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# Project Information Document (PID)

Concept Stage | Date Prepared/Updated: 30-Sep-2021 | Report No: PIDC31498

**BASIC INFORMATION****A. Basic Project Data**

Country Cambodia	Project ID P175380	Parent Project ID (if any)	Project Name Enterprise Digitalization and Technology Adoption Project (P175380)
Region EAST ASIA AND PACIFIC	Estimated Appraisal Date Mar 15, 2022	Estimated Board Date May 19, 2022	Practice Area (Lead) Finance, Competitiveness and Innovation
Financing Instrument Investment Project Financing	Borrower(s) Kingdom of Cambodia	Implementing Agency Ministry of Economy and Finance	

**Proposed Development Objective(s)**

Accelerate the adoption of digital technologies among enterprises and their workforce to support Cambodia's economic recovery from the COVID-19 pandemic.

**PROJECT FINANCING DATA (US\$, Millions)****SUMMARY**

<b>Total Project Cost</b>	40.00
<b>Total Financing</b>	40.00
<b>of which IBRD/IDA</b>	40.00
<b>Financing Gap</b>	0.00

**DETAILS****World Bank Group Financing**

International Development Association (IDA)	40.00
IDA Credit	40.00

Environmental and Social Risk Classification

Concept Review Decision



Low

Track II-The review did authorize the preparation to continue

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Other Decision (as needed)

## B. Introduction and Context

### Country Context

- 1. The global shock triggered by the COVID-19 pandemic has had a devastating impact on Cambodia’s economy.** Prior to the pandemic, Cambodia was a world leader in economic growth and poverty reduction. It sustained an average growth rate of 7.7 percent in 1995-2019, raising its per capita income from USD 323 in 1995 to USD 1,621 in 2019 and graduating to become a lower middle-income economy in 2015. The poverty rate fell from 47.8 percent in 2007 to 13.5 percent in 2014. With a young population and a growing labor force, Cambodia is experiencing a demographic dividend with the pool of potential workers expected to expand by 135,000 yearly on average for the next 35 years.<sup>1</sup> But COVID-19 hit Cambodia’s main drivers of growth dramatically—namely tourism, garment manufacturing and construction. The growth slowdown is among the most pronounced in the East Asia region, with real gross domestic product (GDP) growth estimated to have contracted by 3.1 percent in 2020 and projected to recover to 2.2 percent in 2021, well below pre-COVID-19 trends.
- 2. Following a local outbreak that started on February 20, 2021, Cambodia has experienced a rapidly rising number of reported coronavirus cases and deaths.** The pandemic threatens to reverse years of extraordinary development gains in the country. In the absence of significant mitigation measures, the COVID-19 pandemic could result in sharp increases in unemployment and increased poverty. Poverty simulations based on the national poverty line of KHR 7,440/day in 2014 Phnom Penh prices and stimulating a GDP contraction of between 1 percent and 2.9 percent show that a sudden economic slowdown would produce a substantial increase in poverty of between 5.4 and 6.0 percentage points. This translates into between 859,000 to 950,000 additional poor and a reversal of four years of progress against poverty.
- 3. The devastating economic impact lies in the country’s low economic diversification, a symptom of low competitiveness.** Cambodia was ill-positioned to absorb the shock when the pandemic disrupted cross-border flow of goods, services and capital. In 2018, five products—garments, footwear, rice, cassava, and tourism—accounted for 80 percent of total exports. Together the European Union and the U.S. accounted for 69 percent of merchandise exports. Further, foreign capital—through foreign direct investment (FDI) and official development assistance—accounted for 72 percent of gross fixed capital formation. Economic diversification is fundamental to Cambodia’s longer-term growth strategy as well as a resilient recovery, but the private sector faces key challenges to establish and grow.
- 4. Government support to the affected population has been unprecedented, at up to 5 percent of GDP in 2020.** The broad package of support includes health-related spending and income assistance, equity injections and loan guarantees, development spending, and tax relief. The Government has taken already some immediate and proactive

<sup>1</sup> World Bank (2019a).



measures to mitigate the most urgent economic effects of the pandemic: emergency funds (USD 800 million); a subsidy of 20 percent of the minimum wages to workers in the garment and hospitality sectors; exerting pressure on property owners to avoid evictions or contract terminations; offering low interest state loans; and granting tax reliefs. The Government's large fiscal support program has turned the budget from a surplus in 2019 into a deficit in 2020.

**5. Droughts and flooding in 2020 inflicted another economic shock to the economy, further straining the government's fiscal position.** Cambodia is one of the most vulnerable countries in Southeast Asia to the impacts of climate change and it has a relatively high exposure to natural disasters, including floods and droughts. The effects of climate change pose significant risks to the country's agriculture industry and road and irrigation infrastructure and increase the burden of climate sensitive diseases. Increased temperatures, drought, and changes in seasonal rainfall patterns caused by climate change threaten food security through reduced freshwater availability and, in turn, agricultural and fishery production. In recent years, Cambodia has been experiencing more extreme weather events. Most recently, Cambodia experienced heavy rainfall across the country, triggering extensive flooding from September to November 2020. The effects of these floods on agriculture exacerbated the impacts from droughts that affected the agriculture sector from December 2019 to January 2020.<sup>2</sup>

**6. The Cambodian government projects the damage of climate change could reduce GDP in 2050 by nearly 10 percent.**<sup>3</sup> Furthermore, low adaptive capacity and poor resources impose serious challenges for the country in responding to climate change impacts; Cambodia was ranked 160 out of 181 countries on the climate change vulnerability readiness according to the 2018 Notre Dame Global Adaptation Index.<sup>4</sup> Particularly vulnerable to climate change are pregnant women, mothers, and children who are at increased risk of malnutrition, dietary impacts of frequent crop failures, diarrheal episodes due to unsanitary environments and contaminated water sources during floods, and inappropriate infant weaning in households facing climate-induced risks to their livelihood.

**7. Cambodia's economy provides different opportunities and barriers to women and men.** Women are more likely to be employed as wage workers in the garment and trade and tourism sectors, and less likely to be employed in all other sectors, including the public sector. A significant gender wage gap also exists due to women's lower education levels, household factors closely tied to gender roles, industry of employment, and occupation. Analysis also shows that female-headed households are more likely to rely on remittances, less likely to be in a position to save, and are more vulnerable to economic shocks. Finally, gender stereotypes often associate ICT and digital skills with men, and may pose a deterrent for women's participation in digital skills training or adoption of new technologies, and women may also feel less safe conducting business digitally.

#### Sectoral and Institutional Context

**8. Cambodia's strong economic growth during the past forty years has relied heavily on foreign investment, attracted by the country's comparatively low-cost labor and favorable foreign investment incentives.** This has resulted in the growth of important sectors focused on exporting to international markets, particularly garments, footwear, and tourism services. Foreign investment has more recently been driving growth in the construction and real estate sectors.

<sup>2</sup> Widespread flash flooding also occurred in both 2011 and 2013, as well as tropical storms like Typhoon Ketsana in 2009. In 2015, Cambodia suffered losses of about US\$1.5 billion, which was equivalent to 10 percent of GDP, to the adverse impacts of climate change (ADB, 2016). Flash floods in 2011 resulted in 168 deaths, affected 377,354 households, and destroyed 267,000 hectares of rice fields. United States Agency for International Development (2019). Climate Risk Profile: Cambodia. Washington, D.C.

<sup>3</sup> Ministry of Economy and Finance (2019). Addressing Climate Change Impacts on Economic Growth in Cambodia. Phnom Penh: Royal Government of Cambodia.

<sup>4</sup> The Notre Dame Global Adaptation Index, or ND-GAIN, is a program of the University of Notre Dame's Environmental Change Initiative ranks the climate adaptation performance for 177 countries over the last 17 years. See at: <https://gain.nd.edu/our-work/country-index/>



**9. However, the presence of FDI has had limited impact on the growth and productivity of domestic firms due to lack of linkages with domestic firms and small and medium enterprises (SMEs) that would foster productivity and innovation spillovers.** Looking at medium- and large-sized enterprises, a large productivity gap between domestic and foreign-owned enterprises can be seen. This productivity gap reflects certain challenges in Cambodia's economy. For example, few linkages have been established between domestic enterprises and large enterprises operating in Cambodia's special economic zones (SEZs), whether in garments, agribusiness, or other sectors.<sup>5</sup> Therefore, few spillovers have occurred from foreign-owned enterprises to domestic enterprises in the form of management or technological capabilities that can help the latter to increase productivity and compete in these sectors.

**10. Cambodian-owned enterprises have not demonstrated an adequate capability to grow beyond micro- and small-sized into competitive medium- and large-sized enterprises.** The average enterprise tends not to grow, with the number of employees at enterprises remaining the same up to 30 years after formation.<sup>6</sup> As a result, the enterprise sector in Cambodia is characterized by a large share of microenterprises with SMEs being the 'missing middle', a common feature in the ASEAN region and beyond. According to the Cambodia Inter-censal Economic Survey, 2014 (CIES) there were 513,759 enterprises in Cambodia. Of these, 97.6 percent were microenterprises. The formal SME sector therefore is small, accounting for a little over 2 percent of the overall number of businesses and has potential for significant growth. Based on CIES, SMEs employed 13 percent of the labor force and accounted for 14 percent of annual sales. Importantly, the enterprise sector is largely informal. Based on Ministry of Economy and Finance (MEF) estimates, as of 2019 there are around 61,000 registered enterprises in Cambodia of which approximately 55,000 are SMEs. Of note, women own majority of businesses in Cambodia (approximately 61 percent), mainly among micro-firms<sup>7</sup>.

**11. Cambodia's dependence on FDI as the main engine of growth is increasingly risky in the medium term as trade preferences expire and Cambodia's labor cost advantages dissipate.**<sup>8</sup> Preferential access to the US and EU markets have been reduced as Cambodia's level of development increases. Since August 2020, some of Cambodia's typical export products such as garments, footwear and travel goods are subject to the European Union's customs duties as the EU has partially withdrawn Cambodia's duty-free quota-free access to the EU market. Wage increases driven by the minimum wage law for the garment and footwear sector have outpaced the increase in productivity in those sectors, resulting in unit labor costs (the cost of workers per unit of production) significantly higher in Cambodia than in other garment-producing countries, putting Cambodia at a competitive disadvantage.<sup>9</sup>

**12. Improving the overall business environment remains critical to encouraging the entry and growth of Cambodia's domestic businesses.** Particularly weak areas include government regulations relating to registering a business, tax payments, land titling, construction permit and other sector-specific operating licenses. Corruption and informal payments also increase the cost of doing business in Cambodia and contribute to the informality of the economy, with the perception of corruption still the highest among peers and competitors. Judicial enforcement mechanisms are relatively weak in Cambodia, making it difficult to ensure proper implementation of regulations. In addition, the incentives framework to support diversification of investment into higher value-added activities or support backward linkages to domestic firms is poor. Incentives are mostly tax holidays and are not linked to well-defined and clear policy objectives.

**13. Cambodia needs to accelerate the rate of innovation and entrepreneurship to meet its aspirations of building a competitive and digital economy.** Entrepreneurial capabilities are low as reflected in Cambodia's low rate of enterprise formation and low enterprise growth.<sup>10</sup> Cambodia's entrepreneurship ecosystem is less developed than regional and global competitors. For instance, the 2018 Global Entrepreneurship Index (GEI) ranks Cambodia 113 out of 137 countries

<sup>5</sup> World Bank, 2018a.

<sup>6</sup> World Bank, 2019a

<sup>7</sup> IFC report 2019 "Exploring the potential of women-owned SMEs in Cambodia"

<sup>8</sup> World Bank, 2017.

<sup>9</sup> World Bank, 2019a

<sup>10</sup> World Bank 2018b



assessed.<sup>11</sup> This is behind the lower middle-income average as well as Cambodia's Association of Southeast Asian Nations (ASEAN) peers. A comparative analysis across ecosystem pillars indicates that Cambodia's current ecosystem does not provide adequate support for entrepreneurs and that some factors such as difficulty finding technical and managerial skills, low levels of risk capital particularly at early stages, and low capabilities of privately managed entrepreneurship support organizations such as hubs, incubators, accelerators, and fund managers may limit the creation and growth of enterprises.<sup>12</sup> The incubators and accelerators are largely focused on the ideation and startup phases, with very few capable of providing support to the enterprise expansion and growth phases. In addition, most of the emerging support organizations focus on the ICT sector, which leaves entrepreneurs and enterprises in other sectors without adequate support.

**14. Regarding more specifically digitalization, while Cambodia's population has eagerly adopted mobile technology, the diffusion of digital technologies more broadly and among SMEs in particular is lagging.** Cambodia has made progress in delivery of basic connectivity with high mobile penetration but lags on 4G and fiber connections. The digital adoption for businesses in the service sector has gained momentum through the operations of e-commerce and the demand for e-products and services, driven by the growing number of younger people who comfortably use technology in line with the growth of the use of social media, other digital platforms, and the growing adoption of financial technology (Fintech). However, Cambodia trails regional comparators in both the number of digital solutions firms and the diversity of digital industries, ranking 15th in the East Asia and Pacific (EAP) region on both measures. Cambodia lags behind most ASEAN members when it comes to digital adoption at the firm level, especially among domestic SMEs.<sup>13</sup> Fewer than one-quarter of businesses had a web presence in 2017, well below the world median of 46 percent. Cambodia also has a very low number of secure internet servers per million people. Without addressing demand-side constraints, the returns to supply-side improvements in digital infrastructure and digital skills will be limited.

**15. Firms' use of digital platforms to conduct business practices increased in response to COVID-19 but had not yet translated into significant changes in firms' business model.**<sup>14</sup> A recent series of Business Pulse Surveys (BPS) undertaken in Cambodia by the World Bank showed that by May 2021, 23 percent of firms surveyed reported having made investment in digital solutions and almost half of firms (47 percent) stated that they had increased the use of digital platforms. Among firms that had increased the use of digital platforms, most did so for marketing and sales purposes. However, around two thirds of firms still reported no digital sales, and among those that did, the majority did not see an increase in the share of digital sales in response to COVID-19. Relative to other countries in the region, Cambodia still has one of the lowest shares of firms having adopted or increased its use of digital platforms, above only Laos and Myanmar.

**16. There is an increased risk of a widening digital divide between large firms and SMEs.** The latest BPS data suggests that prior to the pandemic, large firms were more likely to use digital technologies for both customer-facing business functions such as sales, digital payments, marketing, and back-end functions such as customer relationship and supply chain management. These gaps have significantly widened further since the pandemic. Moreover, SMEs are not only less likely to have adopted digital technologies; they are also less likely to have used them *intensively*. Recent research has documented a direct relationship between firm productivity and level of technology sophistication.<sup>15</sup> A growing digital divide may translate to a productivity divide in the long term. This is a critical challenge considering that SMEs play an essential role in Cambodia's economy and represent 70 percent of employment, 99.8 percent of companies and

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<sup>11</sup> *Global Entrepreneurship Index, Global Entrepreneurship Monitor, Global Competitiveness Index, Global Innovation*

<sup>12</sup> World Bank 2018a, World Bank 2018b

<sup>13</sup> Benefiting from the Digital Economy: Cambodia Policy Note. WBG, 2018

<sup>14</sup> See the results and analysis of the series of BPS in the Cambodia Economic Update, Special focus: Adapting to COVID-19 in an uncertain world, November 2020.

<sup>15</sup> See Cirera et al. 2020: <https://www.nber.org/papers/w28080>



contribute to 58 percent of GDP.<sup>16</sup>

**17. Similarly, there is a gender gap that has persisted both before and during the COVID-19 pandemic.** Results from the BPS show that, prior to the pandemic, average revenue of female-owned or managed businesses was already 10 percent lower on average than of their male counterparts. Female-owned firms were further hit hard during the pandemic, with average losses in sales that were about 5 percentage points higher than male-owned firms. Some, but not all, of these differences are due to the sectors and location they operate in. Both female- and male-owned firms quickly adopted digital platforms in response to the pandemic. However, there remains a significant gender gap in investments in digital assets. Further, even though female-owned firms have increased the usage intensity of some digital technologies, they are still using these technologies less intensively than their male counterparts.<sup>17</sup>

**18. Accelerating digital adoption could improve Cambodia's overall competitiveness and help firms cope with future adverse shocks; including those stemming from climate change.** Recent flooding severely limited firms' ability to access services, complete payments and continue business operations. Firms that go digital will be able to move business functions online, removing the need to travel to perform basic functions, allowing marketing and sales to continue. Firms that have an online presence are also able to move business beyond their local market and to global value chains, helping diversify demand outside of Cambodia which is important when extreme weather events reduce demand locally.

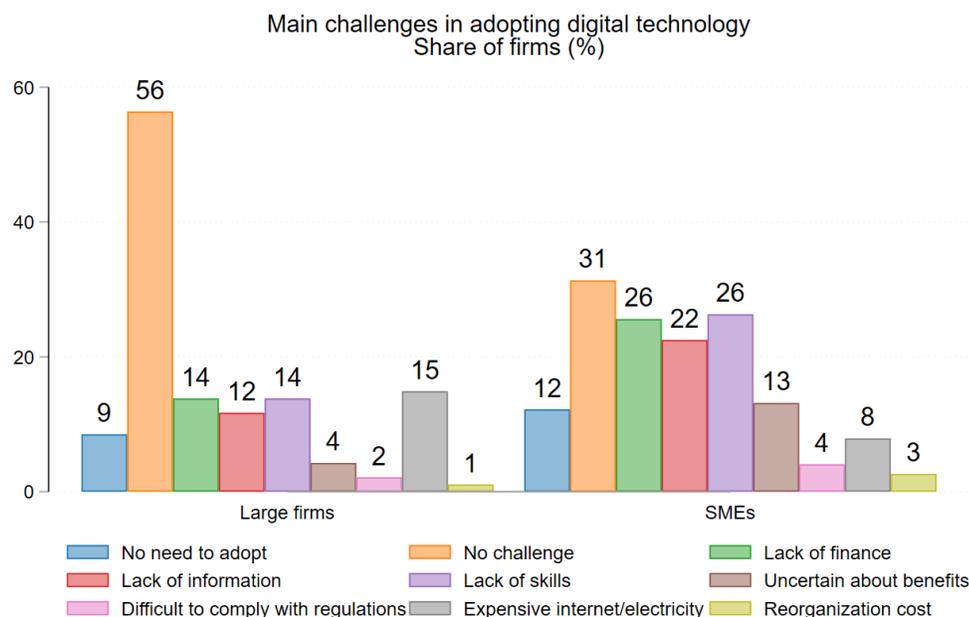
**19. However, several challenges impede digital adoption at the firm level, which have become increasingly urgent in the context of the COVID-19 pandemic especially among SMEs.** The lack of knowledge of the benefits of digital solutions, the necessary financing to obtain the technologies, and the capabilities to employ these technologies. These are becoming critical as how well firms cope with the adverse shocks of the global COVID-19 pandemic will, among other factors, depend on their ability to adjust their business model and invest in digital solutions to facilitate a less contact-intensive environment for employees and customers (for example, through e-commerce).

### Main challenges in adopting digital technology

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<sup>16</sup> Based on the 2014 Cambodia Intercensal Economic Survey, which includes unregistered firms, the total number of SMEs in Cambodia was 513,759 firms – with micro SMEs (MSMEs) representing 97 percent of the total enterprises (60 percent female owned / 95 percent non-registered) and small and medium companies representing only 2 percent of the total (26 percent female owned / 25 percent non-registered).

<sup>17</sup> Estimates based on 4 rounds of the Cambodia Business Pulse Survey, conducted between June 2020 and May 2021.



Source: Cambodia Business Pulse Survey, May 2021

**20. The lack of skills as a major obstacle to technology adoption among SMEs is unsurprising given Cambodia’s low level of human capital: Only 5 percent of Cambodia’s working-age population have completed post-secondary education.** About 78 percent have lower secondary or lower levels of education, much lower than countries with similar levels of income. When adjusted for the quality of education, the level of skills in the workforce would be even lower, by about 30 percent (HCP 2020).<sup>18</sup> While current students and younger workers who comprise the future workforce are slightly more educated than the working age population, the overall levels of skills in the digital workforce will continue to be low for the foreseeable future (World Bank, 2018). This means that a digital Cambodia will need to find ways to impart digital skills at the basic and intermediate levels suitable for the skills landscape of the current and future workforce.

**21. Several challenges prevent firms from investing in digital skills and complementary trainings.** First, though the social returns to digital skills trainings are likely to be high, the private and immediate returns may not be sufficient for private investments in training to be made. In addition, as digital skills are highly portable skills and leakage risk is high, firms themselves are unlikely to invest in improving the digital skills of their workers except when it involves digital skills that are very specific to the firm. Second, there may be constraints that suppress the demand for and/or the utilization of such training opportunities. This potentially stems from firms not having the liquidity to finance training costs, or a general lack of awareness or information about training opportunities and the resultant returns. Third, the development of digital skills may be hampered by a lack of customized digital solutions. Government intervention will therefore likely be necessary to promote private-sector led digital transformation for SMEs as well as production of digital solutions tailored to specific segments of the population, in addition to workforce trainings.

**22. Nevertheless, entrepreneurs and startups are increasingly emerging in Cambodia, mostly among the younger generation.** This is boosted by a growing young population and access to mobile phone and internet services and is supported by the growing presence of incubators, accelerators, tech hubs, innovative universities’ initiatives, and

<sup>18</sup> [https://databank.worldbank.org/data/download/hci/HCI\\_2pager\\_KHM.pdf?cid=GGH\\_e\\_hcpexternal\\_en\\_exte](https://databank.worldbank.org/data/download/hci/HCI_2pager_KHM.pdf?cid=GGH_e_hcpexternal_en_exte)



entrepreneurship programs funded by development partners. Focus groups emphasized that the digital sector, particularly mobile app development, is the most active part of the entrepreneurship and innovation ecosystem in Cambodia. SMEs in traditional sectors are however, still lagging behind while being the highest source of jobs in Cambodia.

**23. Recognizing the above challenges and opportunities, strengthening the competitiveness of domestic entrepreneurs and SMEs through innovation and digitalization is a key development priority within Cambodia's main development strategies.** Promotion of SMEs and entrepreneurship have been listed as priorities in the Rectangular Strategy of the Royal Government of Cambodia, Phase IV (under rectangle 3 on private sector and job development). The need to promote domestic enterprise development is also highlighted in its Industrial Development Policy (IDP) for 2015-2025. The IDP was adopted in 2015 and lays out the Royal Government of Cambodia's (RGC) vision to transform and modernize Cambodia's industrial structure from a labor-intensive industry to a skills-driven one by 2025 through four strategies: enhancing mobility and attracting foreign as well as private domestic investments; developing and modernizing SMEs; revisiting the regulatory environment to strengthen country competitiveness; coordinating supporting policies.

**24. Recently, in May 2021, the Royal Government of Cambodia (RGC) adopted the Cambodia Digital Economy and Social Policy Framework 2021-2035.** This detailed strategy intends to guide the development and transformation of Cambodia into a fully-fledged digital economy in the next 15 years in a coordinated and comprehensive approach. This policy framework identifies five main goals, including: (i) Digital infrastructures; (ii) Building reliability and confidence in digital system; (iii) Digital citizens; (iv) Digital government; and (v) Enabling digital businesses. This last pillar focuses on supporting enterprises—particularly SMEs—to adopt digital technologies widely, creating a conducive ecosystem for startups, and strengthening the participation of businesses in the regional and global digital chains through promoting digital technologies and technology innovation.

**25. As recognized under the Digital Economy and Social Policy Framework, the COVID-19 pandemic has reinforced the importance of digital adoption for a resilient recovery.** The DESF identifies the digital economy has having the potential to transform key industries such as tourism and e-Commerce, drive competitiveness and economic diversification. Digitalization will also help support new approaches in a post-COVID-19 world and is crucial to an effective and resilient recovery and to recovery, featuring prominently in the Government's Post-COVID-19 Economic Recovery Plan. Evidence from past crises indicates that firms that newly emerged in a downturn remain stunted throughout their lifecycle, while existing firms' profits can take up to two years to recover fully and that support—notably in the form of access to capital—can support a recovery.<sup>19</sup>

**26. The RGC has also recently established a range of financial and non-financial schemes to support firms affected by the COVID-19 crisis.** The Ministry of Economy and Finance (MEF) has notably accelerated the operationalization of support schemes for enterprises, facilitating access to loans and emergency grants, including notably: the Credit Guarantee Corporation of Cambodia (CGCC)<sup>20</sup>, the SME Co-Financing Scheme administered by the Small and Medium Enterprise Bank of Cambodia (SMEBC),<sup>21</sup> the Skills Development Fund (SDF),<sup>22</sup> and providing support to startups and SMEs through programs of the Techo Support Center (TSC), the Enterprise Development Fund (EDF) and Khmer Enterprise (KE), its operational arm.<sup>23</sup> The EDF/KE is tasked with offering a wide range of financial and non-financial support programs focusing not only on high-growth potential tech or tech-enabled startups, but also a broader set of SMEs that have growth

<sup>19</sup> de Mel, S., D. McKenzie, and C. Woodruff. 2012. "Enterprise Recovery Following Natural Disasters." *The Economic Journal*, 122(559), 64-91 and <https://www2.census.gov/ces/wp/2017/CES-WP-17-29.pdf>

<sup>20</sup> Established by a sub-decree of the Prime Minister issued in October 2020, the CGCC is a state-owned public enterprise and a non-banking financial institution.

<sup>21</sup> The SMEBC is a state-owned commercial bank recently licensed to provide affordable financing to SMEs in priority sectors.

<sup>22</sup> Ehst, M.; Sak, S.; Sanchez, M., Miguel E.; Van Nguyen, L. 2018. *Entrepreneurial Cambodia. Cambodia policy note*. World Bank, Washington, D.C.

<sup>23</sup> The Ministry of Economy and Finance Prakas No. 135 of February 2018: Establishment of Entrepreneurship Development Fund.



potential and that can operate with more traditional business models. The Ministry of Post and Telecommunications (MPTC) similarly supports a social innovation lab at the National University of Management and a Smart Techno Innovation Space at ITC. The Ministry of Industry, Science, Technology and Innovation (MISTI) is also identifying actions for SMEs and industrial clusters under its forthcoming science and technology innovation (STI) Roadmap, notably the development of an industrial technology center.

**27. Amidst the current uncertain environment for firms due to the COVID-19 pandemic, it is critical for the RGC to implement rapidly its new Digital Economic and Social Policy Framework and scale up its commitments to firms technology adoption support programs, ensuring adequate targeting and implementation capacity are in place.** Firms will have to undertake significant investments in technology and digital tools to adapt their products and selling channels to new domestic or international markets with uncertain outcomes. These investments are not well financed from traditional financing sources such as commercial banks. The RGC can therefore complement and scale up its existing firms support programs, taking stock of those implemented by the EDF and KE for instance, target SMEs identified as having viable digital investment plans and incentivize the acquisition of digital solutions and skills training.

**28. In this context, the project will enhance Cambodia’s support ecosystem through assisting government agencies and stakeholders** in developing digital roadmaps, establishing digital hubs and digital platforms to provide enterprises with information, diagnostics and skills on digitalization opportunities; it will also simplify and digitalize government procedures that affect SMEs. The project will also implement a support program that will provide incentives, high quality business knowledge and advisory services to help existing SMEs upgrade their business functions and innovate in products and processes through digitalization and technology adoption. This project also intends to reduce climate change vulnerabilities by supporting firms in moving business functions online and access global value chains, helping diversify demand outside of Cambodia which is important when extreme weather events reduce demand locally.

#### Relationship to CPF

**29. Supporting Cambodia’s digital economy agenda was agreed with the RGC in the Cambodia World Bank Group (WBG) Country Partnership Framework (CPF) 2019—23.** The CPF supports the RGC’s Rectangular Strategy Phase IV and the Industrial Development Policy and is aligned with the WBG twin goals of eliminating extreme poverty and boosting shared prosperity as well as achievement of the Sustainable Development Goals. The CPF has three focus areas: (i) promoting state efficiency and boosting private sector development; (ii) fostering human development; and (iii) improving agricultural productivity while strengthening the sustainable use of natural resources. A critical underlying theme across all three focus areas is that of governance, institutions, and citizen engagement. In the CPF, it was agreed that the WBG will advise the Government on the preparation and implementation of the Digital Economic and Social Policy Framework, including through an indicative lending project on digital economy and competitiveness.

**30. The activities in the proposed project are in line with the focus areas of the Cambodia WBG CPF 2019—23 of promoting state efficiency and boosting private sector development as well as fostering human development.** In particular, the proposed project would support the CPF objective to boost private sector development by strengthening the competitiveness of SMEs through enhanced technology adoption, access to expertise and skills training (objective 1). It also supports the CPF objective to foster human development by building skills for the digital economy through the provision of skills to SMEs’ workforce (objective 4).

**31. The proposed project further contributes to the Jobs and Economic Transformation agenda.** Several of the activities—including fostering private enterprises and upskilling—aim to create better job opportunities in Cambodia’s economy. Female employment as well as upskilling staff in strategic sectors and promising SMEs are key outcomes of the proposed operation. Ultimately, the private sector development and skills agendas are fundamental to economic



diversification with a view to support Cambodia as it moves to an economy built on greater integration and higher skilled and more productive jobs.

### C. Proposed Development Objective(s)

Accelerate the adoption of digital technologies among enterprises and their workforce to support Cambodia's economic recovery from the COVID-19 pandemic.

#### Key Results (From PCN)

- i. Number of SMEs adopting new digital technologies for business functions, of which a percentage are female owned/led.
- ii. Number of SMEs innovating in products and processes through technology adoption, of which a percentage are female owned/led.
- iii. Number of workers trained on digital skills, of which a percentage are female.

### D. Concept Description

#### **Component 1: Enhance the support environment for SMEs digitalization (US\$15 million)**

**32. This component will strengthen the effectiveness of the Governments' support to SME digitalization.** The impact of COVID-19 on the economy makes it more critical that government establishes an effective SME support system to help firms digitalize and automate their business processes and products to adapt to the changing environment. Under component 1.1, the project will support this objective through establishing an SME Digital Hub network; launching a digital portal providing access to digital solutions and services accredited for SMEs; and building roadmaps for digital business solutions and digitalization skills training schemes for SMEs based on their sectors and business growth stages. In addition, under sub-component 1.2, the project will support e-formalizing mechanisms for SMEs and their employees.

#### ***Sub-component 1.1: Strategic tools for supporting SME digitalization (USD 13 million)***

**33. The project will first establish a Digital Hub in the facilities of the new SME Center in Phnom Penh, structure its governance and capacity, and operationalize its SME digital support programs and tools.** SMEs have identified the lack of access to information and uncertainty about digitalization's benefits as some of the main challenges in adopting digital technologies. In this context, the Digital Hub will act as "first stop shop" for SMEs that intend to go digital and seek support; it will work as a platform for facilitating access to governments' initiatives aiming to accelerate digital adoption of SMEs, providing mainly information, orientation, basic digital readiness services, and connecting SMEs to specialized consultancy and training services as needed, notably subsidized services provided under component 2. This component will not finance new buildings but rather upgrade dedicated facilities in the existing SME Center in Phnom Penh, ensuring that they are retrofitted with materials to withstand climate hazards and/or energy efficient computing systems,



strengthen the Hub's core digital expertise and build capacity in areas critical to its success, including its governance<sup>24</sup>, staff ability to provide adequate outreach and information, basic digital readiness diagnostic, identify digital solutions for SMEs and mobilize expertise, skills and incentives to digitalize SMEs.

**34. The SME Digital Hub will collaborate with other stakeholders to enhance the overall effectiveness of the SME support system, and steer SME's digitalization towards solutions that contribute to climate change reduction, social inclusion, and gender.** Digital hub's staff training will include modules on how digitalization can contribute to climate resilience and to the growth of female-owned enterprises. They would also be trained to conduct communication and outreach activities to increase awareness on benefits of digitalization among SMEs that are on the lower end of the productivity and skills distribution. Awareness activities would also target banks and payment service institutions about the needs of SMEs and help them develop digital products that more adequately serve these enterprises. Another critical role for the Digital Hub staff will be to increase awareness among SMEs about the implications of digitalization in terms of the SMEs' overall business processes and workforce skills needs. This will notably include non-digital skills that complement digital skills, such as cognitive skills (such as communication and problem solving) and socioemotional skills, as it has been extensively documented that usage of digital skills also comes with usage of such other skills, something of particular importance for Cambodia, given the low education levels of its workforce.<sup>25</sup> The project will also ensure that training schedules can be adapted to the specific needs of women, if the case, and consider the use of female role models to encourage digital adaptation.

**35. During project appraisal, in order to increase reach and inclusivity, the project will explore the financing of local, smaller, Digital Hubs in urban centers with a high number of SMEs.** These hubs would be embedded in business associations or other local institutions active in the local SMEs and entrepreneurship ecosystems. In the same way as the Central Digital Hub, these local Digital Hubs will be established in existing local institutions' offices and act as "first stop shops" for local entrepreneurs and SMEs eager to learn more about digital solutions and access support for solutions and training. The hosts and operators of the local Digital Hubs will be selected based on demonstrated capacity and knowledge of the local industries and SMEs digitalization needs. They will be trained in mastering the information, awareness program, digital readiness diagnostic, digital solutions and services provided in the SMEs GO Digital platform and the SME support program described below.

**36. Second, the project will finance an "SMEs Go Digital Portal" offering a range of accredited digital solutions for SMEs.** The project will support the establishment of this platform and (i) Identify and adapt available international and domestic software and mobile platform-based applications for general business functions, including digital payments, which can suit the language and specific needs and different levels of workforce skills of Cambodian SMEs, and (ii) Support local ICT and fintech firms in the development of new software, mobile platform-based applications, and content for improving the efficiency and effectiveness of SMEs. Pre-approved digital solutions for SMEs will be available on the SME Go Digital portal, and Digital Hubs will provide SMEs with awareness, diagnostic, guidance, and training to access and use these solutions. SMEs willing to adopt these solutions may apply for up to a determined percentage of co-financing under component 2 of the project, covering the costs of acquisition, in addition to free consultancy and training to facilitate the adoption and use of the chosen solutions. The portal would offer training modules on the most common digital solutions, adapted for different skill levels and/or needs. The project will ensure that the governance of this portal is efficient and explore contracting out its management to an independent entity, public or private, in charge of ensuring an extensive promotion of the platform and updating its offering on a regular basis. This portal will be interconnected and linked to the information gateway for SMEs to be launched by the Ministry of Industry, Science, Technology and Innovation (MISTI)

<sup>24</sup> Refurbishing of facilities would include climate resilient measures such as retrofitting with materials to withstand climate hazards and/or energy efficient computing systems that include certifications such as Green Start or HQE.

<sup>25</sup> OECD. 2016. "Skills for a Digital World: 2016 Ministerial Meeting on the Digital Economy Background Report." *OECD Digital Economy Papers* 250; OECD. 2019. *OECD Skills Outlook 2019: Thriving in a Digital World*.



by the end of 2021 (i.e., “Khmer SME”).<sup>26</sup>

**37. Third, to ensure that these policy actions are well grounded in SMEs and sector-specific needs, the project will undertake a series of stakeholder consultations, expert assessments, and design sector-specific roadmaps on digital solutions and digital skills training.** These activities will provide needed assessment for the digitalization of priority sectors, identify digital business solutions for SMEs and related digitalization skills training schemes. Structured consultations between Government and Private Sector will involve sector-specific representatives and business associations directly involved with SMEs.<sup>27</sup> The roadmaps on digital solutions and digital skills training will guide SMEs in digital transformation by providing SMEs with a simple guide on useful digital solutions that SMEs in each specific sector can adopt at each stage of their business growth and contain information on relevant training schemes for them to upskill their employees.<sup>28</sup>

### ***Sub-component 1.2: Streamlining and digitalizing critical government procedures for SMEs (USD 2 million)***

**38. The project will support the digitalization of application and obtention processes for licenses critical for SME operations.** As discussed above, the cost, complexity and lack of transparency of government regulations and procedures that apply to businesses is not conducive to enterprise formalization and development. Informality is one of the reasons why Cambodia’s businesses do not effectively invest in digitalization, as informal businesses do not access formal finance, services, and development programs, and they seldom access more sophisticated markets which require digitalization of processes. In addition, by having access to digital G2B services, businesses are encouraged to invest more in their own digitalization and develop digital skills to effectively use these services.

**39. While the Government has already started simplifying processes for paying taxes and launched a company registration portal, much remains to be done to streamline and reduce procedural friction.** SMEs in Cambodia are often required to obtain several licenses from a wide range of government agencies, depending on business activity, firm size, and location.<sup>29</sup> There is no inventory of licenses with transparent information about the procedural requirements for each license and the compliance costs for businesses are high.

**40. This sub-component will support a stock-taking of the licensing requirements for businesses with the aim to (i) make transparent the requirements for each license; (ii) simplify the requirements for licensing by changing the necessary regulations; and (iii) allow businesses to request, pay for, and receive licenses online.** Online processes will allow firms to avoid travelling to various places multiple times as well as avoid submitting the same documents to multiple agencies. This will contribute to reducing the carbon footprint of compliance procedures for firms and allow them to continue accessing government to businesses services in case of an extreme weather event. The existing infrastructure of the Government’s registration portal will be utilized where a pilot to connect several ministries and receive four

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<sup>26</sup> Khmer SME will not offer transactional services in the near term and will focus on providing up-to-date information to business owners relating to markets, financing, technology transfer, export-import. It will act as a gateway to more specialized portals such as the SMEs Go Digital portal financed under the project.

<sup>27</sup> Business associations such as the Federation of Small and Medium, Enterprises of Cambodia (FASMEC), Young Entrepreneurs Association of Cambodia (YEAC) and Cambodia Women Entrepreneurs Association (CWEA) will be involved in the preparation of the roadmaps.

<sup>28</sup> For instance, a guide for the digital solutions for SMEs in food manufacturing will be different from a guide for the digital solutions for SMEs in retail and wholesale.

<sup>29</sup> These licenses include for instance the Certificate of Incorporation (Business Registration), Tourism License, Food Processing Operating License, Tax Registration for Patent Tax, VAT Number and Stamp Tax, Location Approval License, Registration for Opening Enterprise, Establishment Ledger, Payroll and Internal Work Rule, Tax Permit on Sign Board and Permit on Sign Board, etc.



specialized licenses has already been launched.<sup>30</sup> The Deputy Prime Minister and Minister of MEF has been leading this initiative, which will ensure the necessary coordination of different agencies for the implementation of the sub-component.

## **Component 2: Incentivize SMEs digital solutions adoption and technology transformation (US\$22 million)**

**41. The objective of this component is to incentivize and support digital adoption and technology transformation of Cambodia's SMEs.** This component will address the gap in accessing finance, skills and specialized expertise identified by SMEs in recent surveys. It will do so by implementing a targeted matching grant program that supports SME investments in digital solutions and technology adoption. This program would complement and scale up the Government of Cambodia's recent support program of small grants to SMEs implemented by Khmer Enterprise (KE) and/or the Skills Development Fund (SDF) and provide a match-making service to connect participating SMEs with commercial banks, the SMEBC, Microfinance Institutions and other sources of finance.

**42.** The project support will be tailored in two separate windows with specific access criteria for co-financing:

- (a) ***The digitalization of SMEs' general business functions (i.e. managerial tools, accounting, sales, digital marketing, digital payments).*** The project will co-finance the SMEs acquisition of accredited digital solutions available on the SMEs Go Digital Portal developed under component 1 and mobilize consultancy services and skills training needed to ensure that SMEs formalize their operations, actually use the digital solutions, develop their own websites and access e-commerce platforms. The financing will cover up to determined ceiling of the formalization and acquisition costs up to a pre-determined ceiling depending on the type of solutions identified (e.g., up to 70 percent of the costs, with a ceiling of around USD 3,000-4000 of grants to be further assessed and determined during project appraisal). The costs of consultancy and workers' training will be covered and provided through a roster of pre-cleared vendors. The objective of this window is to reach a relatively large number of SMEs and startups (e.g., around 3,000-4,000). This component will implement a pilot with a first batch of SMEs to demonstrate the 'business case' for critical innovative digital technologies that are not currently being used by the majority of small businesses in Cambodia. The key requirement being that the SMEs supported by the program agree on delivering results in terms of 'demonstration effect', which can translate into replication by other small businesses.
- (b) ***Customized digitalization and technology adoption of SMEs, clusters or supply chains with growth and job creation potential in priority sectors such as food manufacturing, wholesale and retail, IT services, and food services.*** In this case, the project will support the digitalization and automation of select growth SMEs, clusters and linkages to upgrade productivity, product quality and access more lucrative markets, including export markets.<sup>31</sup> The financing of digital solutions and automated technologies would be used to modernize supply chain management, production processes, sales and marketing, service delivery, and payments and financial management. A maximum ceiling of co-financing by the project (e.g., up to USD 40,000 matching grant, to be assessed during project appraisal) as well as minimum percent of co-financing by the private sector would be determined along good international practices and Cambodia's context (e.g., between 40-70 percent of the investment plan financed by the program, the remaining part

<sup>30</sup> Since June 2020, the Government of Cambodia has launched the registration services portal (<https://www.registrationservices.gov.kh/en/home/>), empowered by CAM DX, the Government data exchange system. The first phase of the portal was to allow online business registration through a single portal with four agencies: Ministry of Commerce, MEF, General Department of Taxation, Ministry of Labor and Vocational Training. Phase 2 of this project was launched in September 2022 and pilots the simplification and online issuance of 8 specialized licenses linking to the system four other agencies: the Ministry of Industry, Science, Technology and Innovation, the Ministry of Tourism, the Ministry of Posts and Telecommunications and the Non-Banking Financial Services Authority.

<sup>31</sup> A blacklist of specific sectors will be included in project design. Environmental and social impacts will also be considered in the selection criteria.



to be funded by firms' own resources and/or SME loans). This activity will also identify a mechanism to ensure complementarity with existing financing available to SMEs such as KE's small grant programs, credit guarantees, SME loans, or equity investments. This support will be accessible to around 200-300 sub-projects through individual or group applications and to SME business centers, startup incubators, and accelerators, such as the Digital Innovation Center, Fab-Labs initiatives supported by other agencies and donors. A cluster or sector-level approach may be particularly relevant for sector-wide training and to decrease firm concerns about poaching, which have been reported by Cambodian SMEs.

**43. A key feature of the support provided to firms under component 2 will be a diagnostic of the implications of digitalization in terms of firms' business processes and skills needs.** SMEs benefitting from digital support will undergo a prior digital diagnostic that will validate digital needs and potential solutions. These would pay particular attention to implications in terms of skills needs and compare those to the skills of the existing SME workers. A key dimension will be to distinguish between those skills on which the existing workforce may be trained versus those needs that may be outsourced.<sup>32</sup>

**44. The program eligible expenditures would include purchase of digital devices, associated digital content, skills training, technology consulting services and compliance costs, including legal and accounting services.** It could also fund not just procurement of technologies but also business advisory services and technology extension services that focus directly on mentorship/guidance/support to equip firms with the capabilities to use appropriate technologies, also including advice on digital payment acceptance solutions firms could adopt. An outreach and media campaign around the program itself as well as the benefits of adopting technologies for SMEs will also be undertaken as part of this activity.

**45. The project will develop specific tools and services to ensure that climate resilience is supported.** The project will contribute to reduce climate change vulnerabilities from increased flood risk by supporting firms in moving business functions online, removing the need to travel to perform basic functions, allowing marketing and sales to continue. The project activities will also help firms move business beyond their local market and to global value chains, helping diversify demand outside of Cambodia which is important when extreme weather events reduce demand locally.

**46. The project will enhance the availability and accessibility of digital solutions, services and skills training for female entrepreneurs and workers in priority areas.** The project will ensure that digital information, services, training and incentives respond to female entrepreneurs' needs. The project will collect and report gender-disaggregated data on the SMEs GO Digital Hubs and Portal clients to measure and adapt to specific gaps in services relevant for female entrepreneurs and workers, as well as of gender imbalances in the rate of digital solutions uptake. In addition, to assist female entrepreneurs and workers in gaining technical know-how, the implementation of the program supporting the adoption of transactional and informational digital solutions will target specifically female-led SMEs with gender-disaggregated targets. The project will be mindful that female uptake of technology and digital solutions (both in the workforce and in daily life) may be related to lower education levels, lack of business networks and/or low aspirations, family responsibilities, concerns about online safety, and gender stereotypes surrounding the use of ICT, and, again noting that cognitive and socioemotional skills are complements to digital skills, it will encourage SMEs to also receive trainings on these complementary skills.

### Component 3: Project Management (US\$3 million)

**47. The project will be implemented by the MEF through designated implementing units in charge of relevant components and activities, identified during project preparation and appraisal.** The project will rely on autonomous

<sup>32</sup> Anderson, Stephen J.; McKenzie, David. 2020. Improving Business Practices and the Boundary of the Entrepreneur: A Randomized Experiment Comparing Training, Consulting, Insourcing and Outsourcing. Policy Research Working Paper No. 9502. World Bank, Washington, DC. © World Bank.



implementation units of the MEF such as the Techo Support Center (TSC), the EDF/KE, and the SDF, which have been created, staffed and have already piloted and implemented SME support programs and digital entrepreneurship activities in the challenging COVID-19 context. In addition, the project will require a strong coordination within the MEF and other ministries involved in SME development, ICT sector development and skills training, such as the Ministry of Industry, Science, Technology and Innovation (MISTI), the Ministry of Post and Telecommunications (MPTC) and the DG-TVET in the Ministry of Labor and Vocational Affairs. A Project Steering Committee (PSC) would therefore be established by the MEF with representatives from these ministries to provide strategic guidance and inter-ministerial coordination. The Digital Economy and Business Committee established under the National Digital Economy and Society Council for overseeing and monitoring the implementation of the “Digital Business” pillar of the recent Cambodia Digital Economic and Social Policy Framework 2021-2030 could fulfill the PSC’s role.

**48. Component 3 would consist of support to finance project management related issues** including project coordination, procurement, financial management, monitoring & evaluation, project communication, citizen engagement, and environmental and social safeguards. This component would also provide support through office equipment, incremental operating costs, and audits. It would also include technical assistance to strengthen the capacity of the project implementing agencies on social safeguards.

**Component 4: Contingent Emergency Response Component (US\$0)**

**49. A Contingent Emergency Response Component (CERC) is added to the project structure.** This will have an initial zero value but may be financed during the course of the project to allow for an agile response to an eligible crisis or emergency. Adding the component in from the beginning, albeit with zero funding, provides for flexibility to respond to crisis as they arise, and the PIM will be adapted to guide the utilization of this component including risk mitigation strategies. This could include, for instance, environmental disasters that require the provision of emergency infrastructure to replace facilities that have been damaged, or a significant local outbreak of COVID-19 that requires urgent response in the form of additional broadband internet for Government offices (especially health centers and hospitals) or Government employees working from home.

Legal Operational Policies	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	No

Summary of Screening of Environmental and Social Risks and Impacts



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**Approved By**

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