

# **Tracking surveys on the impacts of COVID-19 on formal and informal MSMEs in Cambodia<sup>1</sup>**

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## **Abstract**

This paper seeks to examine if and how formal and informal micro, small and medium-sized enterprises (MSMEs) in Cambodia have been impacted differently by the COVID-19 pandemic. Drawing on a four-wave longitudinal survey (with replacement), which the United Nations Development Programme (UNDP) Cambodia commissioned from July 2020 to November 2021, the study looks at impacts on business operation, debt status, coping mechanisms, and entitlement to government support programmes. The study's panel data revealed that all enterprises, regardless of formal status, were greatly affected by the pandemic during the observed period. The demand for products and services, supply chains, and profit were severely impacted, particularly in the fourth wave of data collection in October/November 2021 in the aftermath of the 20 February event of large-scale COVID-19 community transmission. Although there are no statistically significant differences in the nature and scale of impacts (demand, supply, and profit) between formal and informal enterprises, formal MSMEs appeared to be in a better position to respond to shocks and did not have to take the common negative coping strategies undertaken by informal enterprises, such as taking additional loans, selling assets, negotiating with landlords on rental deferral, or temporarily closing businesses. Informal enterprises also reported challenges accessing new loans. While only five percent of formal enterprises reported that they received support from the government during the COVID-19 pandemic, mostly through partial/total salary subsidy, tax exemption, and utility and rental subsidy, none of the informal enterprises reported receiving any type of support over the same time period. Overall, formal MSMEs appeared to be more resilient to COVID-19 with less debt uptake, easier access to loans, and higher likelihood of receiving government support, although the percentage is still low.

## I. Background

In 2020, more than two billion workers earned their living in the informal economy worldwide. Informal employment represents 90 percent of total employment in low-income countries and 67 percent in middle-income countries (ILO, 2020). According to the 2019 Cambodia Labor Force Survey, the share of informal employment in Cambodia is approximately 88 percent. The global shock resulting from the COVID-19 pandemic has had a detrimental effect on Cambodia's economy, particularly on the key growth drivers such as tourism, construction, and manufacturing exports, which combined, account for more than 70 percent of the country's GDP growth. A recent study by the United Nations Development Programme (UNDP) and the Ministry of Economy and Finance (MEF) showed that COVID-19 caused a significant loss of jobs and income, especially for those working in the informal sector (UNDP and MEF, 2020). It estimated an economic contraction of -4.1 percent of GDP in 2020, alongside an increase in poverty. The increase would reach 17.6 percent in 2020 in the absence of any social protection stimulus, compared to pre-pandemic estimates of 9.6 percent for the same year. The recent poverty figure of the Royal Government of Cambodia of 17.8 percent confirmed the study's estimations, although the increase in the official poverty rate was partially due to the revised poverty line from approximately US\$1.00 in 2014 to around US\$2.70 in 2019-2020 (RGC, 2021).

When COVID-19 arrived in the country in February 2020, UNDP Cambodia rolled out a panel survey to track the socioeconomic impacts of the pandemic on micro, small and medium-sized enterprises (MSMEs) across the country. One main finding of the survey was that 77 percent of them were unregistered and did not pay taxes, which are the main determinants of informality (ILO, 2015). The survey result is featured online as part of UNDP Cambodia's *Data for Cambodia* dashboards.<sup>5</sup> The insights gathered from the dashboards reflected the varied and far-reaching effects of the pandemic on MSMEs and the intersectionality of the impacts among them.

This policy brief aims to look into the implication of the formality status of MSMEs on the extent of the socioeconomic impact from the COVID-19 pandemic to establish a more nuanced understanding of the different vulnerabilities faced by formal and informal enterprises. The

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<sup>5</sup> The UNDP *Data for Cambodia* dashboards can be accessed at <https://www.dataforcambodia.org/>

empirical findings will generate recommendations for policy makers to address the consequences of the COVID-19 pandemic on MSMEs.

## **II. Research methodology**

### **Research questions**

In response to the aforementioned objective, this paper aims to answer, specifically, the following questions:

1. What were the impacts of COVID-19 on formal and informal MSMEs in different aspects such as demand, supply, and profit (disaggregated by sector, owner's gender, and location/province)?
2. How did the impacts of COVID-19 affect the debt status of formal and informal MSMEs?
3. What were the coping mechanisms used by formal and informal MSMEs? How was their ability to absorb shocks and resilience impacted?
4. Did formal and informal MSMEs receive the government stimulus package or any other forms of assistance?

### **Method**

MSMEs in this study are identified as per the definition of the Royal Government of Cambodia's Sub-committee on SME Secretariat, as follows:

1. Micro – enterprises with fewer than 11 employees
2. Small – enterprises with 11-50 employees
3. Medium – enterprises with 51-100 employees
4. Large - enterprises with >100 employees

According to the Cambodia Inter-censal Economic Survey 2014, only 7 percent of these establishments are registered with any relevant government entity. With this in mind, both registered and non-registered MSMEs were included in the study. Formal enterprises are defined in this study as those that (1) are registered and (2) pay tax. Otherwise, they are considered as informal enterprises.

The study employed a telephone interviewing panel study (with replacement) involving four rounds of data collection. This panel study allows for observation on the nature and scale of the impacts on surveyed MSMEs, and for changes to be documented over time over a period of 16 months. The first and second waves were conducted in 2020 to understand both the nature and scale of COVID-19 impacts on MSMEs. The third and the fourth waves were completed in 2021 to map changes over time. Below is the detailed sample size and date of each phase.

|             | Wave 1       | Wave 2       | Wave 3       | Wave 4       |
|-------------|--------------|--------------|--------------|--------------|
| Sample size | 514          | 504          | 482          | 509          |
| Date        | Jul/Aug 2020 | Oct/Nov 2020 | Jan/Feb 2021 | Oct/Nov 2021 |

A significance test (chi-square) was conducted across the four waves to see if there is a significant difference between formal and informal MSMEs.

### **Sampling strategy**

Quantitative sampling was used for the study. The surveys of MSMEs were randomly conducted in five provinces/capital cities across the regions of Phnom Penh, Kampong Cham, Battambang, Siem Reap, and Kandal. Respondents and the quota sampling, stratified by the main business types, were the same in the various survey rounds. Interviews were undertaken exclusively with the owner, general manager, or legal representative of MSMEs. Respondents that could not be reached for re-interviewing were replaced with a new sample.

### **Limitations**

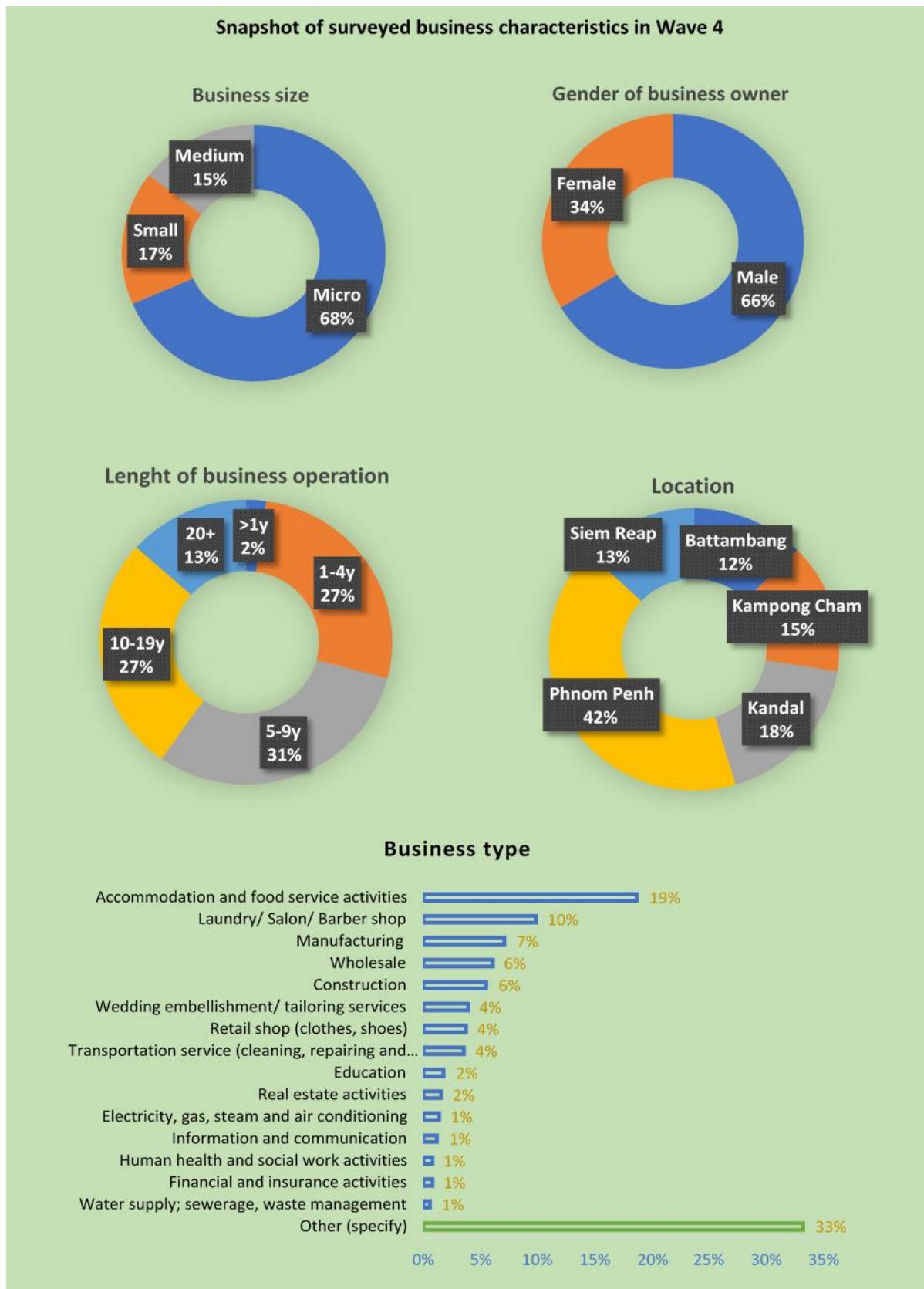
The data for this study was collected by two different research companies (Round 1-3 and Round 4). Due to a change in data collection firms and to comply with the General Data Protection Regulation (GDPR), respondents from the first three rounds were asked if their contact information could be shared with the new agency. One hundred and thirteen respondents declined, resulting in a high attrition rate. To keep a balanced sample, 140 new samples were added in Round 4. This came with a cost, as it could affect comparability of longitudinal data.

### **III. Key findings**

#### **Snapshot of surveyed MSME characteristics**

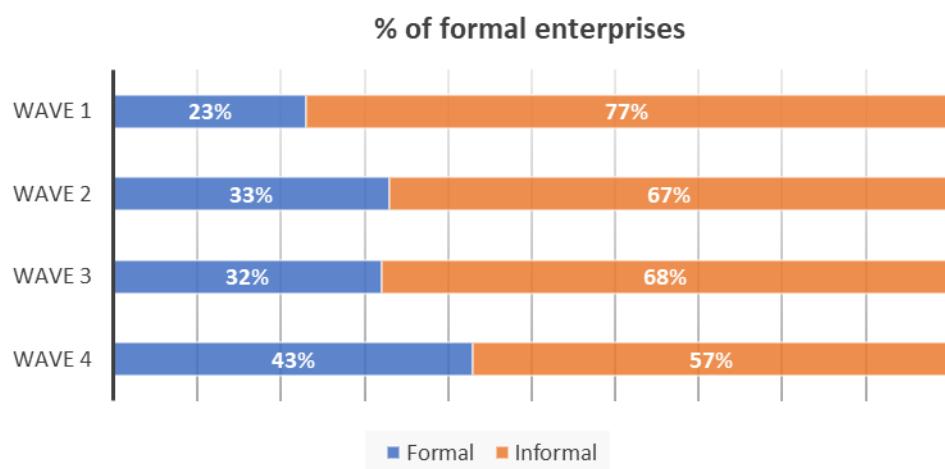
While in Wave 1 about 95 percent of the surveyed MSMEs were micro enterprises, the proportion of small and medium enterprises increased substantially in Wave 4. In the fourth wave, micro enterprises only accounted for 68 percent of the total sample, while small enterprises increased to 17 percent and medium enterprises increased to 15 percent (Graph 1).

Graph 1: Snapshot of surveyed business characteristics in Wave 4



In terms of formality status and according to the following graph, the size of formal enterprises in the surveys increased substantially from 23 percent in Wave 1 to 43 percent in Wave 4 (Graph 2). The increase is attributable to the increase in small and medium enterprise samples which are mostly formal in nature.

Graph 2: Formality status of interviewed MSMEs

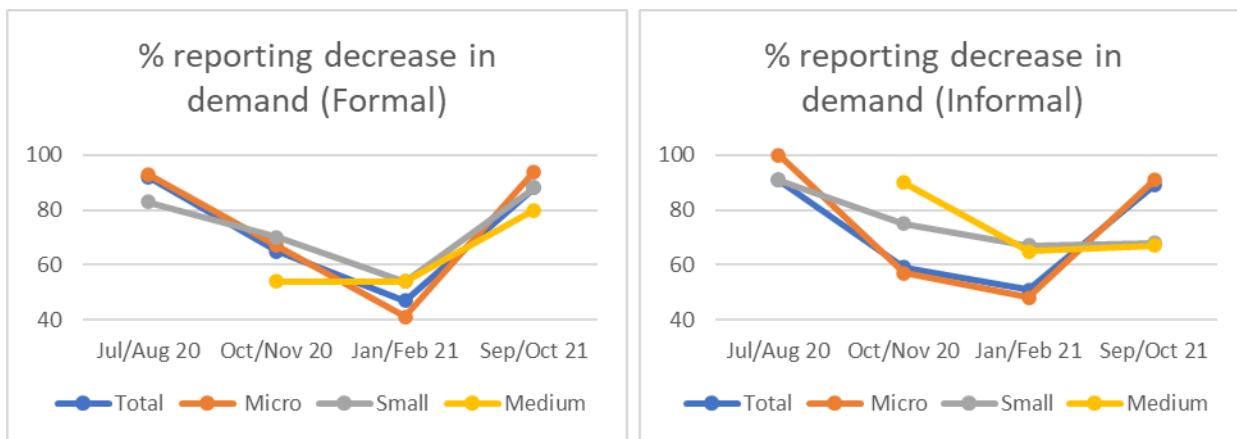


### Economic impacts of COVID-19 on formal and informal MSMEs

- *Changes in demand for goods and services of MSMEs*

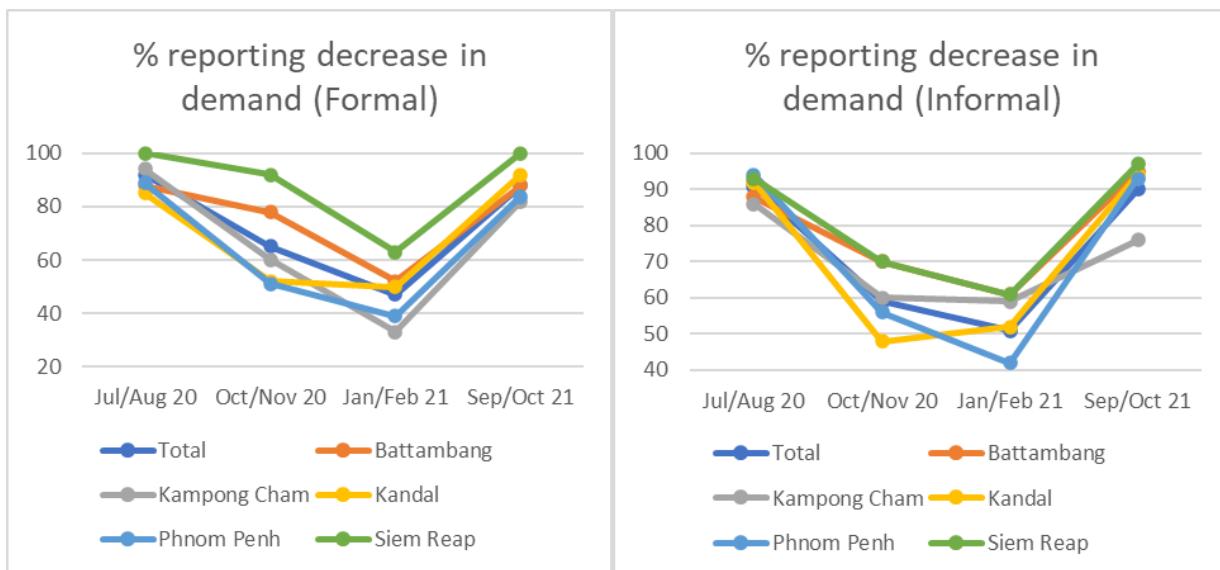
A large majority of formal and informal MSMEs across the four waves reported a decrease in demand for their products and services (with statistical significance, chi-square of 99 percent confidence level), especially in July/August 2020 and in September/October 2021 just after the country implemented strict lockdowns, curfews, and travel restrictions as a result of the 20 February 2021 community event - the most recent and longest community transmission of the COVID-19 virus (Graph 3). In October/November 2020 and January/February 2021, businesses started to recover and reported less of a decrease in demand compared with July 2020 and October 2021.

Graph 3: COVID-19 impacts on demand over time



When disaggregated by province (Graph 4), MSMEs in Siem Reap were found to be the most severely affected due to the reduction in demand, especially among the formal MSMEs, most probably due to the decline in international tourists.<sup>6</sup> This is statistically significant at a 99 percent confidence level. However, overall there is no significant difference between formal and informal enterprises in reporting a decrease in demand across the four rounds ( $p>0.05$ ).

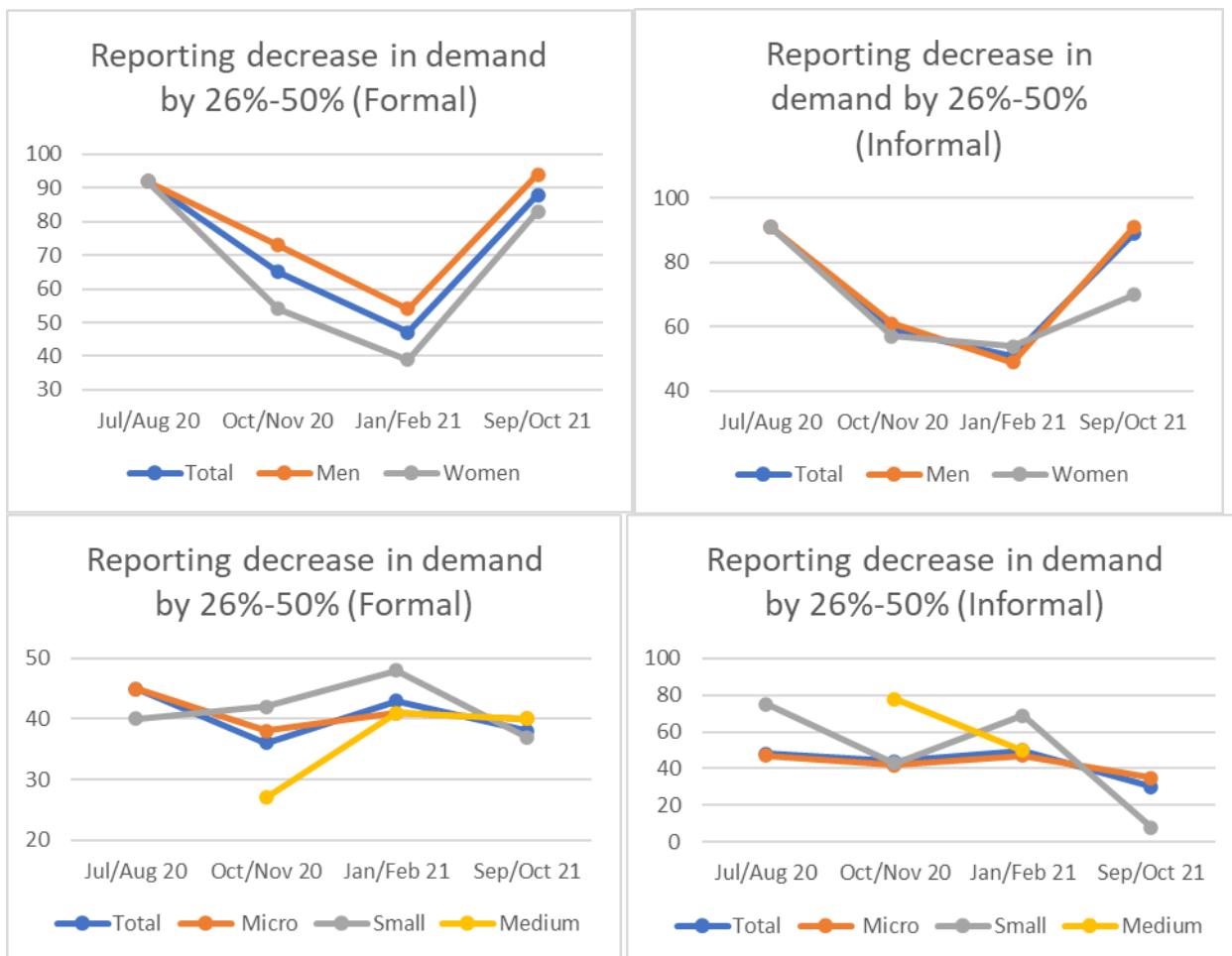
Graph 4: COVID-19 impact on demand by MSME location



<sup>6</sup> Decline of international tourist arrivals can be tracked through the UNDP *Data for Cambodia* dashboard: <https://www.dataforcambodia.org/covid-impact-on-mobility>

When asked about the extent of decline in demand, about 90 percent of the MSMEs reported a decline between 26 percent and 50 percent in Wave 4 compared to the pre-pandemic period. No significant difference in impacts was reported between businesses owned by men or women (Graph 5). Notwithstanding, women-owned businesses in the informal sector were less likely to report a decline of 26 percent to 50 percent in demand (70 percent informal compared to 83 percent formal MSMEs). In Wave 1, while most informal small enterprises (nearly 80 percent) reportedly saw a decline in their demand of 26 percent to 50 percent, less than 50 percent of the formal small enterprises reported this decline. However, in Wave 4, only businesses in the informal economy had a statistically significant difference according to the size of the enterprise ( $p=0.01$ ). There was no significant difference associated with the size of the enterprise among formal MSMEs ( $p>0.05$ ).

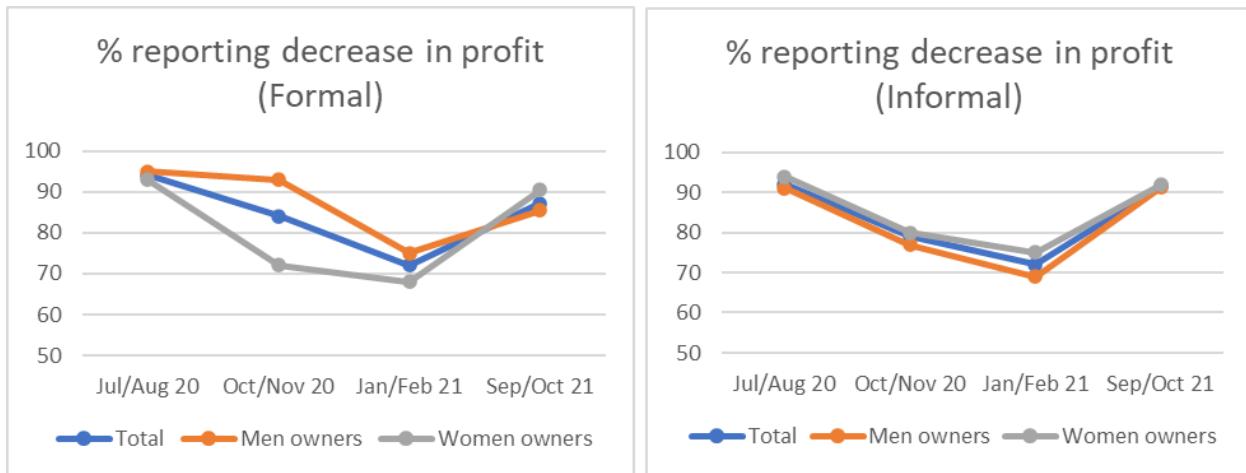
Graph 5: COVID-19 impact on demand over time and by MSME ownership (gender)



- *Profit changes*

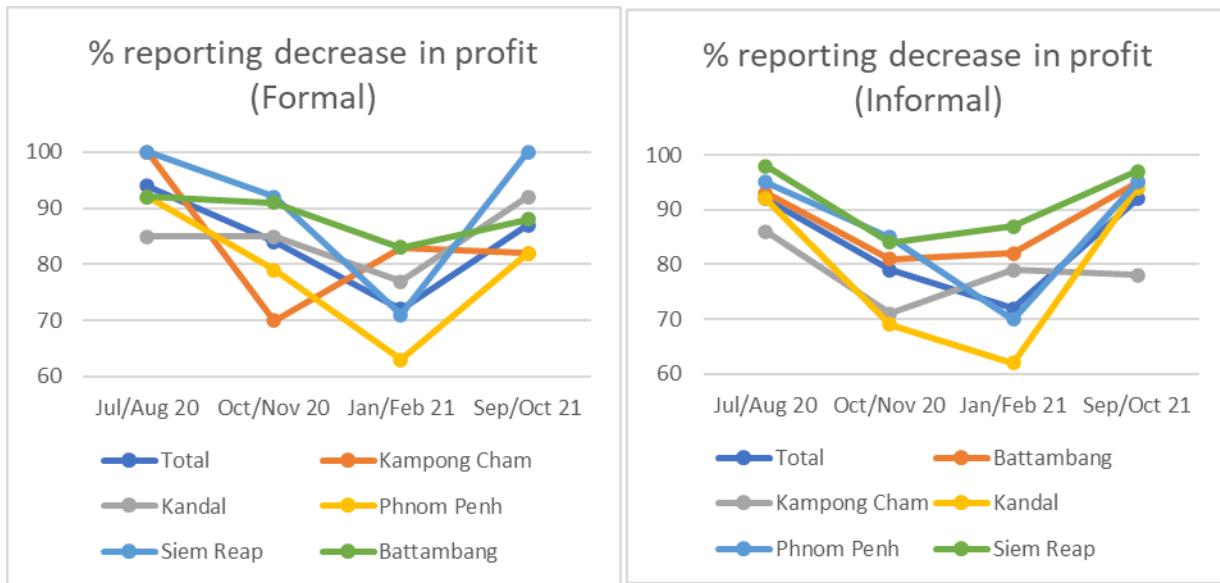
Statistically, there is no significant difference between formal and informal enterprises in reporting reduction of profit from Wave 1 to Wave 4 ( $p>0.05$ ). Over 90 percent of the men and women-owned enterprises, both formal and informal ones, reportedly had a decline in profit in Wave 1, while the profit margin improved in Waves 2 and 3 before it deteriorated again in Wave 4 (Graph 6).

Graph 6: COVID-19 impact on profit over time and by MSME ownership (gender)



In provincial disaggregation (Graph 7), all formal MSMEs in Siem Reap reported the largest decline in profit in Wave 1 and Wave 4, while informal enterprises were slightly less likely to report a profit reduction over the same period. However, the differences of profit decline are not significant when disaggregated by gender, business size, and province for both formal and informal MSMEs ( $p>0.05$ ).

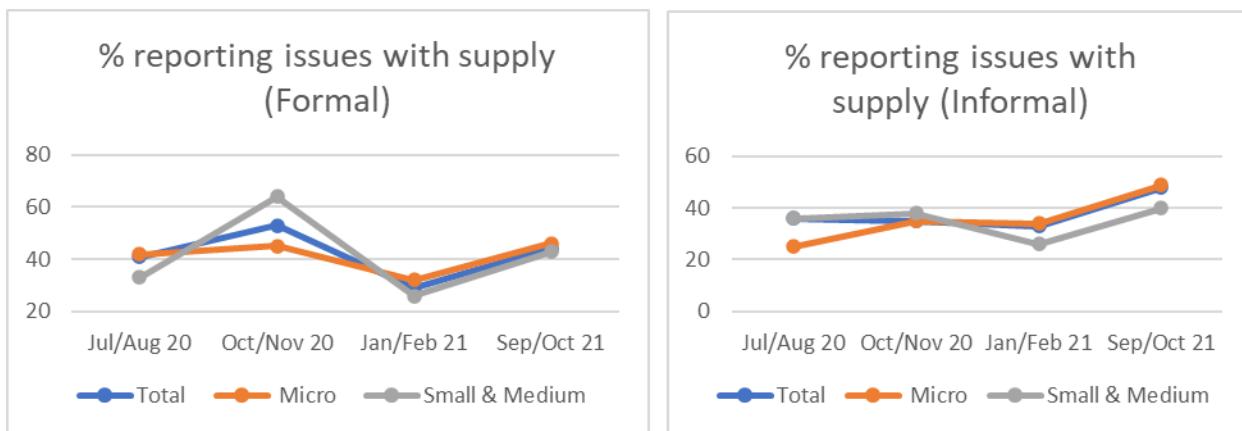
Graph 7: COVID-19 impact on profit by MSME location



- *Impact on supply (inputs and raw materials)*

Statistically, there is no significant difference between formal and informal enterprises in reporting supply issues over the observed periods ( $p>0.05$ ). Between 42 percent and 64 percent of formal MSMEs reported having issues with supply (inputs and raw materials) in October/November 2020 when stricter travel restrictions were imposed in light of the country registering its first community outbreak and disruption to supply chains from major economies such as China (Graph 8). Supply issues abated in January/February 2021 before they rose again to over 40 percent after the 20 February 2021 event. Informal MSMEs have faced a similar level of supply related issues as formal ones. For formal enterprises, significant differences were observed when disaggregated by the size of enterprises and gender of the owner/manager across Waves 2, 3, and 4 ( $p=0.001$ ). No significant difference was reported for informal enterprises. In contrast, when disaggregated by province, there is a statistically significant difference in supply issues for informal MSMEs but not for the formal MSMEs.

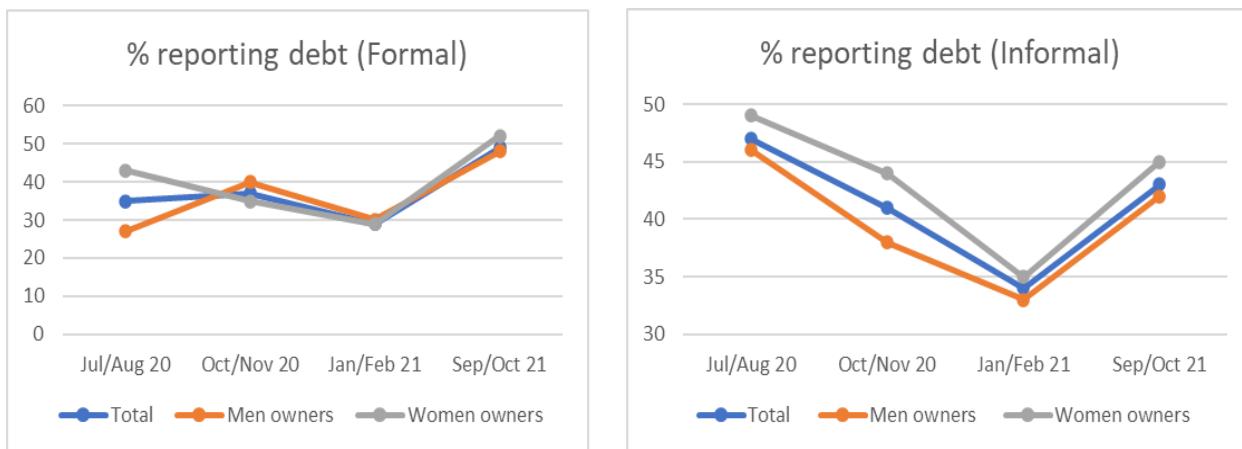
Graph 8: COVID-19 impacts on supply over time



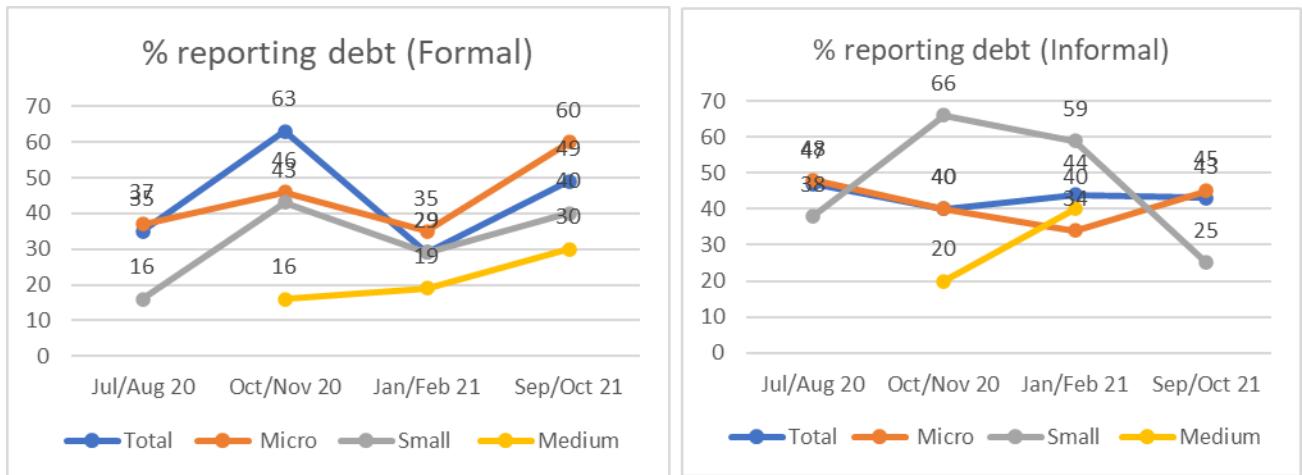
### Debt status of formal and informal MSMEs

Across the four waves, there is a significant difference between formal and informal enterprises when reporting holding debt (at a 99 percent confidence level). By September/October 2021, the level of debt among MSMEs increased, and in that increase, a slightly higher percentage of women-owned enterprises reported debt, compared to men-owned enterprises. Approximately five in 10 formal MSMEs, and four in 10 informal MSMEs were in debt. Meanwhile, formal MSMEs, especially micro enterprises, were more likely to report an increase in debt between July/August 2020 and September/October 2021, compared with that of the informal enterprises (Graph 10).

Graph 9: COVID-19 impact on MSME debt status over time and by ownership (gender)

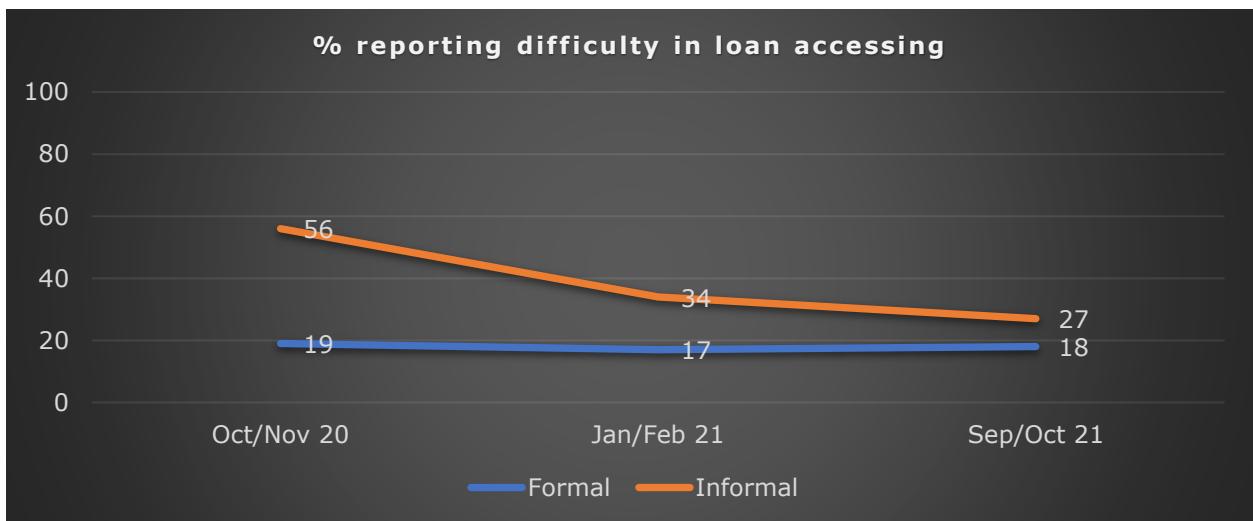


Graph 10: COVID-19 impact on MSME debt by MSME size and formality status



Loan access was more difficult among informal MSMEs (27 percent) compared to formal MSMEs (18 percent) in general, despite some improvement for informal MSMEs within a year, from October 2020 (56 percent) to October 2021 (27 percent). This is statistically significant at a 95 percent confidence level (Graph 11).

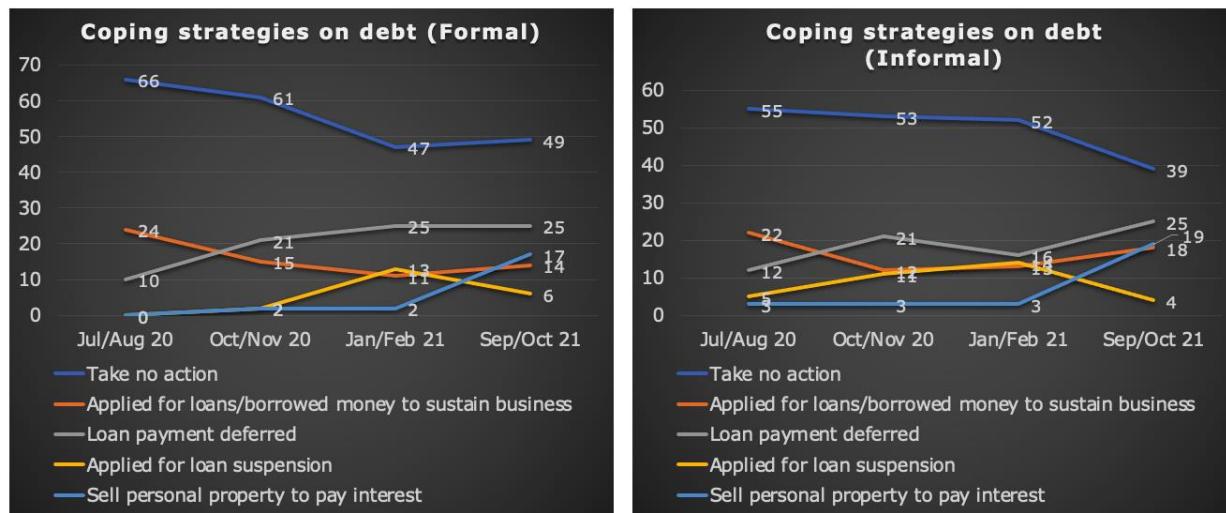
Graph 11: MSME loan access by formality status



## Coping mechanisms of formal and informal MSMEs

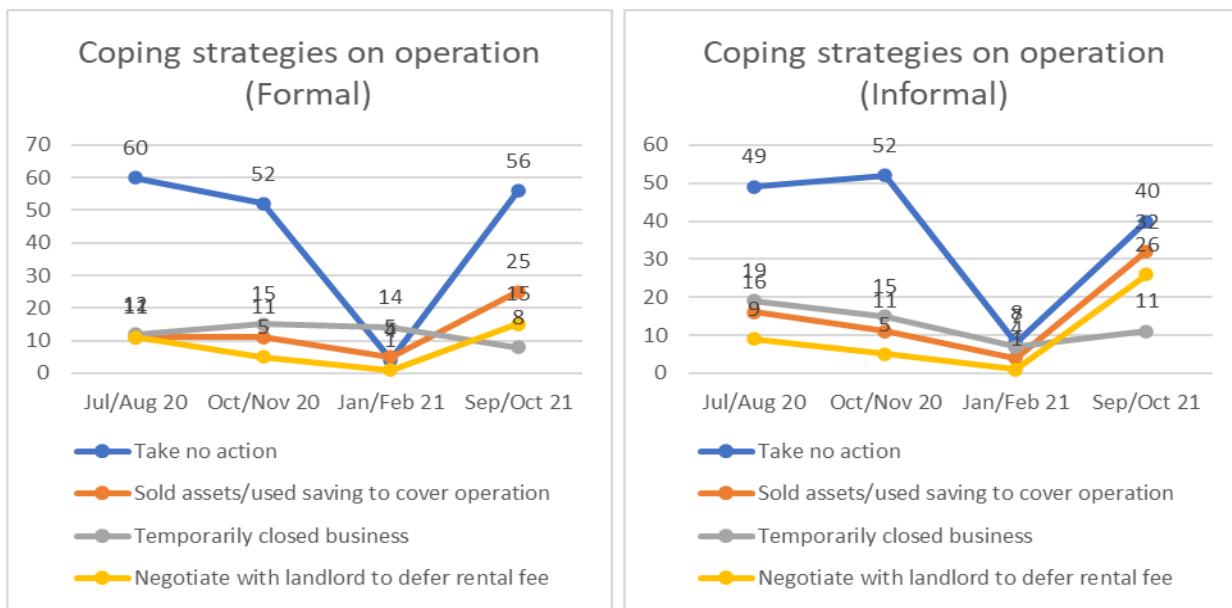
The most common coping strategies to manage debt among formal and informal MSMEs (Graph 12) were loan payment deferral (25 percent), followed by the selling of personal property to pay interest (17 percent - 19 percent), and application for additional loans (14 percent - 18 percent). It is worth noting that about half of formal MSMEs did not take any action when in debt, and about four in 10 informal MSMEs did not either by September/October 2021. There is no statistically significant difference between formal and informal MSMEs in terms of action taken on debt across the four waves.

Graph 12: Debt management by MSMEs during COVID-19 over time and by formality status



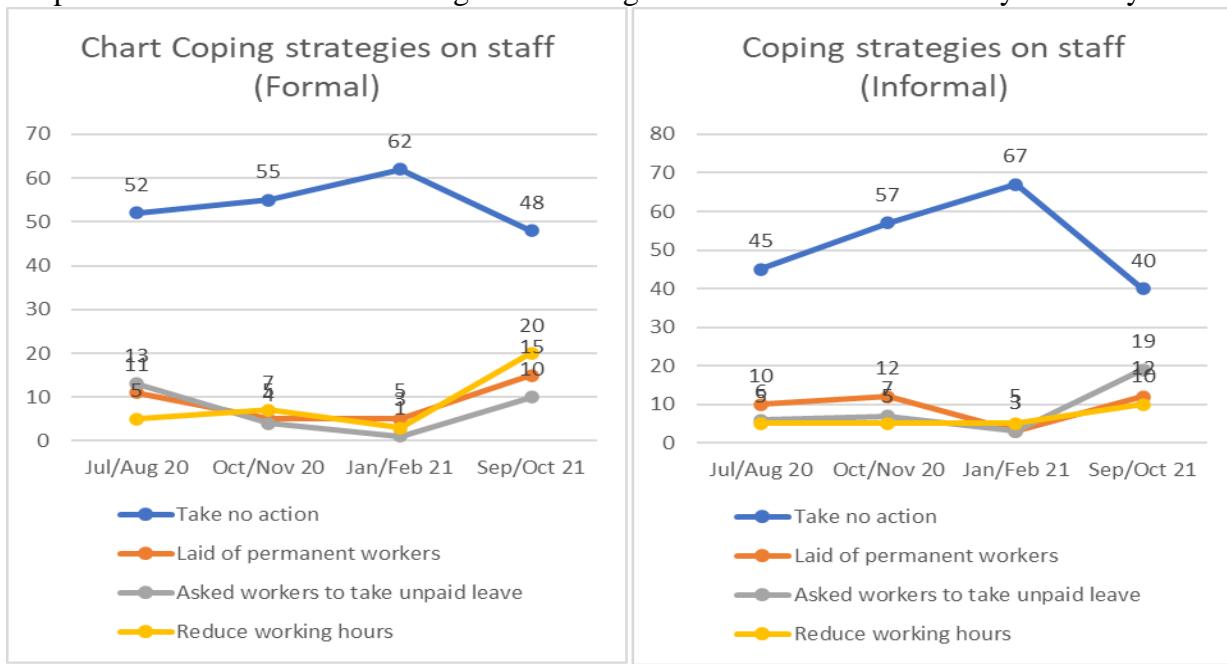
With respect to business continuity (Graph 13), most formal and informal MSMEs did not necessarily resort to negative coping strategies such as selling assets, negotiating with landlords to defer rental fees, or temporarily closing businesses during the first three waves. However, in Wave 4, informal MSMEs were more likely to report selling assets (26 percent) and negotiating with landlords on rental deferral (11 percent), compared with 15 percent and 8 percent of the formal MSMEs, respectively. However, this is not statistically significant ( $p>0.05$ ).

Graph 13: MSME coping strategies during COVID-19 over time and by formality status



Nevertheless, there was a substantial difference among formal and informal MSMEs during Wave 4 with respect to managing their workforces, namely resorting to relevant coping strategies such as laying off permanent workers, asking workers to take unpaid leave, and reducing working hours. No significant differences were observed among formal and informal MSMEs except with respect to reducing working hours for staff (99 percent confidence level).

Graph 14: MSME workforce management during COVID-19 over time and by formality status

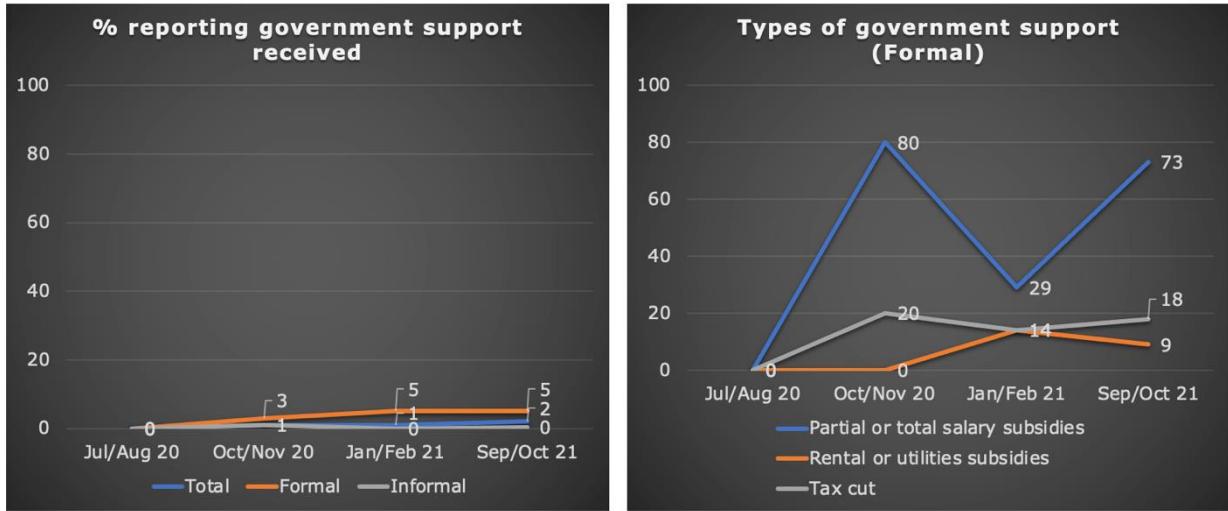


### Government stimulus package

The majority of formal MSMEs did not receive any support from the government during the pandemic. By September/October 2021, only five percent of formal MSMEs reported receiving government support, while none of the informal MSMEs received support. This is significant at a 99 percent confidence level over the observed period.

Formal MSMEs that received government support reported receipt of partial/total salary subsidy, which was the top type of assistance reported (73 percent), by September/October 2021. While approximately two in 10 received tax cuts, about one in 10 received rental/utility support (Graph 15).

Graph 15: Government stimulus package to MSMEs



#### IV. Policy recommendations and conclusion

MSMEs constitute the backbone of the Cambodian economy. Seventy percent of the population works in MSMEs; thus, there is a considerable demand for support to build resilience and capacity to survive in this disrupted business environment. Formal and informal MSMEs present a high degree of heterogeneity, nevertheless, they have both been severely impacted by the COVID-19 pandemic. Formal enterprises appear to be more resilient and have coped better with the impacts associated with the pandemic, however, this capacity to absorb shocks was tried by longer durations of sanitary and movement restrictions. Further regression analyses may be required as a control for other observable characteristics. Based on the insights generated by this study, the following recommendations are set forth:

- *More incentives for formal enterprises.* Five percent of formal enterprises received some type of support from the Royal Government of Cambodia. This proportion is rather small. Extension of support to a larger segment of formal enterprises is instrumental for recovery, and as an incentive for formalization. Measures to mitigate the downfall of the formal economy, especially MSMEs, are also critically important to prevent further ‘informalization’, especially for those on the verge of informality that could easily shift to the informal economy for survival. Financial measures to support MSMEs could help to

mitigate the impact of COVID-19 in the short term and promote greener, more inclusive, resilient, innovative, and diversified economic development in the medium to long term.

- *Access to finance and de-risking of MSMEs.* Lack of collateral security, poor business plans, lack of knowledge, and lack of financial deposit are some of the main obstacles to accessing finance faced by small business operators. A renewed national focus on financial inclusion, promoting financial education and literacy, making credit available to productive sectors of the economy, including the rural and MSME sector, with some sort of loan guarantee coverage is recommended.
- *Simplification of business registration procedures to encourage the shift to formal MSMEs.* In June 2020, the Cambodian government launched a business e-registration platform to reduce costs and expedite registration of new businesses and enterprises. The registration now takes an average of eight days instead of the previous three to six months (Thou, 2020). However, after review, the platform seems to target well-operated and structured businesses rather than micro or small, informal business units. Moving forward, a simple registration platform for informal enterprises is recommended.
- *Extension and expansion of social protection measures – a mix of social assistance, social insurance, and labor market.* The pandemic showed that social protection measures, particularly the *COVID-19 Cash Transfer Programme for Poor and Vulnerable Households*, are effective in mitigating socioeconomic impacts of COVID-19 on the poorest and preventing vulnerable households from sliding back into poverty. With national economies seeking to re-establish themselves, increasingly comprehensive and shock-responsive social protection system policies will be more important than ever for future preparedness. Macroeconomic simulations by MEF and UNDP (2020) showed that social protection measures reduced the speed of development gains erosion (GDP and sliding back into poverty of vulnerable groups). As such, social protection should be considered as an integral component of economic recovery, namely, as a component of fiscal stimulus that can boost aggregate demand and support the economy to bounce back.

Cambodia has sustained an impressive transformation from a largely agrarian economy to the latest Asian Tiger. At the same time, the country recorded one of the world's most impressive declines in poverty over the past decade. Sustaining this pace of progress will prove a formidable challenge,

especially due to climate change, an ageing population, global shifts in manufacturing, and the socioeconomic impacts of the COVID-19 pandemic. Unique times call for bold measures to put Cambodia back on a track towards recovery and to build forward better.

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