FCL 20'							

* For NGOs shipping handicrafts, you need only the letter of authorisation; no need for C/O or VAT permit. Just need proof of NGO registration.

** Import permit from CDC (Council for the Development of Cambodia) is only for large firms to obtain import investment incentives for tax reduction purposes. Abbreviations: FCL (full container/car load); LCL (less than full container/car load); FF/C (freight forwarder/consolidator); CBM (cubic meter)

Easing the Barriers to Formality: Registration Procedures for Microenterprises and Handicraft Exports in Cambodia

Artisans' Association of Cambodia

Cambodia's business registration procedures received considerable attention in recent years especially since the dramatic fall in foreign direct investments in 1996. In response, the Royal Government of Cambodia emphasised its willingness to streamline registration procedures and to create a more enabling business environment.

This report examines business registration procedures and the current legal framework affecting micro and small businesses in Cambodia. Prepared in 2004, it focuses on Cambodia's handicraft industry, which supports the livelihood of thousands of families and promotes total sales well in excess of US\$3 million. Growing at least at 10 percent per year, this industry is worthy of attention for the value it provides to exports, employment and small-scale industry development.

This study presents its findings on the business registration and import/export procedures for handicraft businesses. It emphasises the need to raise the profile of the industry and to secure technical and financial support from various stakeholders. One of its most important recommendations is to strengthen handicraft businesses' representation in government decision-making bodies and, towards this end, to form industry associations.

This is part of a series of papers being published by the Informal Economy, Poverty and Employment Project, implemented by the ILO Subregional Office for East Asia, Bangkok, Thailand. This project is funded by the UK's Department for International Development (DFID).

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