

## Why this Study?

The private sector is the engine for economic growth, and plays a major role in creating employment for new entrants into the labor force. To promote the private sector, a conducive and enabling environment is needed. Currently, the Cambodian private sector's environment encounters various constraints to its development.

One of the private sector's major constraints, highlighted in the World Bank report on "*Investment climate assessment and reform strategy*", is corruption. The estimated magnitude of payments to public officials exceeds 5 percent of annual sales revenue. A recent study by the Economic Institute of Cambodia (EIC) and the World Economic Forum (WEF) indicates that corruption is the most problematic factor for doing business in Cambodia.

For the Cambodian private sector to compete with other exporting countries in the global markets, the problem of corruption needs to be successfully tackled.

While studies on corruption have been conducted by various institutions, there is a lack of clear scientific information about corruption in Cambodia's private sector. Due to this lack of information, this study on corruption assessment in the private sector (CAPS) was initiated by EIC with the sponsorship of USAID, Pact and PADCO | AECOM.

The primary objective of this study is to raise the awareness of the private sector, particularly micro, small and medium enterprises (MSMEs) about the causes, nature and extent of corruption in the country with the publication and dissemination of research findings through seminars or conferences. The study also intends to strengthen the capacity of the private sector through the elaboration of a set of practical recommendations on how the private sector can take part in fighting corruption, along with public administration, and other stakeholders.

The study used a wide range of methodologies which included: literature review, quantitative and qualitative surveys, modeling system to assess the impact of corruption on the private sector and the economy and an advisory team. In April 2006, the study was conducted with a sample of 1,107 enterprises (818 micro-enterprises, 244 small and medium enterprises (SMEs) and 45 large enterprises)<sup>1</sup> in nine major municipalities and provinces of Cambodia. Furthermore, a total of 20 focus group discussions (FGDs) with micro-enterprises and SMEs as well as

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<sup>1</sup> **Note:** Micro-enterprises ( $emps < 10$ ) ; SMEs ( $10 \leq emps < 100$ ) ; Large enterprises ( $emps \geq 100$ )

personal interviews with public officials in the nine provinces and municipalities were conducted (see more detailed methodology in appendix).

To have a fair understanding about corruption in the private sector, fundamental knowledge about the causes, nature, extent and how to successfully curb corruption is important<sup>2</sup>. This USAID, Pact and PADCO|AECOM funded report will provide insightful findings about the nature and causes of corruption in the private sector in Chapter 1 and Chapter 2. The report also offers insights into the extent of corruption in the private sector and the impacts of corruption on the economy in the Chapter 3. The final chapter discusses various recommendations and strategies to reduce corruption in the private sector and how the private sector can take part in the fight against corruption.

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<sup>2</sup> United Nations Office on Drugs and Crime, Regional Office for Southern Africa, Country Corruption Assessment Report, South Africa, 2003, p. 93

# Chapter 1

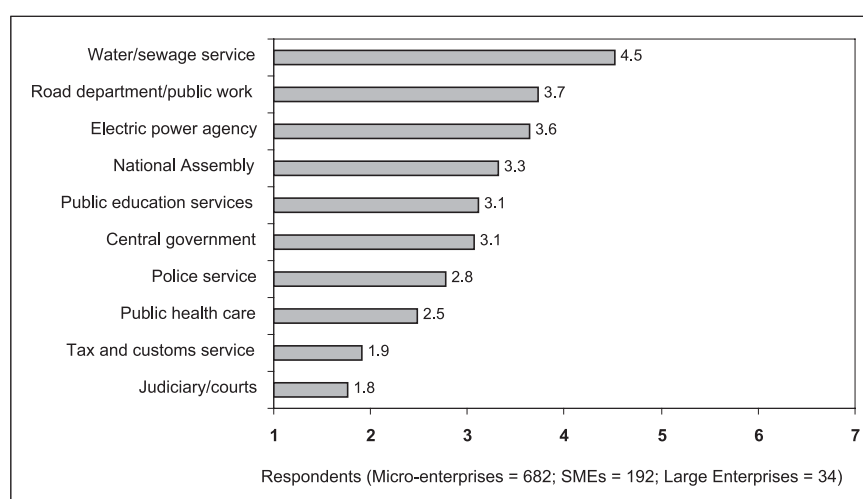
## Nature of Corruption in the Private Sector

Before detailing the nature and causes of corruption in the private sector, it is important to have an understanding of the overall picture of corruption in Cambodia.

In general, corruption in Cambodia has been perceived to be pervasive and widespread. Many public institutions are viewed to be dishonest and involved in corruption. The surveys conducted by CSD and the World Bank confirm this evidence. The World Bank report “*Cambodia Governance and Corruption Diagnostic*” pointed out that public organizations perceived by citizens to be the most dishonest by enterprises and public officials, were the judiciary, revenue-related authorities and agencies involved in the management of public assets<sup>3</sup>. The CSD report “*Corruption and Cambodian Households*” also indicated that courts, tax & customs and the police were perceived as the most dishonest institutions by households<sup>4</sup>.

Likewise, the Corruption Assessment in the Private sector (CAPS) survey conducted by EIC also indicates that most of the country's public institutions are perceived not to be honest. This is corroborated by the perception of all enterprises concerning the honesty and integrity of 10 public institutions. Almost all named institutions, except the water/sewage services, were considered dishonest and lacking in integrity, and rated to be under average (figure 1.1).

**Figure 1.1: Honesty & Integrity of Officials in Public Agencies or Services**  
(1 = Not honest at all, 7 = Very honest)



Source: EIC, CAPS survey, April 2006

<sup>3</sup> See also World Bank, *Cambodia Governance and Corruption Diagnostic: Evidence from citizen, enterprise and public official surveys*, 2000, p. 13

<sup>4</sup> CSD, *Corruption and Cambodian Households*, 2005, p. 45

While enterprises believed that the most honest institution was the water/sewage service, the most corrupt institutions were perceived to be judiciary/courts, followed by tax and custom services, public health care and police.

Taking the above into consideration, relevant public institutions that often deal with the private sector need to be explored. Due to this, this section provides findings concerning inspections in the private sector made by public officials. The section also considers the private sector's perceptions of unofficial fees; if the entrepreneurs are aware of how much they should pay for informal fees in advance, how the informal payments are made, and the efficiency of public services after the unofficial fees are paid.

### 1.1. Frequency of Inspections

Inspection practices remain a burden for the business community. Inspection policies are not clear enough for entrepreneurs to identify how many times a year they should expect inspections by all agencies. MSMEs face several kinds of inspections for their day-to-day operations, depending on the nature, location and type of business. To some extent, inspections are necessary to encourage social as well as regulatory compliance, but in practice, it is difficult to ensure that inspections are not just pretexts to ask for money by different agencies. According to the survey, many enterprises need to pay officials to facilitate the inspection process.

**Table 1.1: Proportion of Firms Being Inspected  
by Different Authorities**

	<b>Micro- enterprises</b>	<b>SMEs</b>	<b>Large Enterprises</b>
Tax authorities	93%	95%	100%
Police	37%	50%	60%
Local authorities	29%	55%	62%
Fire & building safety	28%	58%	84%
Environment <sup>5</sup>	15%	52%	58%
Standard inspection	3%	20%	16%
Labor and social security	2%	31%	82%

**Source:** CAPS Survey, April 2006

**Respondents** (Micro-enterprises = 818; SMEs = 244; Large enterprise = 45)

<sup>5</sup> Environment inspections are normally made by officials from the Ministry of Environment to ensure that enterprises are clean and do not pollute the environment.

Tax inspections appear to be the most frequent kind of inspection for all types of enterprises. Over 90 percent of MSMEs and all large enterprises are inspected by tax authorities either formally or informally. Tax inspections are to ensure that tax obligations declared by enterprises are correct.<sup>6</sup>

In general, the proportion of enterprises inspected by agencies other than the tax department proportionately increases with the size of the enterprise. Once enterprises become more formal, they have more obligations to comply with. Moreover, large enterprises need to forge closer relations with relevant agencies to secure their business.

It is worth highlighting that only 2 percent of micro-enterprises are inspected for labor and social security, while 31 percent of SMEs and 82 percent of large enterprises are inspected for the same purpose. The difference reflects the fact that micro-enterprises are usually operated informally and therefore not much attention is placed on micro-enterprises for labor and social security compliance. For standard inspections<sup>7</sup>, the proportion of firms being inspected varies from 3 percent of micro-enterprises to 20 percent of SMEs and 16 percent of large enterprises. Other relevant agencies such as the departments of tourism, department of commerce, department of agriculture, forestry and fisheries, sanitation authorities, etc. also conduct inspections.

Another issue concerning inspections is how individuals deal with officials. The problem about unofficial fees is that if someone protests or bargains well against the public officials soliciting bribes, it is likely that officials will stop coming to ask for bribes. According to a Phnom Penh vendor, *"If we keep paying them, they will come and ask us for money any time. Who pays them will keep paying. For me, I don't pay them, I do nothing wrong with them. My business is legal. I have licenses from the local authority and the municipality and I regularly pay tax. When I talk strongly to them, they don't dare to come here anymore and normally I don't really face this problem"*.

Likewise, a male micro-entrepreneur in Banteay Meanchey province also shares the same view about this unfair practice, saying: *"If we keep silent and act like the weak, they will keep coming to ask us for money, but if we dare to complain and talk to them seriously with some legal arguments, they don't dare to come anymore"*.

The inspections and unofficial fees demanded by public officials raise some important gender issues as well. Women entrepreneur-headed households face more burdensome inspections by public officials and therefore they need to pay more unofficial fees to maintain good relations with the authorities. The main reason for this is because women who are heads of households and run businesses generally lack education and lack information regarding business regulations and

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<sup>6</sup> Informed by the Tax Department, July 6, 2006

<sup>7</sup> In general, standard inspections are made by MIME to ensure that manufacturing enterprises comply with standard regulations issued by the ministry.

laws. A woman entrepreneur in Kandal province mentioned: “*When I was alone as a widow, many different public officials regularly came to my place to solicit me for bribes, but after I got married to my current husband, they don't dare to ask me for money anymore*”. This is because after her marriage, her husband was the one who took care of the business and deals with officials soliciting bribes.

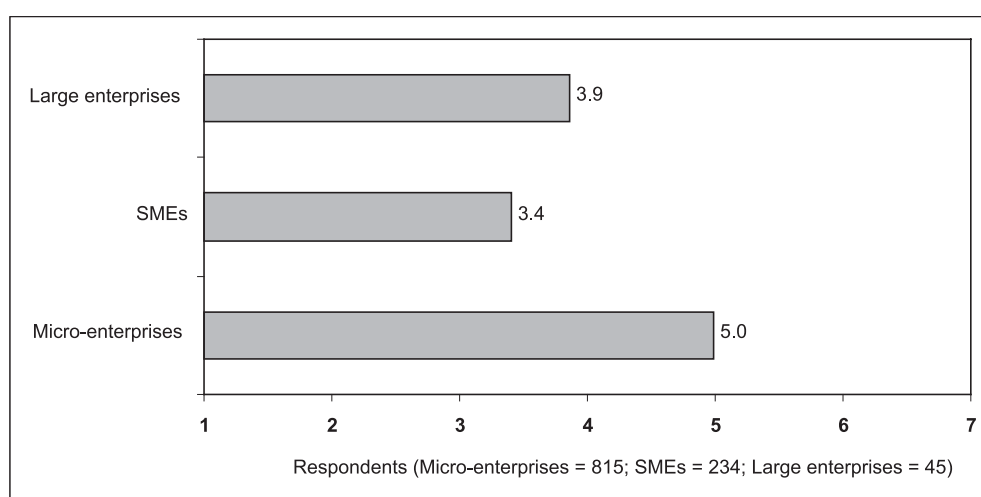
Having good bargaining skills helps reduce the chances of public officials asking for bribes. In this context, women, particularly women entrepreneur-headed households, who lack education, entrepreneurship, bargaining and negotiation skills compared to men, face more troublesome inspections and unofficial fees.

Another crucial gender issue concerning inspections is that women are at risk of being verbally and sexually harassed. The large majority of officials are male (according to Council for Administrative Reforms (CAR), only 31 percent of civil servants are women<sup>8</sup>). This opinion was equally suggested by FGD participants in Kampot, stating: “*Sometimes, when dealing with officials, the male officials flirt with women for fun. Sometimes the officials slightly touch their backs.*”

## 1.2. Predictability of Unofficial Fees

Micro-enterprises are in the best position to know in advance the amount they need to pay in unofficial fees, compared to SMEs and large enterprises. This is because paying unofficial fees to public officials is part of everyday life of micro-entrepreneurs. There seems little difference between Phnom Penh and other provinces (figure 1.2).

**Figure 1.2: Predictability of Unofficial Fees**  
(1 = Never know, 7 = Always know)



Source: EIC, CAPS survey, April 2006

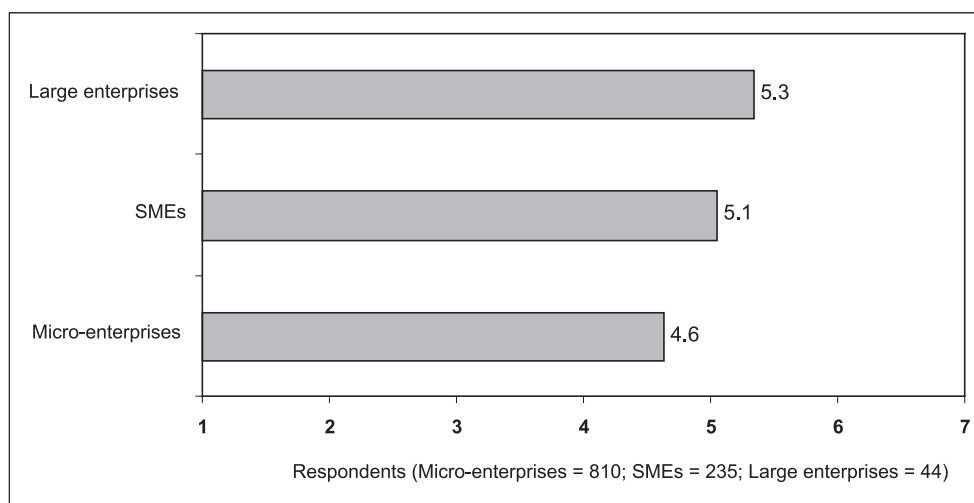
<sup>8</sup> UNIFEM, WB, ADB, UNDP and DFID/UK: A fair share for women: Cambodia gender assessment, 2004, p. 130

The situation is quite different for larger enterprises in terms of size. SMEs and large enterprises normally do not know in advance how much they should pay to public officials; this maybe because of the complexity of their business. This leads to a difference in unofficial fees on a case-by-case basis.

### 1.3. Efficiency of Public Services and Unofficial Fees

All enterprises were questioned if they were satisfied with the services provided by public officials once unofficial payments had been made. They raised no problem with the efficiency of services after they paid unofficial fees. Many enterprises agree that they get efficient services from public officials once unofficial fees are paid (figure 1.3).

**Figure 1.3: Efficiency of Public Services and Unofficial Fees**  
(1 = Never know, 7 = Always know)



**Source:** EIC, CAPS survey, April 2006

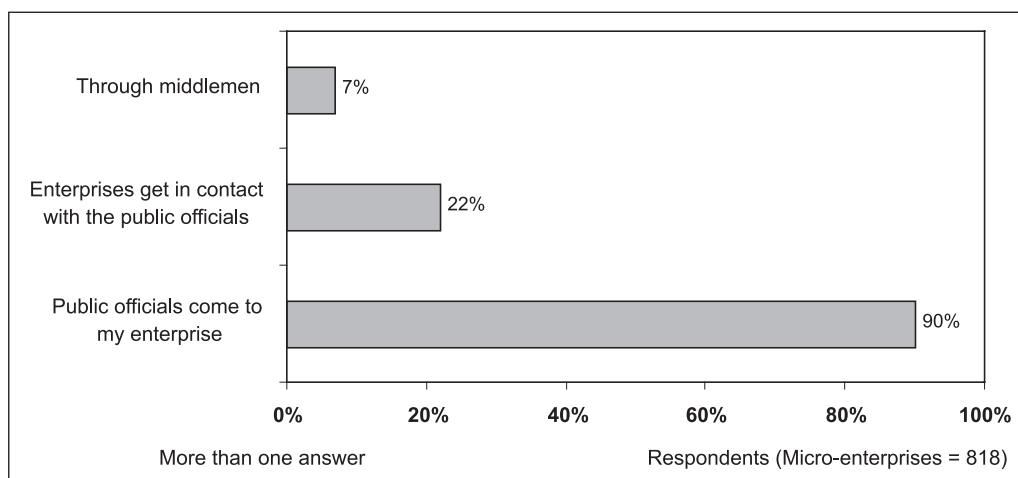
This result seems to comply with an opinion expressed by a micro-entrepreneur who says, “In Cambodia, if you have money, you can do or get anything”. Responses from micro-enterprises seem to be less positive than SMEs and large enterprises. This is because micro-enterprises normally do not require many services from public officials as seen in figure 2.1, revealing that it is public officials who come to ask them for unofficial fees.

### 1.4. How the Informal Payments Occur

Enterprises were asked about how unofficial payments occur. In general, public officials come to their enterprises and demand bribes. About 90 percent of micro-enterprises responded that public officials came to their enterprise directly for unofficial fees. It is rare for micro-enterprises to contact public officers for

bribes, and to use middlemen<sup>9</sup> to approach or facilitate contact with public officials (figure 1.4).

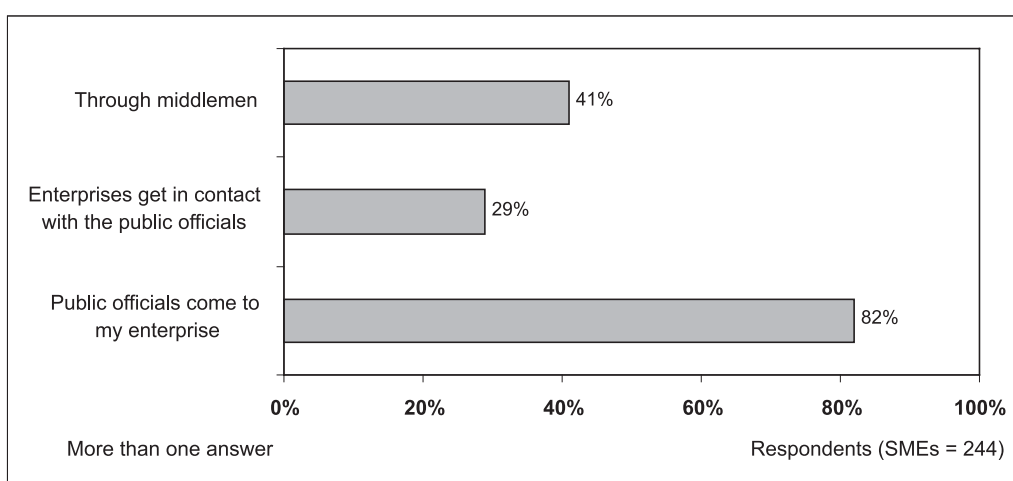
**Figure 1.4: How Informal Payments Occur for Micro-enterprises?**



Source: EIC, CAPS survey, April 2006

Similar to micro-enterprises, SMEs often pay unofficial fees to public officials when they come to their enterprises. Seventy-three percent of SMEs acknowledged that public officials came directly to their enterprise for unofficial fees. However, there were many recorded cases of the use of middlemen (41 percent) by SMEs for public officials to do things for them. Also, there were many cases (29 percent) where SMEs contacted officials directly to get things done (figure 1.5).

**Figure 1.5: How Informal Payments Occur for SMEs?**

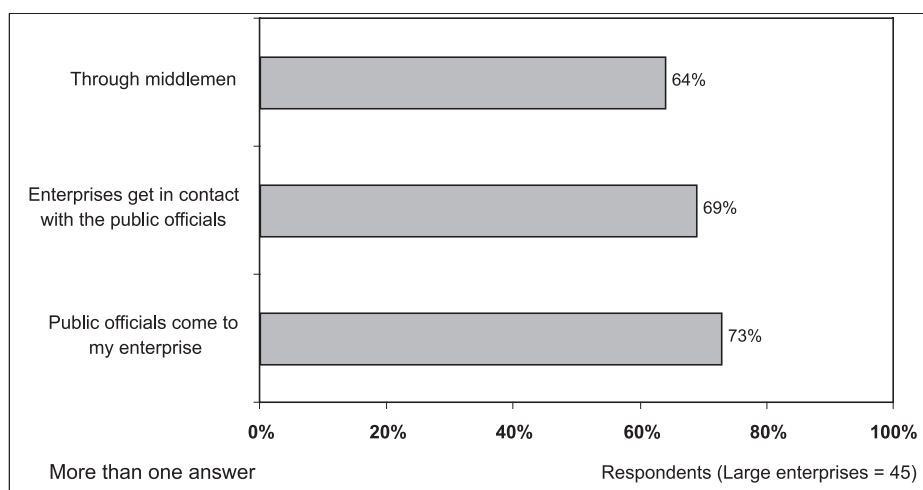


Source: EIC, CAPS survey, April 2006

<sup>9</sup> The term 'middlemen' used in this paper refers to agents hired to complete a task for the hiring enterprises. A middleman could be a lawyer, a private entity or a public official, etc., who ensures the proper authorizations are received, or approvals are obtained for various processes, or provides other professional services.

Like micro-enterprises and SMEs, many public officials visit the premises of large enterprises for unofficial fees, as about 73 percent of large enterprises responded. It is interesting to note that large enterprises use a lot of middlemen (64 percent of respondents) to receive public services. Many large enterprises (69 percent) also contact public officials directly to receive public services, such as approvals for business licensing, etc. (figure 1.6).

**Figure 1.6: How Informal Payments Occur for Large Enterprises?**



**Source:** EIC, CAPS survey, April 2006

Due to the complicated nature of SMEs and large enterprises compared to that of micro-enterprises, the use of middlemen and the direct contact with public officials by these two types of enterprises is more frequent. Large enterprises are the most frequent users of middlemen to facilitate their work due to the complicated bureaucracy they have to fulfill as formal enterprises.

A conclusion can be made that the more formal the enterprise, the more frequent the use of middlemen since formal enterprises face a lot of bureaucracy. Due to the extensive bureaucracy for larger enterprises, the more frequent the need for middlemen to facilitate bureaucratic procedures. Equally, more formal enterprises are likely to directly contact public officials to do things for them.

