

The Competitiveness of Cambodia in the World Economy

Lessons Learned From the Business Community

In the era of globalisation, competitiveness of the nation is key for development.

The government should consider seriously tackling corruption to improve the competitiveness of Cambodia.

Cambodia has experienced different stages of development. After the 1993 peace settlement, the country has undertaken various reforms to change from a planned to a market economy. With the effort to integrate itself in the globalisation movement, Cambodia has become a member of ASEAN and recently became a member of WTO.

Cambodia's small-scale economy, though attractive to foreign direct investment projects, still faces major barriers impeding on the country's competitiveness with regional countries preventing full economic growth.

In addition, businesses are facing barriers, which necessitate fundamental government change. A still new economy, after decades of civil war and factional fighting, major internal structures and government policies are keeping the business environment from opening up to other markets and exporting high quality products.

Reforms are critical to improve the country's competitiveness in order to attract more investments needed for growth diversification. The direct impact on competitiveness is to reduce transaction costs. This can be done by eliminating unnecessary bureaucracies and costs from business start-ups to import-export activities. Moreover, a predictable legal environment and enforcement are keys to protect and promote investment confidence in the country.

The article aims at providing a detailed assessment of the country's competitiveness from a business executive point of view. It details outcomes of an Executive Opinion Survey, whose results were used by the World Economic Forum (WEF) to rank the Cambodia's competitiveness

among 117 countries assessed this year. The survey was conducted among 100 leading business executives in Cambodia during February to early April 2005.

How Competitive is Cambodia in the International Markets?

The assessment by the World Economic Forum presents Cambodia with a relatively low performance compared to the rest of the world. Cambodia's competitiveness was placed in 112th position among the 117 countries. Compared to its neighbouring countries, Cambodia performs worse than Thailand, Vietnam and Bangladesh, which are ranked

respectively 36th, 81st and 110th.

The only five less competitive countries than Cambodia are Paraguay, Benin, Guyana, Kyrgyz Republic and Chad. Finland is ranked the most competitive country this year followed by the United State, according to the WEF. Singapore is ranked 6th, Japan 12th, Thailand 36th, China ranked 49th, India 50th.

The country's poor performance is the result of the low scores given to the three components considered in the Growth Competitiveness Index of the World Economic Forum. These are the quality of its macro-economic environment, the quality of its public institutions and the role of technology in the development

**Table 1: Growth Competitiveness Index for 2005
(Selected Countries)**

	GCI		Macroeconomic environment Index		Public Institutions Index		Technology Index	
Country	Rank	Score*	Rank	Score*	Rank	Score*	Rank	Score*
Finland	1	5.94	4	5.52	5	6.19	2	6.02
United States	2	5.81	23	5.07	18	5.77	1	6.19
Singapore	6	5.48	1	5.82	4	6.25	10	4.93
Japan	12	5.18	42	4.40	14	5.84	8	5.24
Thailand	36	4.50	26	4.94	41	4.88	43	3.69
China	49	4.07	33	4.61	56	4.41	64	3.18
Indonesia	74	3.53	64	3.89	89	3.58	66	3.13
Vietnam	81	3.37	60	3.96	97	3.43	92	2.72
Bangladesh	110	2.86	83	3.43	117	2.55	101	2.06
Cambodia	112	2.82	104	3.04	114	2.90	105	2.51
Paraguay	113	2.80	102	3.07	112	2.97	111	2.35
Benin	114	2.74	101	3.08	110	3.06	116	2.09
Guyana	115	2.73	113	2.77	109	3.01	112	2.34
Kyrgyz Republic	116	2.62	115	2.62	115	2.89	113	2.34
Chad	117	2.37	114	2.67	116	2.64	117	1.80

Source: World Economic Forum, Global Competitiveness Report 2005-2006

* 1: the least competitive, 7: the most competitive

process.

With competitive disadvantages in almost all areas, Cambodia is, according to the assessment of the WEF, notably competitive for its stable inflation and real effective exchange rate. This is maybe largely due to the country's dollarized economy. Contrarily, corruption and high lending-borrowing interest rate spread are viewed as Cambodia's most competitive disadvantages to attract investment.

Technology

In terms of technology, Cambodia is ranked 105th out of 117 countries in the Growth Competitiveness Index of the World Economic Forum. Yet, one of Cambodia's competitive weaknesses is its technological infrastructure. With the perceived limited number of scientists and engineers within the country, Cambodia does not seem to have a good foundation for its technology infrastructure.

Its institutional environment as well as its financing capacity does not yet allow the country to be a pioneer in new technology. Scientific research institutions is seen almost non-existent. As a non-core economy, innovation is not an important source of technology in Cambodia, with technology transfer coming mainly through FDI.

At the company level, business is not yet ready for technology despite its potential. Companies in Cambodia are observed to lack aggressiveness in absorbing new technology. Usually, they do not spend heavily on research and development. Neither do they have good business collaboration in research and development (R&D) with local universities, which causes Cambodia's level of technological readiness to lag far behind other countries. Moreover, production processes are reportedly either labour-intensive or based on obsolete technology.

It must be noted that the government of Cambodia understands the

importance of ICT in accelerating the economic growth but fails to promote it. Indeed, the National Information Communication Technology Development (NIDA) has been established with the objective to improve and strengthen the country's ICT system but due to limited resources, it is not likely to play a significant role in promoting the use of ICT in Cambodia.

As a result, only a small proportion of the population has access to the internet or telecommunication services. According to data for 2003, the internet user rate is only 25 per 10,000 inhabitants, while the telephone line user rate is 0.3 per 100 inhabitants. Moreover, laws relating to the use of ICT are practically non-existent in Cambodia, while competition among internet service providers is seen as not sufficiently intense to ensure high quality, infrequent interruptions and low prices.

Macroeconomic Environment

Cambodia's macroeconomic environment ranks 104th out of 117 countries assessed by the World Economic Forum, meaning that Cambodia still lags behind in establishing a sound, predictable and sustainable macroeconomic environment which contributes to business and investor

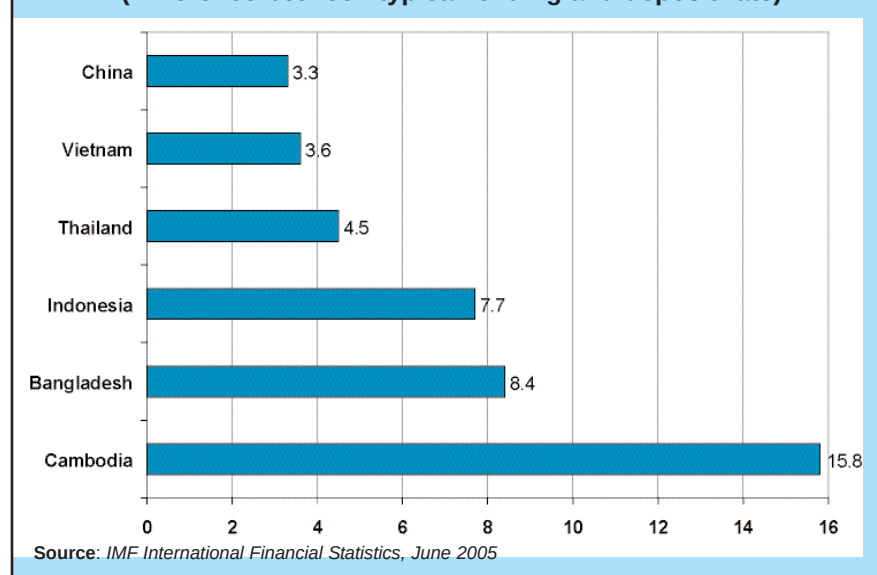
confidence.

The country's relative weakness focuses on the high government deficit, high lending-borrowing interest rate spread, low country credit rating and difficulty in acquiring business credit.

Hard data reveals that the average interest rate spread between typical lending and deposit rates in Cambodia was as high as 15.8 percent, while the government deficit reached 6.1 percent of GDP in 2004. In addition, the country's trade deficit has become an important challenge that the Cambodian government must pay attention to. It has been increasingly significant within the last few years, reaching almost 16 percent of GDP in 2004. Mostly all Executive Opinion Survey respondents agreed that public spending is somehow wasteful, with the government unable to provide necessary goods and services its citizens are entitled to.

Besides the country's macroeconomic uncertainty, Cambodia is still considered one of the world's riskier countries to invest in. Cambodia's country credit rating in 2004 ranked 107th out of 117 countries. Investors to this day prefer investing in less precarious countries and if investment is made, a high rate of return is required.

Figure 1: Interest Rate Spread, 2004
(Difference between typical lending and deposit rate)



However, for a short term outlook, the business executives are more positive for both their own business operations and the socio-political situation. This overall optimism may be explained by their recent positive business experience. More than 70 percent of the Executive Opinion Survey respondents report normal or good business in 2004, and expect to maintain this trend in 2005. It is interesting that a large proportion of the respondents forecast high growth for their businesses, yet they expect only a modest one for the country's economy.

Poverty reduction, which has been the focal point of the government's national strategy for many years, remains a major challenge. The survey shows that the government effort to reduce poverty and address income inequality is perceived insufficient.

Public Institutions

Cambodia's public institutions is ranked 114th out of the 117 countries, assessed by the World Economic Forum. They are seen on the whole as ineffective. No doubt, they are among the world's worst and are comparable only with the Kyrgyz Republic, Chad and Bangladesh - which are the bottom countries in the Public Institutions Index of the World Economic Forum.

Businesses are facing government ineffectiveness, which hampers the overall possibility for Cambodia's business community to emerge on the world scene. Weak contract and law enforcement and corruption are believed to negatively affect the country's business operations.

Business executives severely criticized Cambodia's judicial system, which plays an important role in establishing an effective and solid business environment. They believe the ability of Cambodia's legal framework to settle disputes and challenge the legality of government actions and regulations is ineffective and sub-

ject to manipulation.

Almost three quarters of the business executives surveyed point to political influences that severely compromise the court of law. The establishment of a legal framework able to effectively settle private business disputes is perceived as a great challenge by the business community. Inefficient and complex government bureaucracy is also cited by all sectors as being a major barrier to develop business competitiveness.

Last but not least, corruption has been judged pervasive in Cambodia. It has currently become a serious and sensitive issue. Both the Investment Climate of the World Bank (released in August 2004) and the Executive Opinion Survey 2005 suggest that corruption is the most problematic factor for businesses in Cambodia. The corruption index by the World Economic Forum assesses Cambodia as the third most corrupt country (among the 117 countries) before Chad and Bangladesh. Unofficial payment is very common in order to receive satisfactory public services.

In other words corruption is believed most pervasive in connection with import and export permits, tax collection, awarding of public contracts and obtaining favourable judicial decisions.

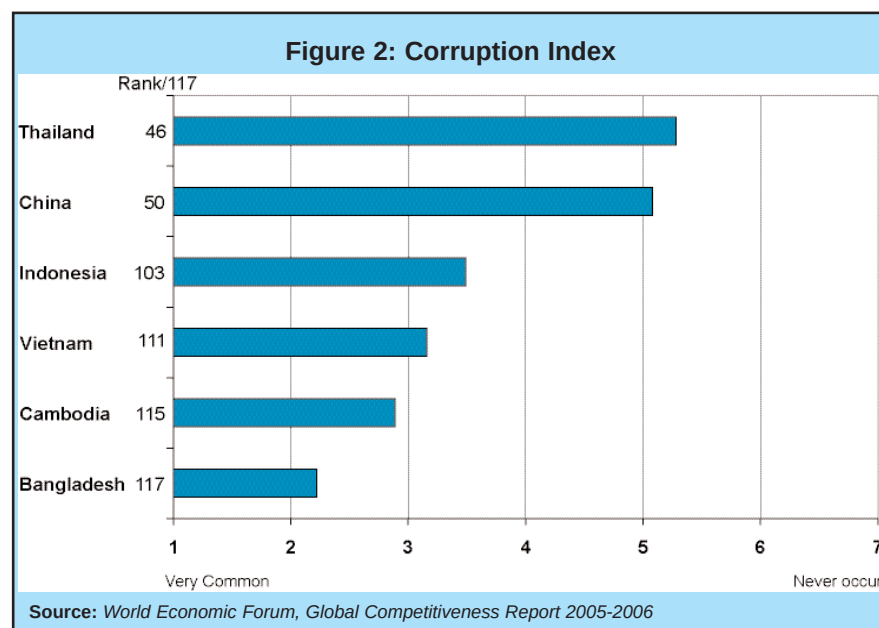
Quality of National Business Environment

Cambodia's national business environment is globally ranked 107rd out of 116 countries, assessed by Prof. Michael E. Porter - a leading expert on strategies for competitiveness at Harvard Business School. It is linked largely to the unavailability or poor quality of its infrastructure and supporting industries.

Input Conditions

Unarguably, Cambodia has a poor physical infrastructure. The companies in Cambodia are not satisfied with the quality of the country's physical infrastructure, which forces them to increase their input costs. Electricity supply in Cambodia is one of the worst in the world. Poor or non-existent infrastructure means time-consuming efforts to import or export essential materials, another hurdle to establish a coherent and effective communication network much needed in today's global economy.

The country has notable competitive advantages from its cheap labor costs and natural resources. Business executives view Cambodia's work force as having important potential, saying the country's people are dynamic and willing



to learn. What impedes this potentially dynamic workforce is the current education system, which does not lift the skills and learning capacity of job seekers.

The potential of Cambodia's labor has been recognized but the country's present and future workforce is prevented from flourishing because of the government's ineptitude to reinforce the quality of higher education to meet today's business requirements.

Related and Supporting Industries

It is argued that Cambodia is extremely weak in building up a supporting industry for its local businesses. The role of related and supporting industries in improving competitiveness is largely inexistent in Cambodia. Local supplies are perceived as very limited in terms of quantity and quality while the majority of firms argue that specialized research and training services are somewhat unavailable in Cambodia.

The lack of supporting industries in Cambodia is one of the most comparative disadvantages of Cambodian firms in the international markets, where competition is intense and thus opportunities become tighter and tighter.

Demand Conditions

Buyers in Cambodia are generally unsophisticated and base their buying decisions simply on the lowest price rather than on a product's performance. The government demand is viewed as not large enough to attract majors investors.

Cambodia's notable weaknesses are also in the areas related to law and regulations, more particularly the law relating to ICT, regulatory standards and stringency of environment regulations. Much improvement can be made in this area to protect consumers as well as business interests which in turn will ensure long-term competitiveness.

Context for Firm Strategy and Rivalry

To a certain extent, competition in Cambodia's local market is seen as being intense in most industries, which is healthy for consumers. Weaknesses remain, however, due to the perceived high business costs caused by corruption and favoritism of government officials.

Yet, results from the Executive Opinion Survey 2005 in Cambodia show that intellectual property and the interests of minority shareholders are not well protected, while the efficiency of corporate boards and labor-employer relations are comparatively rated higher. Noticeably, Cambodia seems to be more open to foreign ownership, which is probably the result of its investment policy to attract foreign investors.

Company Operation and Strategy

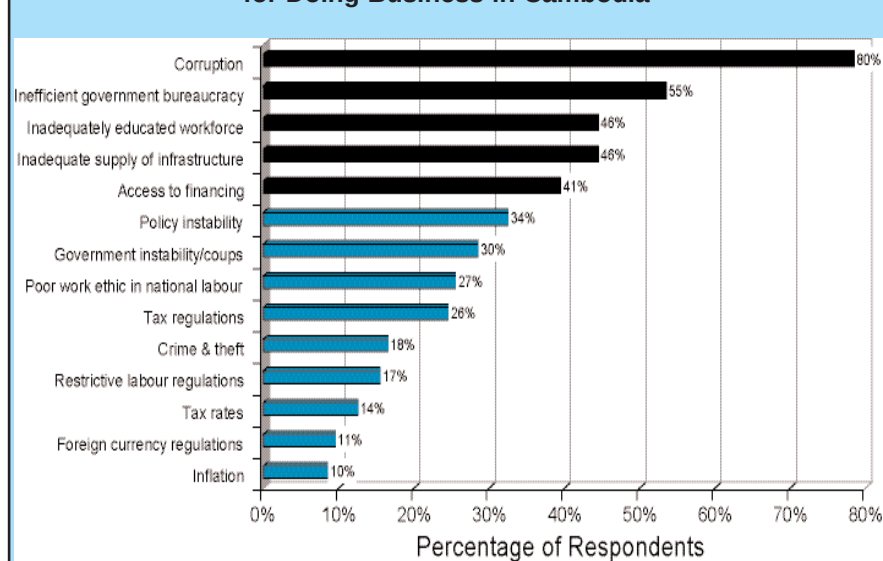
According to the Business Competitiveness Index of Prof. Michael E. Porter, the company operation and strategy of Cambodian firms ranks 103rd out of 116 countries.

Competitiveness of Cambodian firms is derived primarily from natural resources, while about 70 percent of the surveyed companies believed that exporting companies in Cambodia are, most likely, involved in resource extraction. One should note that, there has been to an alarming degree, the deterioration of national natural resources due to over resource extraction within the past decade. Without proper natural resource management and reforms, Cambodia's natural resources risk being diminished and unable to serve as a source of long-term competitiveness anymore.

At the company level, production process is perceived by the business community to use labor-intensive methods rather than advanced technology for efficiency. Yet, management professionalism seems to receive a higher satisfaction than the other criteria considered in this section. It seems that the general approach by the companies towards development of human resources is at best lax. Incentives for managers are restricted to salaries without any provisions for bonuses or share options.

Access of exported Cambo-

Figure 3: The Most Problematic Factors for Doing Business in Cambodia



Source: EIC, Executive Opinion Survey 2005 in Cambodia, February-April 2005

Note: From a list of 14 factors, respondents were asked to select the five most problematic factors for doing business in Cambodia

dian products to the international market is limited to only a small number of foreign markets and usually international distribution takes place through foreign companies. 80 percent of the business executives participated in the survey indicate their exports are limited to a small number of foreign markets. The bulk of their exports are garments which amount to 85 percent of the country's total export heads for the US and European markets.

In addition to businesses facing external national impediments the still inexperienced business community also suffers because of a lack of know-how in marketing and management. The internal structure and strategies of companies are also preventing real business growth. In general, product and service quality in the local market is not up to par.

Although companies in Cambodia are believed not able to pursue the best strategy to be competitive on the international market, they would be inclined to upgrade their strategies if an opportunity was available or in other words, when the quality of the national business environment is improved.

Impediments for doing Business

Corruption appears as the greatest challenge and imposes significant costs for businesses in Cambodia. According to the Executive Opinion Survey, corruption is identified as the leading constraint for doing business in Cambodia. An overwhelming 80 percent of the surveyed business executives agree with the statement.

With demands for large numbers of cash, contacts and financial excesses, the situation can be harmful and even fatal to many businesses trying to get a foothold in their respective markets.

The second most problematic issue for doing business in Cambodia is the insufficient government bureaucracy, followed by an inadequately educated workforce, poor infrastruc-

ture and poor access to financing.

Critical Reforms

Results from the Executive Opinion Survey highlighted that several fundamental business requirements still need to be developed for the business community to reach the levels of its regional counterparts.

The business community perceived public administrative reforms as the most critical and as a need that the government has to integrate well in its overall strategy. A climate of stability and transparency should be created to help local business to be competitive in the world's markets.

Legal & judicial reforms and financial and banking reforms are among the top-three most critical reforms while trade policy reforms is the fourth most cited area to be reformed for business to sustain and growth.

Concluding Remarks

Cambodia's competitiveness lags far behind the rest of the world, including its main neighboring countries: Vietnam, Thailand, China and Indonesia.

In order to remove business constraints and restore national competitiveness, critical reforms are nec-

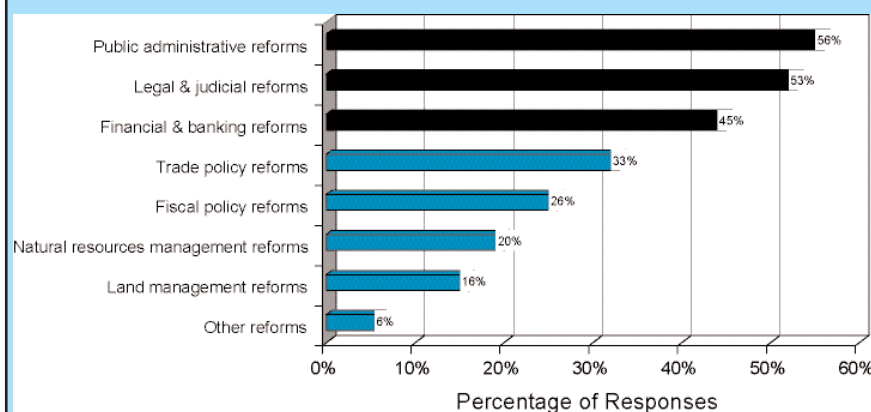
essary. The public institutional reforms are the most critical starting points to which the government should pay the most attention. Governance and the rule of law must be ensured to obtain public as well as investor confidence. Only then can Cambodia attract more investment, both domestic and foreign, that would bring in new, innovative technology.

Only when public institutions can deliver necessary services and corruption is curbed can the country's business environment be improved, which will provide opportunities for companies to upgrade their operations and strategies so that they become competitive in international markets. Without the proper functioning of its public institutions, Cambodia will not be able to become competitive.

Furthermore, some initiatives should be prioritized towards areas considered as the most competitive disadvantages of Cambodia. The quality of human resources can be improved through strengthening the country's educational system. Educational quality should be high not only for the public schools but also for higher education, particularly in business/management schools in order to meet business requirements.

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Figure 4: Critical Reforms for Business in Cambodia



Source: EIC, Executive Opinion Survey 2005 in Cambodia, February-April 2005

Note: From a list of 8 factors, respondents were asked to select the three most critical reforms for doing business in Cambodia