Non-Equity Modes of Trade in ASEAN

Promoting new forms of trade between Japan and ASEAN

PAPER 2

AUGUST 2019

ASEAN

ASEAN-JAPAN CENTRE

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NOTES

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The following symbols have been used in the tables:

- Two dots (..) indicate that data are not available or are not separately reported.
- A dash (-) indicates that the item is equal to zero or its value is negligible.
- Use of a dash (-) between dates representing years, e.g., 2015–2016, signifies the full period involved, including the beginning and end years.

Reference to "dollars" ($) means United States dollars, unless otherwise indicated.

There are 10 papers in total. The other nine papers will be produced subsequently.

Paper 1. Brunei Darussalam
Paper 2. Cambodia
Paper 3. Indonesia
Paper 4. Lao People's Democratic Republic
Paper 5. Malaysia
Paper 6. Myanmar
Paper 7. Philippines
Paper 8. Singapore
Paper 9. Thailand
Paper 10. Viet Nam

Prepared by Dr. Rajah Rasiah (University of Malaya, Malaysia) and the trade staff members of the AJC, who assisted with research and statistical assistance. Errors and omissions are only those of the authors and should not be attributed to the organization.

CONTENTS

KEY MESSAGES

- Non-equity modes (NEMs) of production are gradually spreading in Cambodia with major expansions experienced in services, the garment industry and agriculture.
- Cambodian firms are in the initial stage of being involved in various types of NEMs through subcontracting, management contracts and franchising arrangements.
- Contract farming has evolved through both land leases and subcontract agreements, while in the garment industry NEMs have grown sharply through subcontract linkages with foreign firms operating in special economic zones (SEZs). Franchising and management contracts have dominated hotel NEM operations.
- Ownership in the garment industry is dominated by transnational corporations (TNCs). The industry is among the highest generators of exports and employment in Cambodia. The volume of NEM exports was estimated at $5.6 billion in 2017, accounting for over 80 per cent of overall garment exports from Cambodia.
- Through aggressive promotion by the government, contract farming of cassava is poised to make Cambodia a major global supplier of the vegetable.
- International hotels are expanding rapidly into Cambodia through either management contracts or franchise agreements, or long-term leases of land on which hotels are built. Local partnerships with foreign hotel owners are mushrooming because Cambodia does not allow foreign ownership of land.
- As TNCs can easily terminate contracts, long-term relationships cannot be easily established, particularly so when the quality of services or goods does not meet TNCs' standards and local firms in other countries are more competitive.
- Development of the local community, including local NEM firms and employees, is important when selecting NEMs for government support.
- Worker training should focus on local firms to stimulate technological upgrading so that NEM firms can move up the value chain.
- Although NEMs are characterized by national equity, refinement of regulations to attract foreign and domestic investment is necessary to stimulate NEM activities in Cambodia.
- NEM firms and complementary foreign and joint-venture firms can pursue upgrading strategies if the required skills and expertise are in place. The government should build more schools to raise the literacy rates to complement technical and vocational training in the country.
- The growth of NEM and Cambodian exports, employment and revenue can be further enhanced if the government strengthens the basic infrastructure where firms operate.
- Although strong basic infrastructure is critical to raise the efficiency levels of firms, the development of science, technology and innovation (STI) infrastructure is important to stimulate firms' participation in innovation activities. Organizations such as science-based universities, standards organizations and research and development labs will help solve collective action problems faced by local firms.
- Local employees should be shielded from unreasonably exploitative conditions. This protection would also help raise productivity.
- The government should tighten regulations and offer incentives for local firms to "green" their business activities.

1. INTRODUCTION

An extensive account of trade between countries can be presented using aggregate statistics, on the basis of broad ownership patterns, and broken down largely by national and joint-venture firms and by foreign firms. However, few accounts have examined non-equity modes (NEMs) of ownership, in which trade links appear with supply chains, or in many cases as part of the global value chains (GVCs) of transnational corporations (TNCs). They tend to dominate trade in industries, such as clothing and electronics, and even manifest in the form of TNC trade, vertically or horizontally. NEMs linked to trade in GVCs started gaining significance following the successful export expansion of firms from Japan, the Republic of Korea, and Taiwan Province of China into global markets. Given the capacity of NEMs to generate foreign exchange, and the deeper and broader implications they have for overall economic development, there is growing recognition that NEMs associated with trade would help not only to check resource outflows from national economies but also to help national productive capabilities evolve. Trade between Japan and ASEAN members promises such a development.

As in other ASEAN countries, NEM-related trade is also gradually spreading in Cambodia in the form of international subcontracting in manufacturing industries, such as garments and electronics; especially since 2015 when Cambodia established the Cambodia Special Economic Zone Board and opened special economic zones (SEZs). Other forms of NEMs have also emerged in Cambodia: e.g. contract farming in agriculture and contract manufacturing; international franchising in fast food and retail stores; variations of build-own-operate transfer arrangements and other concessions in infrastructure projects; and management contracts (e.g. in international hotel chains). This report examines the case of Cambodia in the overall framework of the ASEAN-Japan Centre (AJC) project (box 1), targeting NEMs particularly in the garment, food manufacturing, and hotel industries.

Clothing is the largest manufactured export of Cambodia; in nominal prices its value more than doubled between 2010 and 2016, from $5.1 billion to $11 billion (table 1). More than 70 per cent of clothing and textile exports from Cambodia goes to the United States and the European Union (EU), thanks to the generalized scheme of preferences (GSP), which allows vulnerable developing countries such as Cambodia to pay no duties on exports within the allowed quota limit. Cambodia still enjoys the "Everything but arms" clause with Europe. Many foreign apparel manufacturers that utilize the preferential schemes have set up operations in Cambodia.

Other industries in Cambodia with growing exports include bicycle manufacturing and electric components manufacturing, such as insulated electric wire and electrical transformers. In 2017, Cambodia exported 1.4 million bicycles to the EU to become its number one exporter, taking the place of Taiwan Province of China. In fact, Taiwanese bicycle manufacturers, such as A&J, Smart Teck and Worldtec Cycles, have also established production operations in Cambodia. They enjoy the benefit of the duty- and quota-free status allocated to Cambodia. Exports of electronic components grew rapidly after 2012 when Japanese electronics makers, such as Sumi (Cambodia) Wiring System and Yazaki, started producing wire harness products in Cambodia's SEZs. Exports of insulated wires increased by more than five times between 2012 and 2016, from $34 million to $186 million. These foreign companies chose Cambodia as an ideal production base, to benefit from their "China Plus One" and "Thailand Plus One" strategies.

Market liberalization and the rising importance of FDI to Cambodia is now well documented (Rasiah, 2009a). In Asia, technological catch-up assisted the transformation of national firms in the Republic of Korea, Taiwan Province of China and China from a focus on low value added activities to high value added ones through integration with GVCs (Rasiah, Kong and Zhang, 2013). Although the number

Box 1. **The NEM project, ASEAN-Japan Centre**

Other than arms-length relationships, equity is not the only means of exerting control over international value chains. Companies also enter into contractual relationships with other independent firms, which is gaining importance following rising integration into global value chains. In light of its importance, this report seeks to fill an important void in which there is a lacuna in knowledge and research gap in ASEAN. It also calls for an overall analytic framework to assess development impacts in order to propose a generic policy framework for dealing with such transactions. The fundamental difference between NEMs and normal trade is that non-equity forms of trade relate to contractual relationships between private firms with little or no equity ownership by the contracting firms. The role of the state related to this partnership is limited to facilitating the creating favourable conditions within which private parties can freely negotiate the terms of their cooperation. By understanding better this phenomenon, including scale and scope, the AJC seeks to provide a profound policy analysis to offer ASEAN governments recommendations that they could consider to appropriate benefits from these new forms of trade and investment.

In order to understand the scale and scope of non-equity involvement in major industrial sectors, a case study methodology is used. The reasons for taking this approach are two-fold: (1) balance of payments and supplementary statistics do not provide the details necessary to measure accurately cross-border NEM activities; (2) the relevant microdata are fragmented and disconnected; and (3) it is only through case studies that we can draw actual reasons that shaped firms' conduct in the development of NEMs. Nevertheless, the case studies are used to complement rather than substitute existing research and statistics.

New opportunities are opening up for ASEAN countries, which are largely emerging from changes in TNCs international innovation networks (IINs). While attracting foreign direct investment (FDI) and encouraging foreign TNCs to establish affiliates remain an important option for ASEAN countries, ASEAN governments need to review their current regulatory regimes in the context of NEMs and IINs. A key objective of this study is to make policy relevant recommendations on investment, trade and industrial policies that ASEAN governments can consider to benefit from these emerging opportunities.

of national firms overwhelms the number of foreign ones, firms from China, Hong Kong (China), the Republic of Korea and Taiwan Province of China actively support GVCs through integration with brand holders in the United States and Europe (Rasiah, 2009b; Rasiah, Gopala and Sanjivee, 2013).

Attempts to examine the factors that make locations attractive and conducive to NEMs require a profound screening of overlapping factors that contribute to both FDI and NEMs. As with FDI, locational factors include political and social stability, effective competitive policies, attractive incentives for companies, smooth trading procedures and sound macroeconomic policies.

In addition to the policy-related factors considered as standards for FDI selection, there are also factors that provide particular support for NEM development in host countries. First, as NEMs are in essence forms of contract-based engagements that are often integrated in TNC networks in host economies, stable contract and commercial law is important. For example, for franchises and contract farming, it is important that there is sufficient protection of intellectual property rights.

Second, as with FDI, facilitation measures to promote business are very important for attracting NEMs. For example, promotion activities and incentives should be applied with a broad scope; for example, investment promotion institutions should explicitly include foreign franchisers as partners for promising local companies. Regional enterprises' access to capital is also an important factor, given its potential for promoting the expansion of NEM production.

Table 1. **Major export and import products, Cambodia 2016**

Major export items				Major import items (% of total import)			
Major Export Items	**Export Value (M$)**	**% of Total Export**	**Export RCA***	**Major Import Items**	**Import Value (M$)**	**% of Total Import**	**Import RCA***
Textiles	11 000	60	16.2	Textiles	3 610	25	10.7
Footwear and headwear	2 130	12	17.2	Refined petroleum	1 300	9	3
Precious metals/Gold	1 960	11	4.6	Gold	585	4	1
Bicycles	415	2	42.1	Cars	381	3	0.6
Rice	331	2	5.8	Two-wheel vehicle parts	287	2	20.2
Cassava	268	2	59.8	Rolled tobacco	281	2	8.2
Trunks and cases	268	2	5.4	Flavoured water	275	2	14.8
Insulated wire	186	1	1.0	Raw sugar	234	2	6
Rubber	170	1	33.4	Raw fur skins	159	1	32.6
Others	**1 672**	**7**		**Others**	**7 388**	**50**	
Total	**18 400**	**100**		**Total**	**14 500**	**100**	

Source: Global Atlas/UN Comtrade.
Note: RCA means revealed comparative advantage, a measure of whether a country is an exporter of a product based on the relative advantage or disadvantage a country has in the export of a certain good.

TNCs must establish footholds from which they can support NEM businesses. That could be a minimal threshold of having a commercial presence, as do purchasing and quality management organizations that provide support for outsourced manufacturing operations or logistics support operations that provide connectivity to franchise locations for retail and quick services restaurant businesses.

The existence of reliable and capable regional enterprises, and the ability to access them effectively, are important factors for NEM operations. Most NEMs require local partners that are strong, and sometimes promoters, capable of taking on risks on behalf of TNCs. For example, where TNCs do not enter contracts directly with individual farms, agricultural cooperatives can act as intermediaries to reduce business risks and provide reliability (Barrett et al., 2010).

Third, the degree of economic development and the strength of economic and social capital in a country is important to the growth of NEMs in that country. For example, consumer market scale and growth, and access to regional markets, are as important to NEMs – such as franchises and out-licensing contracts – as they are to FDI. Other major areas of interest to companies are the provision of basic infrastructure and the costs of transport, energy and communications.

Technological capabilities and the capacity to improve the quality and productivity of regional enterprises are critical elements for both TNCs and NEM firms. Government policies targeted at improving such capabilities in national firms, as well as regulations to stimulate strong corporate social responsibility (CSR) practices, including the observance of specific minimum labour conditions, are also important, to stimulate the upgrading of production in both TNCs and NEM firms. Such initiatives also help expand the pool of NEM firms that are available to network with TNCs. For example, in Malaysia the government has introduced a law specifically concerning franchises and has implemented other measures to promote TNC participation in its local economies. In the Philippines, the government has promoted services outsourcing, specifically the information technology and business process outsourcing (IT-BPO) industry. In Cambodia, the government has no specific initiative to promote NEMs.

Whereas several factors have thus contributed to increase the overall allure of countries as sites for various types of NEMs, some factors are decisive in the development of specific modes. Table 2 summarizes the major locational determinants of each mode.

Table 2. **Location determinants, FDI and NEM**

Relevant for FDI and NEMs	More relevant for FDI	More relevant for NEMs
	Policy framework	
• Economic, political and social stability • Competition policy • Trade policy • Tax policy	• Rules regarding entry and operations • Standards of treatment of foreign affiliates • International investment agreements • Privatization policy	• Stable general commercial and contract law • Specific laws governing NEM contractual forms • (e.g. recognizing licensing, franchising contracts) • Intellectual property protection
	Business facilitation	
• Reduction of hassle costs • (e.g. cost of doing business)	• Investment promotion • Investment incentives • Provision of after-care • Provision of social amenities (e.g. quality of life)	• Facilitation efforts aimed at - upgrading of technological quality, productivity standards of local firms - enterprise development, increasing local entrepreneurial drive, business facilitation - subsidies, fiscal incentives for start-ups - information provision, awareness-building on NEM opportunities with local groups - support for minimum standards of working conditions and CSR in local firms
	Economic determinants	
• Infrastructure • Market size and per capita income • Market growth • Access to regional and global markets • Country-specific consumer preferences • Access to raw materials • Access to low-cost labour • Access to skilled labour • Relative cost and productivity of resources/assets • Other input costs (e.g. transportation, communication, energy)	• Access to strategic assets • Created assets (e.g. technology, intellectual property) • Strategic infrastructure	• Presence of credible local entrepreneurs and business partners • Access to local capital

Source: AJC.

2. CHARACTERISTICS AND SCOPE

The characteristics and scope of the different modalities vary; hence it is important to discuss each separately so that efforts to promote them are cognizant of the unique elements associated with each. As most NEM modalities have already emerged in Cambodia (table 3), a systematic discussion is provided below.

2.1 Scale and scope of NEMs

According to the National Bank of Cambodia, in 2017 the country's total external trade in goods and in services reached some $11 billion and $5 billion, respectively. Although the goods trade balance has faced deficits in the recent past, the service trade balance has registered a growing surplus. In particular, the contribution of the tourism industry has been impressive in recent years.[1]

Since it is clearer to explain NEMs through a comparison with TNC operations, table 4 presents the different forms of NEMs that have emerged in Cambodia from the perspective of TNCs' motivations for engaging in them. For example, contract farming is motivated by a search for resource-based agricultural output (Dolan and Humphrey, 2000), whereas contract manufacturing and outsourcing (or subcontracting) are motivated by the desire to improve efficiency by reducing costs and risks where local characteristics offer NEM firms the opportunity to enter into such captive activities. For example, the restriction of land ownership to citizens ensures that access to such activities is undertaken through land leases and concession agreements with Cambodian owners; in a number of cases the farming is also outsourced to NEM firms.

Licensing and franchising are motivated by the desire to penetrate markets. Whereas subcontracting is similar to FDI in that it consists of transferring resources, technologies and expertise to contractors in the form of "packages", licensing and management contracts involve few direct transfers. This paper looks at the characteristics that constitute the different modalities in operation in Cambodia, in particular subcontracting, contract farming and franchising.

Subcontracting has expanded into labour-intensive industries, such as apparel, footwear and toy industries. From simple cut, make and pack (CMP) operations, subcontractors that are connected to clothing value chains have evolved to become intermediaries handling a large section of the stages involved in those value chains – e.g. manufacturing and logistics throughout Africa, Asia and Latin America (Rasiah, 2007, 2012; UNCTAD, 2011).

Garments is the major industry in which NEM operations have accelerated in Cambodia. However, investments have also grown in manufacturing of machinery, bicycles and electronics, with consequent expansion through NEMs.

[1] According to the World Travel and Tourism Council report, the direct contribution of travel and tourism to GDP amounted to $3,135 million – 14 per cent of GDP in 2017. The industry generated 2,663,500 jobs that year, which accounted for 30 per cent of employment in the country. In the tourism industry, the hotels and restaurants segment can best contribute to NEM operations, through contract management and franchising.

Table 3. **Description of selected non-equity modalities, Cambodia**

Modality	Description (in the international context)	Typical industries	Company examples
Subcontracting	Agreement whereby a TNC contracts out to a host-country firm one or more aspects of product design, processing or manufacturing. Includes contract manufacturing and design, as well as outsourcing in the case of services or business processes.	• Electronics	Izumi Electronics
		• Garments	Golden Apparel Universal Jeans
		• Mechanical equipment	MinebeaMitsumi
Contract farming/ contract mining	Agreement between a TNC buyer and host-country farmers or miners (including governments) that establishes conditions for the production and marketing of farm or mining products	• Agriculture	GreenLeader
Licensing	Contractual relationship in which a TNC (licensor) grants to a host-country firm (licensee) the right to use an intellectual property (e.g. copyrights, trademarks, patents, industrial design rights, trade secrets) in exchange for a payment (royalties). Includes brand, product and process licensing, as well as cross-licensing and intra-firm licensing.	• Family amusement • Logistics	Mollyfantagy NPE Logistics
		• Restaurant	Maxim's Caterers
Franchising	Contractual relationship in which a TNC (franchisor) permits a host-country firm (franchisee) to run a specified business modeled on a system developed by the franchisor in exchange for a fee.	• Restaurant	Coffee Beans & Tea Leaf Café Amazon Domino's Pizza
		• Education	Kumon, KooBits
Management contracts	Agreement under which operational control of an asset in a host country is vested in a TNC contractor that manages the asset in return for a fee.	• Tourism and hospitality	Lodgis Hospitality
Other (e.g. build-operate-transfer and the like)	Includes concessions, lease agreements, build-operate-transfer arrangements, etc., in the context of public-private partnerships.	• Electricity	Pestech

Source: AJC.

Table 4. **NEM operations by major sectors, selected industries, 2017**

Sector	**Primary**		**Secondary**		**Tertiary**	
Industry	Rice	Cassava	Garment	Bicycle	Convenience store	Hotel
Product or services	Aromatic rice Long-grain white rice Parboiled rice	Dried chips Dried starch Wet starch	Garments Footwear	Road bikes Cyclo-cross bikes Touring bikes Adventure road bikes Mountain bikes City bikes	Small retail groceries Snack foods Confectionery Soft drinks Tobacco	Lodging Welcome Comfort Quality Trust Safety services
No. of companies (NEM-related estimation)	Cambodia Rice Federation	Several local associations for cassava production	Garment Manufacturers Association (Over 600 members, 570 of them export-oriented garment factories, most of them NEM firms)	No specific associations	18 Circle-K stores Various franchise restaurants	781 hotels 2,255 guesthouses
Major companies (local partner or main franchisee)	Marubeni (AKR)	Green Leader Charoen Pokphand Foods	Uniqlo (Golden Apparel) GAP (Cambo Handsome)	Atalantic Cycle Asama Strong Man Smart Tech World Tech Cycle	Circle-K (TH Group)	Raffles (Lodges) The Okura Prestage (TEHO Development, open 2020) Hyatt (Chip Mong Group, open 2020)
Estimated export volume (estimated export by NEM)	23,659 tonnes $331 million (local NEM production)	10,210,000 tonnes $21 million (dried cassava, local NEM production)	$7.3 billion ($5.6 billion)	$415 million (over $125 million) Ref. GIANT (OEM 30%)	Operating since February 2018 (franchise fee, licence fee and other fees are revenue of franchiser)	$3.4 billion for travel and tourism (Management contract fee is 10% or more of profit)

.../

Table 4. **NEM operations by major sectors, selected industries, 2017** (Concluded)

Sector	**Primary**		**Secondary**		**Tertiary**	
Modality in NEM	Contract farming Growing OEM brand Concession		Subcontracting		Franchising Licensing	Licensing Management contract
Number of jobs	3 million	Over 90,000 families	Over 600,000	Over 15,000	Operating since February 2018	Over 2.2 million (hotels and restaurants)
Average export growth	15% increase from 2015 ($287 million)	260% growth from 2012 ($7.8 million)	140% growth from 2012 ($4.5 billion)	140% growth from 2012 ($296 million)	Approximately 7% annual economic growth	Expected to grow by 6.2% per year from 2017 to 2027 (to $6.8 billion)
Market or trade scale	China: 22% France: 16% Germany: 12%	Thailand: 60% China: 39%	EU: 38% United States: 33% Japan: 6%	Germany: 38% United Kingdom: 23% Belgium: 11% United States: 6% Canada: 3%	Market competition has just started in urban areas between international capital convenience stores and local stores.	Viet Nam: 19% China: 17% Thailand: 8% Lao People's Democratic Republic: 7% Republic of Korea: 7% United States: 5% Japan: 4%
Product or service scope	Further improvement of rice production and commercialization is expected.	Governmental initiative to produce more cassava is expected to enable farmers to export more cassava to different destinations.	The EU and the United States have stable demand. Some Japanese companies have interest in transferring their factories from China to Cambodia.	Major Taiwanese bicycle manufacturers operate in SEZs. More manufacturing production can occur at SEZs.	More international convenience chains have opportunities to enter the market.	More International hotel chains have room to enter local resort markets.

Source: AJC.

A wide range of NEM exporters have emerged in Cambodia. In agriculture, for example rice and rubber are produced and exported through contract farming methods undertaken using NEMs. Other major exports that use contract farming as the NEM activity include palm oil and cassava wine.

Contract farming

Agribusiness TNCs use NEMs in more than 110 developing countries and for a diverse range of agricultural products (UNCTAD, 2011). Contract farming is a tool for efficient procurement of agricultural products because it enables TNCs to secure the quantity and quality of products they require. In addition, farmers can secure stable sales and income levels. TNCs demand high quality from contract farmers, and in return, farmers acquire new information and technology through these contracts.

Contract farming is widespread in Cambodia. It has grown strongly owing to the fertile soil, the stringent laws prohibiting foreigners from owning some land and the lower costs of production in the country. In 2018, agriculture accounted for 25 per cent of Cambodia's total GDP, and 64 per cent of the population relied on it for their livelihoods.[2] Rice, rubber and cassava are major agricultural export products of the country, and they play a vital role in generating employment, income, GDP growth and foreign currency earnings.

Contract farming generates a large number of jobs for small-scale farms, producing a reasonable impact on the reduction of poverty. Although the total number of contract farms is hard to identify, data from individual projects show that several tens of thousands of workers are employed at farms that use this NEM.

Subcontracting

The degree to which subcontracting accounts for overall production varies by industry type. In the toy, sporting goods, electronics and automotive industries worldwide, subcontracting generates 50 per cent or more of value added (UNCTAD, 2011). Subcontracting also accounted for slightly less than 50 per cent of value added in pharmaceutical products in 2010.

In Cambodia, the garment industry has played a major role in driving exports since TNC subsidiaries began operations in the country in the 1990s. Textiles and clothing together accounted for 60 per cent of total exports of goods from Cambodia in 2016, thanks to the GSP offered by the United States and the EU for the least developed countries (LDCs), which allows vulnerable developing countries such as Cambodia to pay no duties on exports within specified quota limits (Rasiah, 2009a).

In services, Cambodia is no exception to the global trend of rapid growth in subcontracted IT services. Various support services from ASEAN neighbours have already brought greater IT connectivity to the country. IT is expected to be a major sector for the growth of NEMs, which will not only stimulate its economic contribution to the national economy but also its complementary support of other industries and sectors. The industry is developing in Cambodia, but local firms must realize that the industry is more mature in neighbouring ASEAN members.

Franchising

Franchising is well known as a business mode for marketing and distributing products or services. Through franchise management, franchisers are able not only to rapidly and efficiently expand operations, but also to procure capital. The formula is being applied to the retail industry in many

[2] FAO Stat, accessed in January 2019.

parts of Southeast Asia, including high street retail and goods stores, restaurants, hotels, business services, education and a variety of other business types.

Imported fast food brands, such as KFC, Dairy Queen and Burger King, have attracted Cambodian NEM firms as partners. With the growth in consumer purchasing power in the country, these TNCs have started to penetrate the local market by opening franchise shops. Starbucks and other international and regional restaurants, including Japanese restaurants, are further examples .

In franchise agreements, normally franchisers provide franchisees with various types of support related to business operations, which includes initial and ongoing support, training, management guidance, marketing, and administration and human resource management advice. Franchisees pay royalties to franchisors to enjoy these services.

Licensing

Licensing is the process of transferring the rights to use firms' products and services to companies that then produce or sell them. Licensing also includes agreements allowing licensees to use the technology of the licensor. In exchange for a payment (royalty), the licensor allows the licensee to use an intellectual property (e.g. copyright, trademark, patent, industrial design right, trade secret) in order to gain access to know-how or establish a presence in the markets covered by the licensee. The international expansion of pharmaceuticals, consumer goods and electronics firms has often been through licensing contracts. Samsung Semiconductor, which now leads the memory storage industry, used this route successfully to catch up and leapfrog market leaders (Edquist and Jacobssen, 1987).

In Cambodia, the carbonated soft drink Pepsi Cola is manufactured by Cambreu under a licensing agreement. In services, Nippon Express, a logistics company, entered into a franchise agreement with NEP Logistics to conduct land transportation.[3] Aeon Fantasy, which creates, manages and promotes indoor theme parks with entertainment and amusement facilities, made a franchising agreement to open its indoor theme parks in Phnom Penh.

The analysis of NEMs is complex because "the web of directly owned, partially owned, contract-based and arm's-length forms of international operation of TNCs is tangled, and some of the distinctions between the different modes are blurred" (UNCTAD, 2011). Thus, the analysis in this report is limited to a number of industries in which NEMs are especially important.

Trade volume by NEMs in Cambodian exports is difficult to estimate. Nonetheless, for textiles and clothing, which account for 60 per cent of exports from Cambodia, officials from the Garment Manufacturers Association of Cambodia (GMAC) estimated that the share of NEM firms would be about 80 per cent of the total volume of exports. Their estimation was guided by the following observations:

- Of the more than 600 garment factories that are members of GMAC, 570 are export-oriented.
- None of the global retail apparel companies, such as Zara, GAP, H&M and Uniqlo, have garment factories in Cambodia. They have only what they call partner factories or contract factories.

Therefore, according to the conservative estimate by the GMAC, 80 per cent of the total volume of Cambodian textile exports – $5.8 billion in value – would be NEM trade. In addition, although the sector currently employs about 600,000 workers, more than 2 million people in Cambodia are partly or wholly dependent on garment factory salaries from a spouse, parent or child for their living, which shows that NEM trade in the industry has a significant impact on the Cambodian economy.

[3] Nippon Express Press release, July 28, 2011.

2.2 NEM case studies

Several foreign firms and TNCs do business with local partners using NEM arrangements in various industries. Their involvement in NEM operations and their contribution to the Cambodian economy vary by modality and industry. To understand better NEM operations in Cambodia, fieldwork was undertaken on firms in the garment and agribusiness industries using questionnaires and interviews. Of the targeted 50 firms, 21 firms (10 in garments and 11 in agribusiness) replied to the questionnaire survey and answered the interview questions.[4]

The fieldwork shows that all 10 garment companies export and none have domestic sales, whereas all 11 agribusiness companies have domestic sales and 5 also engage in export activities (table 5). In addition, most of the garment companies are foreign owned. As far as destinations are concerned, most garment exports go to North America and Europe, whereas agribusiness exports are dispersed among East Asia, North America and Europe, and ASEAN member states.

Most of the 11 agribusiness companies are domestic, with nearly half of their sales in domestic markets. They employ on average approximately 100 workers. The mean number of workers at the garment firms was large, at 2,370. Whereas all garment firms reported training employees, only three agribusiness firms reported the same. One garment firm and two agribusiness firms had research and development (R&D) operations but focused on supporting incremental innovations.

Table 5. **Profiles of firms studied in Cambodia**

Economic sector	Garment	Agribusiness
Respondents (%)	10 (40%)	11 (44%)
Foreign owned	8	1
Year of establishment (Ave.)	2006	2006
Number of employees (Ave.)	2,370	100
Export-oriented (Ave.)	100%	55%
Major export destinations (Ave.)	North America and Europe (72%) East Asia (20%) ASEAN (5%)	East Asia (26%) North America and Europe (13%) ASEAN (11%)
Undertake contract R&D	1	2
Number of companies that receive training	10	3

Source: AJC.

(1) Contract farming: Cassava

Cassava is the second most important crop in Cambodia after rice, contributing 1.5 per cent of total exports from the country in 2016, at a value of $268 million. Cambodian agricultural producers have for many years focused on neighbouring markets. Cassava producers are no exception. The main export destination is Thailand, which receives 95 per cent of exports, followed by China at 5 per cent. The exported cassava is used as biomass fuel and processed as poultry and livestock feed meal.

4 The field studies were conducted throughout February 2016 using a national consultant, targeting 25 large firms each from the garment and the agribusiness industries.

Whereas global production of cassava is dominated[5] by African countries, such as Nigeria (ranked first in 2016, at 59 million tons) and the Congo (second, at 31 million tons), global exports are dominated by the Southeast Asian countries of Thailand (42 per cent of the total), Viet Nam (10 per cent) and Cambodia (9.7 per cent).[6] Cambodia has a strong potential to be a larger supplier of cassava for the global market owing to its fertile soils and ideal climate conditions. Hence, the Cambodian government has taken on a big role to develop the industry.

The government recently launched its new strategy, which aims to position Cambodia as a reliable cassava supplier for cassava-based products to the global market. In order to reach this goal, the government has focused on achieving three main strategic objectives:[7]

1. To transform cassava production from subsistence level to commercial level, to enhance farmers' income, stabilize prices and strengthen the sustainability of land use
2. To attract investment to produce cassava, including processing it, and to shift farming to high value added cassava-based products to supply diverse markets.
3. To enhance the trade competitiveness of Cambodian cassava by expanding its sale in markets by improving trade facilitation and reducing trade-related costs.

Upgrading existing processors and attracting new investments to build advanced and sustainable factories, addressing cassava production issues and improving business-enabling environments could raise the competitiveness of cassava exports from Cambodia.

The Cambodian government's strategy is to promote a contract farming scheme,[8] which is considered an efficient mechanism to help smallholder farmers to derive benefits by growing cassava while giving some control to companies (buyers) without allowing them to own the land. This very much fits into Cambodia's aim of expanding exports into high value added products. Table 6 presents a stakeholder analysis of cassava value chains in Cambodia.

Eaton and Shepherd (2001) categorized five contract farming models (including for cassava), as follows:

- **Centralized:** An agribusiness company buys produce from a large number of smallholders (small-scale farmers), exerting tight control over quality and quantity.
- **Nucleus estate:** An agribusiness company combines contract farming with direct involvement in plantation production.
- **Multipartite:** Farmers sign contracts in a joint venture between an agribusiness company and a local entity.
- **Informal**: More informal verbal purchase agreements are signed on a seasonal basis, with inputs that are provided by the company often being restricted to seed and fertilizer.
- **Intermediary:** An agribusiness company has contracts with intermediaries who then sign contracts with a large number of farmers.

This report examines case studies for two companies, Green Leader Holding Group Ltd and Charoen Pokphand Foods Plc (CPF) (boxes 2 and 3). Green Leader is characterized by the centralized model. The company directly signs agreements with smallholder farmers that stipulate the quantity

[5] FAOSTAT, accessed in January 2019.
[6] UN COMTRADE, accessed in January 2019.
[7] National Strategy for Cassava 2018–2022.
[8] Cambodian government has established a legal framework to support the contract farming scheme: the sub-degree on contract farming 2011.

and quality of cassava to be produced and purchased. In return, the company provides inputs and technology support to the farmers. CPF uses features of both the centralized model and the intermediary model (box 3).

Table 6. **Stakeholder analysis of the cassava value chain, Cambodia**

Stakeholder	Activity	Main challenge
Input suppliers	Produce inputs such as fertilizer and pesticides	- No proper industry in Cambodia, high dependence on high-cost imported products or illegal low-quality imported products - Lack of knowledge in farmers about pests and diseases, and lack of experience by the majority of input suppliers in cassava production
Farmers	Produce cassava	- Insufficient financial capacity of farmers to cover production costs (land rent – although 99% of farmers grow cassava on their own land, land preparation, labour costs, high interest of credit) - Lack of support for farmers on technical issues, price and market information, knowledge of production
Traders	Buy cassava directly from farmers, then sell to buyer	- Some production areas inaccessible without a vehicle
Transporter	Provide service to traders in areas that traders cannot access	- Some inadequate transport infrastructure, including facilities for storing cassava. Scarce cold-storage facilities.
Processors	Process cassava	- Dependence on imported foreign technology and second-hand machines that need frequent maintenance and repair - Lack of domestic experts to train local staff - High cost of electricity and transportation - Unstable price of cassava, requiring a lot of capital for storing fruits while waiting for a price increase - Lack of compliance of final products with international standards

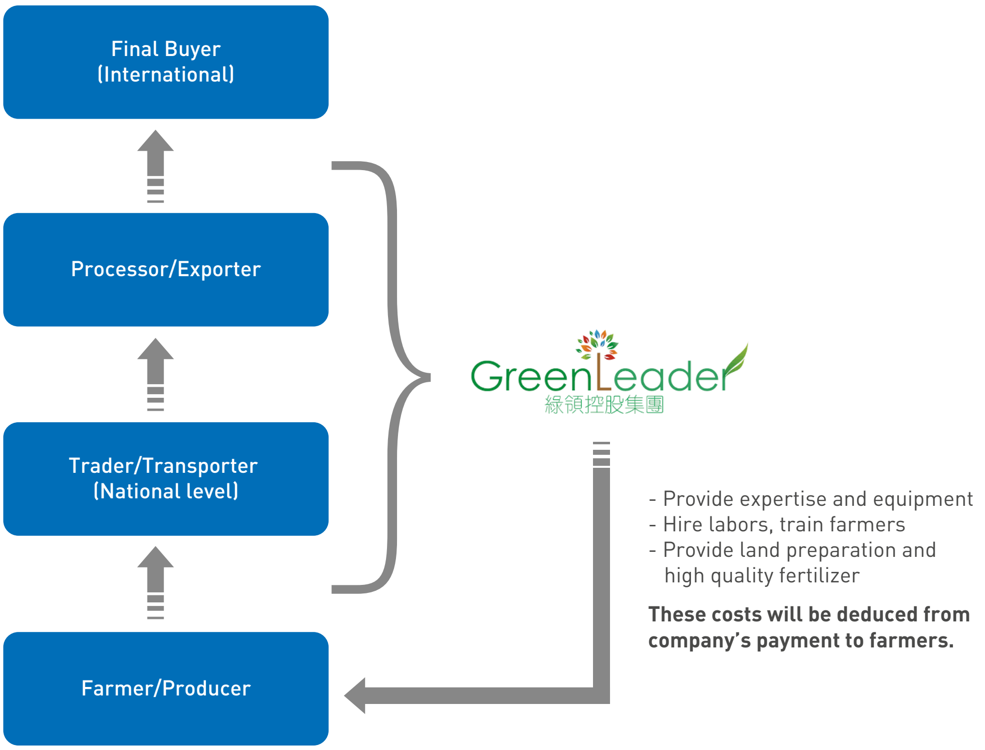
Source: AJC based on SNV (2015).

Box 2. **Contract farming: Green Leader Holding Group, Ltd**

Green Leader Holding Group, based in Hong Kong (China), is an investment company that engages in coal mining, agricultural cultivation, energy derivatives and systems integration businesses in China and Cambodia. At the beginning of 2018, Green Leader signed a memorandum of understanding with the Cambodian Ministry of Agriculture, Forestry and Fishery (MAFF) to invest in cassava plantations and build 20 processing plants in the country.

Partnering with the United Nations Development Programme and the Cambodian Ministry of Commerce, Green Leader agreed to establish a smallholder contract farming scheme, as shown in box figure 2-1. The company's aim is to raise production from 10–15 tonnes of fresh cassava per hectare to about 25 tonnes per hectare once the new technology and farming methods are fully implemented. Farmers have embraced this arrangement to raise their incomes while obtaining more knowledge of production and markets.

Box figure 2.1. **Contract farming scheme, Green Leader**



Box 3. **Contract farming: Charoen Pokphand Foods Plc**

Charoen Pokphand Group is Thailand's largest private company and one of the world's largest conglomerates. Its main businesses are in telecommunications and media, agro-food, retail and distribution, e-commerce and digital business, property development, automotive and industrials, pharmaceuticals, finance and investments.

Charoen Pokphand Foods (CPF) is a member company of the group that engages in the agro-food industry. CPF's core businesses include livestock, animal feed, meat and food production, and aquaculture. Charoen Pokphand Cambodia Co., Ltd., with registered capital of $67 million, is one of CPF's investments. Its main activities include the animal feed production and sale, livestock farming and a food processing plant (box table 3-1). The company has been working closely with farmers in a contract farming scheme since 1995, growing cassava and corn in seven provinces – Battambong, Kampong Cham, Pursat, Ratanakiri, Kandal, Mondulkiri and Pailin.

CPF has two types of contractual agreements drawn from guidelines defined by UNIDROIT, the independent intergovernmental organization on universal law:

- CPF works directly with farmers to have them grow what it wants. A written contract is made with farmers on prices, quality and terms.
- CPF works with middlemen who collect produce from farmers and are responsible for the quality of the product. CPF signs a written agreement with the middlemen, but the middlemen use informal (verbal) agreements with farmers.

The contract farming scheme represents a win-win strategy. Under this scheme, on the one hand, farmers will obtain technical support, a guaranteed income, and knowledge about the production and market. On the other hand, the scheme provides a solution for investors to reduce equity investment, and hence expose with less risk (box table 3-2).

Box Table 3.2 **Benefits of contract farming by Charoen Pokphand Cambodia, 2017**

For farmers	- Guaranteed prices, market and income - Capacity-building (117 trainings in 2017, technical support) - Access to finance
For CPF	- High-quality crops without acquiring land - Political accessibility - Reliable supply of products and shared risk

Source: CPF Sustainability Report 2017.

(2) Subcontracting: Garments

The clothing industry has played a significant role in the export-oriented industrialization in East Asia's early phase of rapid economic growth (Rasiah, 2012). Three of the Asian Tigers or Asian Dragons, i.e., Hong Kong (China), Taiwan Province of China and the Republic of Korea, benefited from massive garment exports from the 1960s until the early 1980s. They were followed in this success by ASEAN members Indonesia, Malaysia, Thailand, and the Philippines. The latter countries took advantage of the relocation of firms from the Asian Tigers and Japan to expand their garment exports. Two major developments since the turn of the millennium have transformed trade in garments. First, by 2010 China had extended its grip on global garment exports to about 40 per cent, thereby reducing the space available for other countries (WTO, 2015). Second, developed countries such as those of the EU offered LDCs such as Cambodia preferential access to major markets following the scrapping of the Multi Fibre Arrangement in 2004 (Rasiah, 2012).

The Cambodian textile industry has relied extensively on the GSP to access major markets. In 2017 the United Nations had designated 47 countries, including Cambodia, as LDCs.[9] The LDCs of Bangladesh, the Lao People's Democratic Republic and Myanmar met the criteria for graduation from the status in March 2018, according to UNCTAD. Some of these countries are expected to lose their GSP privileges in 2024 if they meet the graduation criteria again in 2021. Cambodia, which met one of the three criteria in 2018, may lose its GSP privileges in 2027. Therefore, it is important that the Cambodian government develop infrastructure and related policy instruments for the medium and long terms to handle the transition to open tariffs without any significant problems.

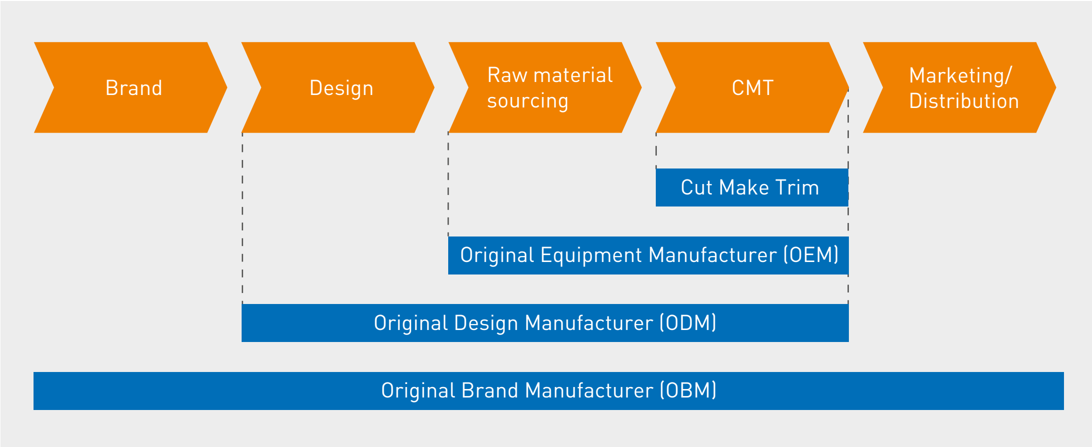
Since the opening of Cambodia for FDI inflows in 1994, the garment industry in the country has contributed enormously to boosting national income and reducing poverty by creating employment opportunities. In 2013 the industry accounted for 13 per cent of Cambodian GDP. In 2010, it accounted for 50 per cent of manufacturing employment. However, less than 10 per cent of local factories benefit from the industry's growth. In general, the industry has four types of business models: original brand manufacturer (OBM), original design manufacturer (ODM), original equipment manufacturer (OEM), and cut make trim (CMT).[10] Their involvement in the production cycle is shown in figure 1.

Since OBMs control garment value chains, CMT suppliers start with little bargaining power compared to their buyers. The GMAC (which was established in 1999) listed 605 garment factories – most of which have NEM contracts – as members in 2018. (Two NEM firms in the garment industry are examined in box 4 and box 5.) Among the objectives of the GMAC is to obtain a better business environment by lobbying the Cambodian government to develop infrastructure, offer security and set up legislation to support their businesses.

[9] As of 20 November 2018 (UNCTAD).

[10] OBM refers to a company that typically sells its own branded products, which are made by a second company. The company is responsible for design (possibly by another company), raw material sourcing (possibly by another company), CMT (possibly by another company), marketing and distribution.
ODM refers to a company that designs and manufactures a product that is then rebranded by another company for sale.
OEM refers to a company that sources the inputs for products and produces products that may be remarketed by another manufacturer.
CMT requires the basic knowledge of design patterns and the ability to produce the products ordered by OEMs or ODMs with the inputs and materials they provide. Most contract manufacturers in Cambodia provide CMT and assembly services. Only a few factories operate as ODMs and only at a very small scale.

Figure 1. **Business model in textile and apparel industry**



Source: Textile and Apparel Industry Report, FPT Securities (2014).

Box 4. **Fashion giant H&M and H&M (Cambodia) International Manufacturing Ltd**

Hennes & Mauritz AB (H&M) is a multinational retail clothing company based in Sweden. As of 2017, H&M had 4,739 stores and 43 online markets in 62 countries. H&M's supply chains are summarized in box table 4-1.

Box Table 4.1. **H&M's supply chain**

Designing, Planning and Buying	Production	Distribution
- Over 100 in-house designers - 400 more people work in other aspects of product development	- 20 production offices around the world place orders, ensure product delivery times, and manage relationships with suppliers. They are also responsible for ensuring that the company respects labour laws in supplier countries. - 900 suppliers, mainly in Europe and Asia - In-house grading system to evaluate suppliers on their performance (see box table 4-2)	- Transportation outsourced, mainly by ship and rail - Operates 13 distribution centres (DCs) and call-off centres

Source: H&M Supply Chain Strategy.

M&V (Cambodia) International Manufacturing Ltd is a leading knitwear company founded in 1980 (under the names Chong Cheong (Macau) Knitting Factory Ltd, Chong Cheong (Zhongshan) Knitting Factory Ltd and M&V International Manufacturing (Viet Nam) Ltd.). In 1994, the company moved from Viet Nam to Cambodia. Its main activities include designing and producing for some of globally renowned brands, such as H&M, Next, Marks & Spencer, Mango, Muji and Niko. Notably, it is a gold-rated supplier to H&M (box table 4-2).

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Box 4. **Fashion giant H&M and H&M (Cambodia) International Manufacturing Ltd** (Concluded)

Box Table 4.2. **H&M's supply grading system**

Platinum and Gold	Top suppliers and preferred suppliers with long-term strategic partnerships, account for 60% of H&M products. As best performers in all areas, including sustainability, these partners have opportunities for training, workshops or even joint investments with H&M.
Silver	H&M provides training and supports them with long-term partnerships.
Others	Suppliers and factories that have worked with H&M for less than one year or have filled only a test order; H&M works rarely with this category.

Source: H&M Sustainability Report 2017.

Box Table 4.3. **Contract stipulations between H&M and M&V (Cambodia) and with other strategic partners, and pertinent regulations of the Cambodian Labour Law**

	Contract Between H&M and M&V	Other partners	Cambodian Labour Law
Wages	Workers paid by piece rate at an average of $ 6.87/day, $181/month (mid-2015) for 208 hours. However, when there are fewer orders (as of November 2015), $143.50/month	Other strategic partners: $148-$158/month (mid-2015), if fewer orders, then lower wages	- $140/month (minimum wage for a garment worker) for 208 hours - $80/month (minimum wage for piece-rate employees), working regular hours (48 hours per week). If pay based on piece rates would be less, the employer must still pay $80 per month
Duration of contract	Legal contracts	As of December 2015, 31 of 72 H&M suppliers continued to use illegal contracts (CENTRAL, 2016)	Two types of contract: - Undetermined duration - Fixed duration: up to two years; after two years, automatically convert to undetermined duration
Working hours	- No overtime due to decreasing orders - Partial suspension of overtime since June 2015, full suspension from December 2015 to April 2016	Other strategic partners: an average 10 hours of overwork per week	- Overtime is defined as more than 8 hours/day - Overtime should be limited to 12 hours/week, or 2 hours/day - Overtime work should be voluntary
Annual leave	18 days/year	18 days/year	18 days/year
Maternity leave	90 days at 50% of pay	90 days at 50% of pay	90 days at 50% of pay
Sick leave	Available with a doctor's certificate, which is in accordance with the law	Some strategic partners do not provide the sick leave in accordance with the law, for example: only 2 days of sick leave are allowed, or attendance bonus is reduced due to sick leave	An employer must give an employee sick leave for up to 6 months if an employee: - is absent from work because of illness; and - has a certificate from a qualified doctor - An employer may dismiss an employee if the employee is on sick leave for more than 6 months.
Freedom of association	Several unions, two of which are considered as independent unions	In other strategic suppliers, no independent unions	- The right to strike and the right to non-violent demonstration - The right to form unions of their choice

Source: Summarized from Preston, J., and Leffler, C. (2016) and Asia Floor Wage Alliance (2016).
Note: Other partners include only Platinum and Gold partners.

Box 5. **New Wide (Cambodia) Garment Co., Ltd**

New Wide (Cambodia) Garment Co., Ltd. is an international textile and garment supplier located in Cambodia. This firm belongs to the garments conglomerate New Wide Group, which was established in 1975 in Taiwan Province of China. New Wide Group core businesses are manufacturing, fabric research and garment production. It now has offices and factories in four continents, including North America and Africa. In 2001, it started textile, knitting and dyeing factories in China as a fundamental step towards globalization. By 2017, it had expanded garment operations to China, Lesotho, Kenya and Viet Nam, as well as Cambodia, with low operating costs (including wages) as the main attraction of those countries. New Wide established its Cambodia operations in 2006.

The company's main product is fashion knitwear. In 2013, it employed 1,299 workers on 22 production lines, with 32 workers per line, producing 500,000 garments each month. Its main clients are United States apparel makers, such as Charming Shoppers, Wal-Mart, LF USA, Dick's, Mother's Work, Belk, Trimark, FCR, Tchibo, and PI.

New Wide Group has enjoyed massive scale-based advantages from integrating the entire textile and garments value chain. Internalized but productive collaboration based on a blend of competition and cooperation has ensured that subsidiaries downstream have managed to access stable and reasonable prices and quality of supply.[11] The company's subsidiary in China supplies raw materials to the Cambodian subsidiary.

New Wide (Cambodia) has introduced labour-friendly policies that seek not to discriminate, including equal opportunity and compensation for pregnant workers, unrestricted access to toilets during work hours for workers, eliminated restrictions on access to the health clinic for ill and injured employees, and unionization and freedom of association.

Shortages of workers and consequently rising wages in eastern China have driven significantly the relocation of garment manufacturing to the CLMV countries (Cambodia, the Lao People's Democratic Republic, Myanmar and Viet Nam). Despite inputs supplied from China, total production costs in Cambodia are lower than those in China. In addition, the Cambodian textile and apparel industry has expanded its exports by complying with labour conditions imposed by the International Labour Organization (ILO).[12] Consequently, M&V (Cambodia) International Manufacturing Ltd, New Wide (Cambodia), Garment Co., Ltd and other foreign textile and apparel companies in the country have also generally complied with these conditions.

(3) Management contracts and franchises in hotels

The hotel industry links up with many other industries that function as major conduits of employment and economic development. Examples include online booking services, restaurant services, food and beverage services, linen services and furniture and decoration industries, as well as transport services.[13] Cambodia's historic and scenic landscapes have made tourism a major industry in the country, and the government has identified the tourism industry as one of its priority sectors for development. The provinces and municipalities of Siem Reap, Kampot, Sihanoukville, and Phnom Penh in particular have become major conurbations for tourists from all over the world. The greatest

[11] See Piore and Sabel (1984) to comprehend the positive synergies associated with such relationships.
[12] In order to maintain the preferential duties in the United States, the Cambodian government need to have a labour law, allow the organization of labour unions, and accept audits by the ILO.
[13] According to to the World Travel and Tourism Council (2017), in 2016 travel and tourism generated 988,000 jobs directly and the industry's total contribution to employment (including broader effects from investment, the supply chain and induced income impacts) reached 2,252,500 jobs.

numbers of branded hotels are generally concentrated in Phnom Penh and Siem Reap, where they cater to commercial demand and government needs. Yet there presence of international hotels in the leisure destinations remains limited, as demand continues to outstrip supply.

One of the most critical factors affecting TNCs' decision to choose the NEM option in Cambodia is local regulations, which de facto favour NEMs over FDI. Hotel management and operations are constrained by land ownership restrictions, and hence, foreign investors have to engage in such businesses through management contracts, franchises or long-term leases of land.

With the rapid growth of international tourism in recent years, the number of hotels in Cambodia has soared. Between 2018 and 2020, some 2,000 rooms are scheduled for completion, of which 38 per cent are in luxury and upscale hotels.[14] According to Rosario (2007), the hotel industry has two entry modes: FDI and NEMs, i.e. management contracts or franchising.

In the global hotel industry, it is well acknowledged that instead of investing in real estate, high degrees of control and lucrative revenues can be derived by establishing contractual agreements with local businesses (Quer, Claver and Andreu, 2007). Conceptually, the internalization theory suggests that contractual agreements allow firms to be more flexible in modifying their decisions in response to unforeseen changes in conditions in the host countries. For example, high transaction costs might arise due to cultural differences in host countries (Anderson and Gatignon, 1986).

All of the above explains why firms may prefer to commit fewer resources abroad. This is evident in Cambodia, as many new hotels are scheduled to open under NEMs. Table 7 shows some examples of international hotel brands expected to open facilities in Cambodia.

Table 7. **Examples of international hotels scheduled to open in Cambodia, 2019–2020**

Year	Hotel name	Operator	Owner	Business model
2021	Fairfield by Marriott Phnom Penh	Marriott International	Royal Field Development Co Ltd	Management contract
2020	Hyatt Regency Phnom Penh	Hyatt Hotels Corporation	Chip Mong Group	Management contract
2019	Shangri-La Phnom Penh	Shangri-La International Hotel Management Ltd	Oxley Gem (Cambodia), Ltd	Management contract
2019	Ibis Phnom Penh	Accor Hotels Group	Accor	FDI
N/A	Novotel	Accor Hotels Group		Management contract

Source: AJC.

This section examines three hotels that are scheduled to open in Phnom Penh through NEMs: the Hyatt Regency (box 6), the Fairfield by Marriott (box 7) and the Shangri-La (box 8). The specifics of land regulations and the prominence of these hotel brands have made foreign-domestic arrangements an important mode of operation.

[14] Knight Frank, Cambodia Real Estate Highlights, 1st half 2018.

Box 6. **Hyatt Regency Phnom Penh**

Hyatt Hotel Corporation is a world-class multinational hotel group headquartered in Chicago, Illinois (United States), managing hundreds of hotels worldwide, owning and managing over 140,000 rooms. It has developed different brands to meet the needs of different types of travellers, Hyatt Regency, its luxury brand hotels, are mid- to large-scale premium hotels (box table 6-1).

Box Table 6.1. **Features of Hyatt Hotel brands**

Style	Name	Typical range (rooms)
Flagship brand	Park Hyatt	125–250
Luxury brand	Grand Hyatt, Hyatt Regency, Hyatt	350–700, 200–2,000, 150–300
Design and boutique hotel	Andaz, Hyatt Centric, Unbound Collection	125–250, 100–250, 125–250
Basic service brand	Hyatt Place, Hyatt House	120–200, 120–200
All-inclusive resorts	Hyatt Zilarsta, Hyatt Ziva, Miraval	200–600, 200–600, 100–400

Source: Hyatt Hotel Corporation.

In 2016, a management agreement was signed between Hyatt Hotel Corporation and Chip Mong Group for the first Hyatt Regency hotel in Phnom Penh. The 250-room hotel, which is expected to open in 2020, will be located in one of the most popular areas of the city, close to the National Museum and the Royal Palace. Founded in 1982, the Chip Mong Group is a leading conglomerate in Cambodia, which is involved in many fields and products, such as beer, drinking water and other beverages; construction materials, ready-mixed concrete, roof tiles and pipes, cement, cans, consumer products, property development, hospitality and hotels, feed, retail and banking (box table 6-2).

Box Table 6.2. **Chip Mong Group's Portfolio**

Subsidiaries	Sector	Partnership
Hyatt Regency Phnom Penh	Hospitality	Hyatt Hotel Corporation
Khmer Brewery Limited	Drink	N/A
Chip Mong Land	Real estate development	N/A
Chip Mong Industries	Manufacturing	Siam City Concrete Co., Ltd.. (Thailand)
Chip Mong Trading	Distribution	N/A
Chip Mong Feed	Agriculture	N/A
Chip Mong Insee Cement	Manufacturing	Siam City Cement Co.
CROWN Khmer Beverage Cans	Packaging	CROWN Holdings Inc..
Chip Mong Ritta	Construction	Ritta Company Ltd. (Thailand)
Chip Mong Retail	Retailing	N/A
Chip Mong Commercial Bank	Financial	N/A
Royal Field Development	Hospitality	Marriot International (United States)

Source: Chip Mong Group.

In general, three models characterize Hyatt Hotel Corporation's arrangements across the globe (box table 6-3): (1) franchise model, (2) management model, and (3) ownership and lease model. The Hyatt Regency Phnom Penh will be operated under a combination of the franchise and management models (box figure 6-1).

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Box 6. **Hyatt Regency Phnom Penh**

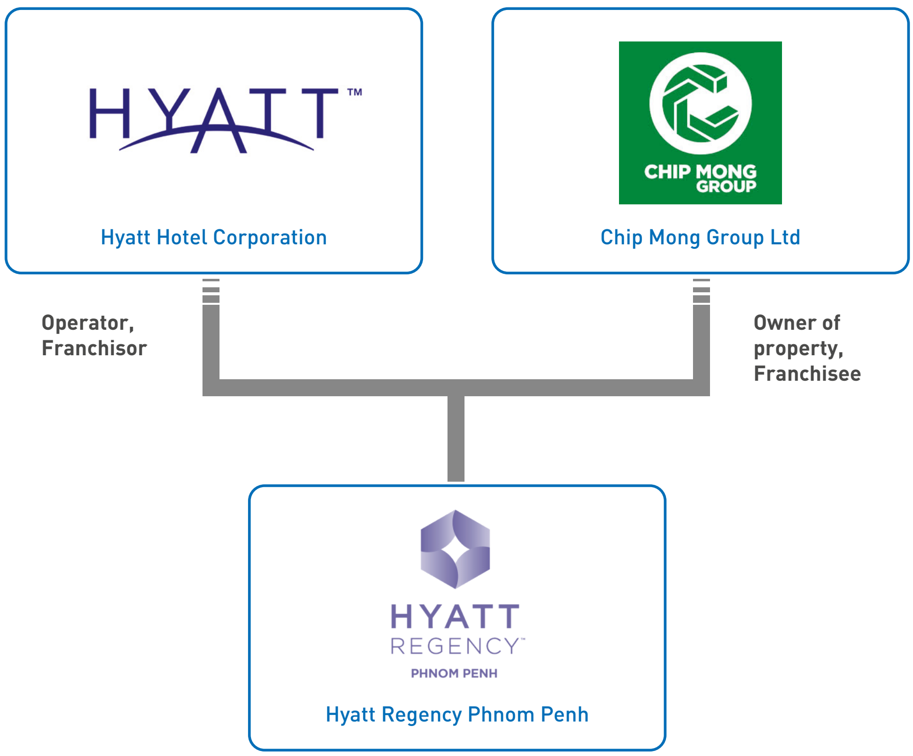
Box Table 6.3. **Hyatt Hotel Corporation's business models**

	Franchise	Management	Ownership and leased
Revenue	Initial franchise fee + Ongoing franchise fee + Other service fee	Base fee + Incentive fee	Room rent + F&B sales + Revenue from other services
Properties	248 hotels and 5 all-inclusive properties	264 hotels and 10 residential properties	35 hotels, 1 residential property and 8 leased hotels

Source: Matthews (2015).

Based on publicly available information retrieved from Hyatt's website, the Hyatt Regency Phnom Penh will be the first Hyatt Regency brand hotel in Cambodia run by Hyatt Hotel Corporation under a mix of the franchise and management models (box figure 6-1).

Box figure 6.1. **Hyatt Corporation and Chip Mong Group Agreement**



Source: AJC.

The details of management agreements signed between Hyatt Hotel Corporation and Chip Mong Group have not been disclosed. Box table 6-4 summarizes the expected fee system, services, term and renewal details of the agreement.

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Box 6. **Hyatt Regency Phnom Penh** (Concluded)

Box Table 6.4. **Expected fee system, responsibilities, terms and renewal**

Fees charged by Hyatt Hotel Group	Services provided by Hyatt Hotel Group	Terms and renewability
Fee for Hyatt (Hyatt Regency is considered a full-service hotel): Franchise fee: - Application fee: $100,000 or $300 per guest room - Franchise fee: 6% of gross room revenues, 3% of gross food and beverage revenues. - Other service fees Management fee: - Base fee: an agreement on percentage of gross revenues from hotel operations - Incentive fee: calculated as a percentage of a hotel profitability measure Fee for running the Hyatt Regency Phnom Penh: - Operating costs - Capital expenditures	- Use of the Hyatt Regency brand name - Maintenance and repair of hotel - Hiring, training, and supervising of hotel managers and employees - Annual budget preparation - Local sales and marketing efforts - Financial analysis - Food and beverage services *All above costs to be approved and reimbursed by owners.*	Franchise agreement: The term of Hyatt franchise agreements is typically 20 years, with one 10-year renewal option exercisable by the franchisee, assuming the franchisee has complied with franchise agreement requirements and standards. Management agreement: If no renewal options are exercised by either party, for Asia and Pacific region, the average term is 14 years; if the agreement includes the exercise of extension options that are in Hyatt's sole discretion, the average term is 16 years.

Source: Based on a similar management agreement disclosed in Hyatt Hotel Corporation's 2016 annual report.

Box 7. **Fairfield by Marriott Phnom Penh**

Marriott International is a United States-based global lodging company that has 6,500 properties in 127 countries and territories with over 1.2 million rooms (as of September 2017); it is headquartered in Washington, D.C. Marriott International operates 30 brands internationally (box table 7-1). Fairfield is an economy chain of hotels targeted at competing with economy hotels globally. Marriott International generally operates this hotel chain under one of two business models (see box table 7-2): (1) franchising, licensing, and joint-venture programs, and (2) company-operated programs through management agreements, and lease agreements.

Box Table 7.1. **Chain categories and names of Marriott International brands**

Luxury	St. Regis Hotels & Resorts, The Ritz-Carlton, JW Marriott, Edition, The Luxury Collection, W Hotels, BVLGARI Hotels & Resorts
Upper Upscale	Autograph Collection Hotels, Le Meriden, Tribute Portfolio, Westin Hotels & Resorts, Renaissance Hotels, Gaylord Hotels, Marriott, Delta Hotels, Sheraton, Marriott Executive Hotels
Upscale	Courtyard, Four Points by Sheraton, Springhill Suites by Marriott, Residence Inn by Marriott, AC Hotels, Aloft Hotels, Element by Westin
Upper midscale	Moxy Hotels, Protea Hotels, Fairfield, Towneplace Suites

Source: Marriott International Annual Report 2017.

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Box 7. **Fairfield by Marriott Phnom Penh**

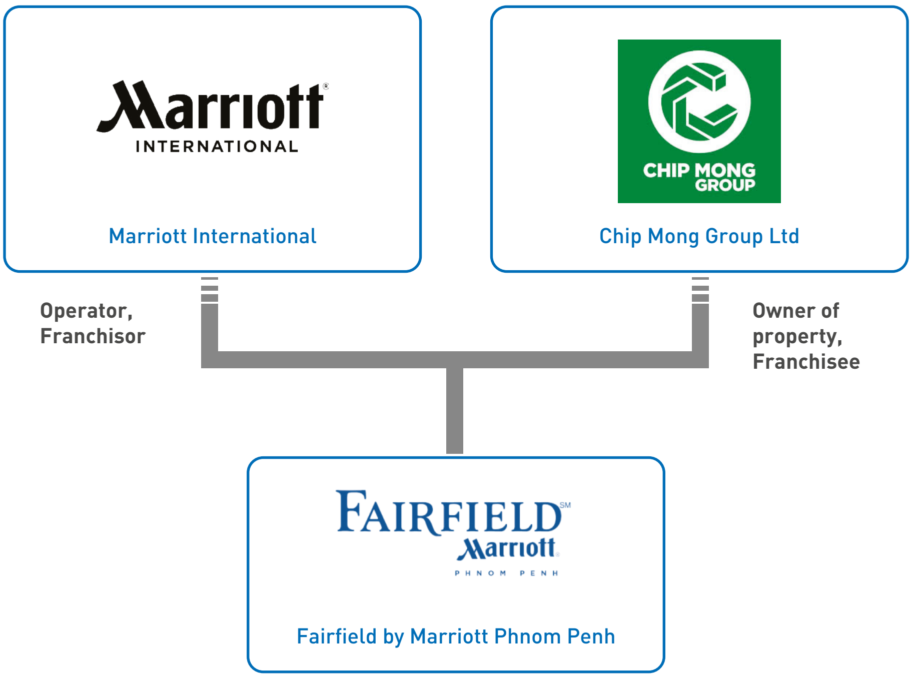
In 2017, Marriott International and Royal Field Development Co. Ltd. signed a management contract to open the first Fairfield branded hotel in Phnom Penh in 2021. Royal Field Development is a subsidiary of the Chip Mong Group (box figure 7-1). The hotel has been earmarked to be located in the administrative centre of Phnom Penh, just 20 minutes from the airport. Facilities will include a restaurant and a fitness centre.

Box Table 7.2. **Marriott International's business models**

	Franchising, licensing, or joint venture	Management agreement, or lease agreement (together, operating agreement)
Definition	Property owner or other operator can use Marriott's brand names and systems	Management agreement: property owner uses Marriott's manager to operate the property Lease agreement: Marriott leases the hotel from the property owner
Features	4,432 franchised and licensed properties (as of 2017), the majority "select service"	1,959 company-operated hotels (as of 2017), the majority full-service

Source: Marriott International Annual Report 2017.

Box figure 7.1. **Fairfield Marriott Phnom Penh**



Source: Marriott International Annual Report 2017.

According to the director of new business development of Chip Mong Group, a budget of $100 million will be allocated for the construction and operation of the Fairfield Marriott Phnom Penh. Using the limited data available, an analysis may be made of a possible fee system for the various services provided by Marriott and the terms and renewability of the agreement (box table 7-3).

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Box 7. **Fairfield by Marriott Phnom Penh** (Concluded)

Box Table 7.3. **Possible fee system, services provided, term and renewal for Fairfield by Marriott Phnom Penh**

Fees charged by Marriott International	Services provided by Marriott International	Terms and renewability
Fee charged by Marriott International (Fairfield by Marriott is a select-service hotel) Franchise fee: - Application fee and continuing royalty fees: range from 4% to 6% of room revenues for all brands. - Fees for use of centralized reservation system: $4.24 per guestroom reserved Management Fee: - Base fee: a certain percentage of hotel revenues - Incentive fee: based on hotel profits	- Hiring - Training - Supervising - Centralized reservation service - National adverting - Marketing - Promotional services - Various accounting and data processing services *All costs to be approved and reimbursed by owners.*	Franchise agreement: The length of the initial franchise term is 20 years. The agreement is not renewable. Management agreement: Initial periods of 20 to 30 years, with options for Marriott to renew for up to 50 or more additional years. Many agreements permit owners to terminate the agreement if Marriott does not meet certain performance metrics or defined financial return level.

Source: Marriott International Annual Report 2017.

Box 8. **Shangri-La Hotel Phnom Penh**

Shangri-La International Hotel Management Ltd is a hospitality company owned by Robert Kuok that is based in Hong Kong, China. Founded in 1971, the company owns and manages about 100 hotels and resorts under various brands (box table 8-1). In 2017, Shangri-La Hotel Management had 20 hotels owned by third parties through strategic partnerships, which do not require capital commitments at the host sites. Another seven hotels are under development in Nanning, Qiantan, Suzhou (China); Kota Kinabalu (Malaysia); Bali (Indonesia); Jeddah (Saudi Arabia); Phnom Penh (Cambodia); Melbourne (Australia); and Manana (Bahrain).

The first Shangri-La hotel in Cambodia is expected to open in Phnom Penh in 2019, under a management agreement between Shangri-La International Hotel Management and Oxley Gem (Cambodia) Co. Ltd., announced in October 2014. It will be located along the Mekong River facing Diamond Island. The hotel is expected to have 300 rooms.

Box Table 8.1. **List of Shangri-La International Hotel's brands**

Shangri-La Hotels	Five-star luxury properties in premier cities
Shangri-La Resorts	Resorts offering travellers and families relaxing and engaging vacations in exotic destinations
Traders Hotels	Located in the business hubs in Asia and Middle East, offering services for business travellers
Kerry Hotels	New brand, five-star designed hotels
Hotel Jen	Middle-range hotels in Asia

Source: Shangri-La International Hotel.

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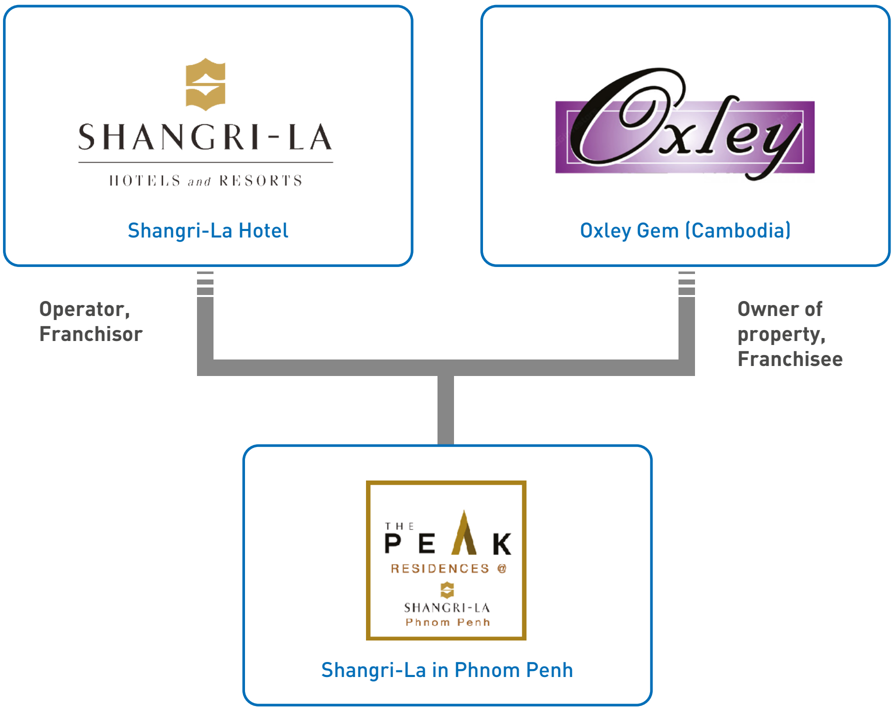
Box 8. **Shangri-La Hotel Phnom Penh**

Unlike the Fairfield Marriott, the Shangri-La Phnom Penh will be a five-star luxury hotel. Shangri-La organizes its hotel business in three main segments: hotel ownership, property rentals, and hotel management services. Box figure 8-1 presents the strategic partnership between Shangri-La Hotel Management and Oxley Gem (Cambodia).

Box figure 8.1. **Management Agreement between Shangri-La Hotel Management and Oxley Gem (Cambodia)**



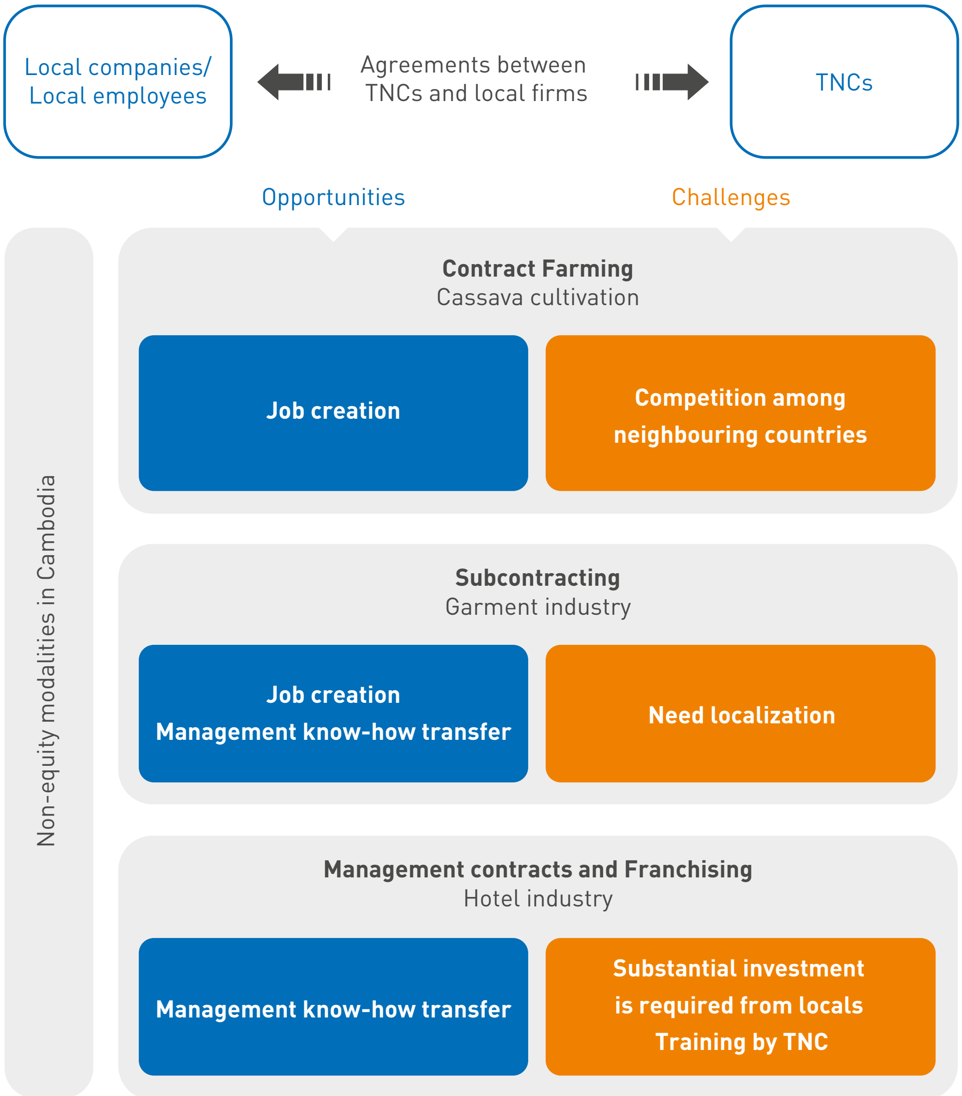
Source: Shangri-La International Hotel.

The local partner, Oxley Gem, was founded in July 2013. Its main activities include retail, hotel, residential and commercial in Phnom Penh. Oxley Holdings Ltd., a Singapore lifestyle property, owns 75 per cent of Oxley Gem and 25 per cent is owned by Worldbridge Land (Cambodia) Co., Ltd., a leading property company in the country. Oxley Gem is the developer of the "Peak", a mixed-use development project occupying approximately 12,609 square meters in the heart of Phnom Penh. It comprises two residential towers, one commercial tower with offices, and the new Shangri-la hotel.

3. OPPORTUNITIES AND CHALLENGES

This section analyses the opportunities and challenges Cambodia faces in promoting and capitalizing on economic synergies from the establishment and expansion of NEMs (figure 2). The development of NEMs with TNC linkages will offer local industries a number of opportunities. Although the potential is huge, the realization of economic benefits from these agreements is not without challenges.

Figure 2. **Opportunities for NEMs in Cambodia**



Source: AJC.
Note: Major NEM industries only.

The issues faced by local firms relate to contractual agreements, industry characteristics and TNC strategies, among other matters. Both opportunities and challenges can be found for each.

The issues can be grouped in four categories: continuity (footlooseness), NEM characteristics, capacity-building, and local firms' initiatives and local embeddedness (table 8).

In their quest to take advantage of the opportunities, local NEM firms will also face challenges if they seek to strategically adopt TNCs' know-how and technological skills for their use (table 8). They may also build their capacity to deal with these challenges and even expand their businesses by using TNCs' GVC networks. In addition, local NEM firms can use their supply chain experience with TNCs to eventually export directly to foreign markets.

Table 8. **Opportunities and challenges facing local firms engaged in NEMs**

Opportunities	Typical industries concerned	Challenges
Continuity (footlooseness) issues		
Easier to find TNC partners both in and outside the country through, for example, matching events (since TNCs do not directly invest into the business).	Garments & Footwear	Easier for TNCs to terminate the contract, and long-term relationship is not guaranteed, if quality of services or goods do not meet TNC's standards and if local firms in other countries are more competitive (e.g. competitors in the IT-BPO/BPM industry in India or Viet Nam).
NEM characteristics issues		
Easier to enter new market or new area even where demand is not present in the country. Skills, talents or resources that are available in the country but are not required there can be usefully utilized outside the country.	Tourism	Demand and markets are outside the country (e.g. customers of hotel industry, and subcontracting products). Demand from TNCs may change depending on the interest and taste of their clients (e.g. changes in trends in tourism destinations, trends in furniture and home decor).
Capacity-building issues		
Easier for local employees to work in business activities because of low skills.	Agriculture	Not easy for local firm to build further capacity, apart from that gained through receiving orders from customers, as under NEMs they receive only relevant know-how at most (thus, upgrading value chain activities through local firms' efforts alone is not easy).
Initiatives and local embeddedness issues		
Local firms can adopt foreign design and management approaches and thus do not need to think about local values and localization strategies (that is, it is quicker for local firms to make a profit by using TNCs' business models).	Tourism	Local firms may lose their initiative, design ability and traditional values, apart from designing for limited products (e.g. local firms may follow TNCs business models of hotel industry as they do not need to implement localization strategy).
Local firms and franchisees should consider localization model carefully, so it takes a longer time for local firms to make profits. Therefore, they seek to initiative for their operations or activities leading to embeddedness.	Convenience Store	In the short term, franchisees or local firms may face difficulties in adapting TNCs' original strategies to local tastes and need to learn through experience until they become part of the community (e.g. in the retail industry, franchisees need to localize the TNCs' strategy to meet local customers' demands that TNCs are not aware of).

Source: AJC.

3.1 Ownership

NEM operations provide the host country and local firms with both opportunities and challenges. Even if foreign ownership is not directly achieved through equity, TNCs can still exert quasi-ownership control over local firms through contracts by means of providing important inputs, access to markets, required technology and income sources. If TNCs can find local firms that offer the same or better services than their own affiliates, they are likely to establish contracts with local firms and enter NEM arrangements.

In Cambodia, there are potential opportunities for local firms to have contractual agreements with TNCs in a wide range of industries including cassava, clothing and hotels. Garments have been the chief export of Cambodia for over a decade now, the country's history and culture make hotels attractive for tourism, and the climate and soil is ideal for cassava. Capabilities are already evolving in these three industries. Whereas the government is targeting the cassava and hotel industries to become world-leading industries in the future, the garment industry already shows considerable promise for upgrading. Although local firms have already emerged to generate NEM synergies from the expansion in these industries, there is a need to coordinate better the attempt to boost local ownership rates in all three.

Although directly or jointly owned operations offer nationals room to expand into GVCs, the ability to remain connected in value chains requires constant upgrading, so as to offer TNCs sufficiently competitive options. TNCs typically make decisions on whether to produce their raw materials and intermediate components in-house or to purchase them from suppliers on the basis of a wide range of factors. One key factor is the existence or the potential emergence of competent suppliers within Cambodia. TNCs are likely to contract out supplies to local firms if they benefit economically from such outsourcing, relative to producing them in-house or importing them from abroad. Such contractual arrangements can benefit host countries through the expansion of linkages into countries. Thus, there are potential opportunities for local firms in the garment, electronics, rice, tobacco and hotel industries, as well as others that tend to be the focus of contractual agreements with TNCs.

However, these opportunities can only be taken advantage of effectively if local firms acquire and develop the requisite capabilities to participate in such contractual relationships. These capabilities include management, inventory and quality control systems and production technology. There will also be a pressing need to sustain rapid technological upgrading among national NEM firms for them to remain connected to GVCs, as well as to move to higher value added activities, which will become inevitable once unemployment falls and production costs rise. This is how Foxconn from Taiwan Province of China managed to transform its linkage with Apple from being an OEM to taking control of the design and R&D of the components it supplies (Sturgeon, 2002). Flextronics and Celestica are other examples. Also, if local NEM firms do not remain competitive – for example, in supplying materials to garment and electronics firms, and in hotel franchises – TNCs will switch suppliers or terminate their branding agreements. In the hotel industry, established brand holders have terminated contractual agreements with host-country owners when their standards were compromised. Examples include the termination of contracts by Park Hotel and Holiday Inn in Malaysia. Hence, the franchise modality is often vulnerable to the vicissitudes of volatile demand fluctuations. In industries such as garments, TNCs often engage a few suppliers simultaneously so that orders filled by competent and successful firms can compensate for orders terminated from unsuccessful firms (Rasiah, 2009a, 2009b).

3.2 Control

Even though foreign firms do not directly own NEM firms, more often than not they control them. Control takes the form of buyer firms being able to dominate pricing decisions, assessment of quality and determination of lead times. In CMT operations in the garment industry, Cambodian NEM firms are completely reliant on buyers with respect to lead times, specifications and materials sourced (Rasiah, 2009a; 2009b). Similarly, in the hotel industry, franchise holders determine the terms and conditions under which NEM firms must operate.

The positive side of these conditions includes the pressure imposed by TNCs on NEM firms to upgrade; that said, NEM firms always remain exposed to contract termination if TNCs are not satisfied with their supply or if more capable suppliers emerge. Such circumstances often arise when TNCs upgrade and thereby require that their suppliers also upgrade their operations. Examples of NEM firms that have met such upgrading requirements include Flextronics, Celestica and Foxconn, which have all developed R&D capabilities to undertake design and R&D involving components, both completely knocked down and completely built-up units for their buyers (Rasiah, 1994; Sturgeon, 2002). Such circumstances can also emerge if the TNCs find other suppliers in other countries to be more efficient or if those other countries provide better access to markets. Nevertheless, NEM firms that catch the wave of competition to upgrade provoked by major export markets enjoy the opportunity to move up the value chain, and even – as in the Republic of Korea and Taiwan Province of China – to leapfrog incumbents (Hirshman, 1970; Amsden, 1989; Kim, 1997; Amsden and Chu, 2003). Samsung Semiconductor, which started operations in 1975, and Taiwan Semiconductor Manufacturing Company, which started operations in 1987, now lead the memory and logic chip value chains respectively (Rasiah, Yap and Yap, 2015). In Cambodia, the science, technology and innovation (STI) infrastructure will require massive transformation to bring about such developments (see Rasiah, 2018).

If buyer TNCs' subsidiaries are located in Cambodia to procure inputs from NEM firms, the control those TNCs exercise can be stronger than otherwise. In LDCs, such TNCs often make efforts to train the workforce of host-country NEM suppliers or sometimes invest in skills development centres to develop the host country's human resources or implement rooting strategies for its own expansion (Rasiah, 1995). The host government often plays a central leveraging role to initiate and coordinate such developments, as seen in Singapore[15] and Malaysia.[16] The garment and electronics industries in Cambodia can benefit from adopting such a framework. TNCs often adopt such a function to strengthen their value chain globally.

[15] Singapore's Economic Development Board successfully played such a role (Rasiah and Yap, 2016).

[16] The Penang Skills Development Center, established in 1989, is financed together with TNCs (Rasiah, 1995). Hirschman (1970) actually emphasized this point when discussing the role of host-country governments in stimulating backward linkages.

3.3 NEM modalities and industries

Particular modalities are often linked to specific industries. For example, in Cambodia both contract farming and subcontracting characterize cassava cultivation, whereas subcontracting dominates garment manufacturing, and management contracts and franchising dominate the hotel industry. There are TNC-owned subsidiaries in Cambodia that have entered contractual agreements with customer firms outside the country in industries such as cassava production and garment manufacturing. In such cases, these subsidiaries create offshore outsourcing with TNC vendors, which has created opportunities for local employees to be integrated in subsidiaries' business activities; however, it does not guarantee capacity building for local firms, which requires internal efforts. Local NEM firms that have contractual agreements with TNCs' subsidiaries in the cassava and garment value chains encounter offshore outsourcing opportunities (figure 1). Through this modality, local firms have potential opportunities to receive orders from customer TNCs located outside the country.

Other modalities characterize the hotel and retail industries. Most brand holders in the hotel industry use management contracts and franchising. Examples include the Hyatt Regency Phnom Penh and Fairfield Phnom Penh (with Chong Ming Group as the local partner), and Shangri-La (with Oxley Gem as its local partner). The prohibition of foreign ownership of land is the main leveraging point that has allowed the participation of local partners. Such management contracts and franchising modalities should be promoted further as foreign brand holders have demonstrated a strong global marketing ability to attract tourists worldwide to Cambodia as a country and to the country's hotels.

However, because brand holders impose stringent conditions to protect their brands, national owners must keep their operating standards high in order to remain attractive to the brand holders. Indeed, throughout ASEAN, management contracts and franchise agreements are the typical modalities engaged in by TNCs in the hotel industry, though there are also hotels that are owned jointly with foreign capital and managed directly by foreign hoteliers in countries such as Malaysia and the Philippines. The generation of tourism synergies from the promotion of NEMs in the hotel industry also requires that the government improves infrastructure (including IT support) and security throughout the country.

3.4 Localization strategies

Governments have often launched localization strategies when foreign TNCs engage in manufacturing for domestic markets. This is how Indonesia, Malaysia and Thailand initially promoted local suppliers in the automobile industry (Rasiah, 2010). However, such opportunities have largely fizzled out since the onset of deregulation in the region (following the launch of the ASEAN Free Trade Area in 1992 and later the ASEAN Economic Community in 2015) and around the world (by the World Trade Organization in 1995). Nevertheless, governments still enjoy the space to promote linkages with national NEM firms without infringing the Trade-Related Investment Measures (TRIMs) instrument of the WTO, which prohibits differential trade treatment on the basis of ownership (Rasiah, 2005). Also, as was done in Singapore, Indonesia and Vietnam in the past, the Cambodian government can use leveraging strategies based on its bargaining strength to impose conditions for TNCs to train national workers and to source from capable NEM firms. This is an effective tool when the TNCs enjoy incentives or benefits from sales in the domestic market. The cassava, garment and hotel industries can be targeted for the development of NEMs as suppliers; they can also export once they develop sufficient capabilities.

TNCs' efforts to outsource a part or the whole of any goods or services, or even part of their GVC stages, to a host country increase when the TNCs look for nearby suppliers so as to attain zero inventory levels. This is the case when TNCs seek to reduce transport costs and to coordinate effectively the implementation of just-in-time inventory control systems, as well as to enhance the application of kaizen (continuous improvement) activities. This is why foreign TNCs have developed nearby suppliers in the electronics and automobile industries, though unless local capabilities are built up, foreign suppliers often fill the void (Rasiah, 1994). In the garment and electronics industries Cambodian NEM firms can improve the quality of their silk fibre, electronics parts (e.g. plastic injection moulding) and textile manufacturing activity, both to supply TNCs in the country and to export. National NEM firms should undertake initiatives independently to integrate their operations and activities with TNCs' overall production networks and GVCs.

The challenges include the need to develop human capital and the need for local firms to undergo massive technological upgrading to meet international standards. Local firms need to have a minimum level of management skills, including autonomous acquisition initiatives, technological skills and capacity, depending on the industry, as TNCs' support cannot be taken for granted. In addition, TNCs' decisions about selecting local partners and terminating contracts with them are often unpredictable, since such contracts are typically not guaranteed over the long term and can be ended anytime. Two characteristics of NEMs are that demand for particular products or services can come from subsidiaries located in different places and that such demand is not predictable. In the absence of control over demand, local firms remain vulnerable to market fluctuations, despite their acquisition and development of NEM capabilities.

In industries with franchising agreements, operations or activities are characterized by two main types of identity. On the one hand, in the hotel industry TNCs' operations and activities are standardized at the international level but at the same time tailored to synergize with local hospitality. The merging of global and local features has been referred to as glocalization. Hence, firms' operations or activities do not need to be spearheaded through a deliberate localization strategy. Local management can eventually build the capacity to run local hotels, which can seek to expand regionally once the expertise brought by international hotel chains standards has been transferred and modified to include the unique features of local hospitality.

TNCs may terminate agreements with local firms when more efficient suppliers capture their business. Efforts to discourage such behavior require the successful implementation of a profound localization strategy by the government, one that is cognizant of the strategies of both TNCs and local firms – even in NEM operations. Local firms should also take initiatives independent of TNCs to integrate their operations and activities into TNCs' overall production networks and GVCs. The government will need to distribute information in Khmer underscoring what is allowed under existing contractual practices and laws, as well as what is required by international trading practices and activities that the government is promoting.

3.5 Basic and science, technology and innovation infrastructure

The infrastructure in Cambodia has advanced considerably since the civil war ended, and trade shipment, road transport and the movement of people have all improved to facilitate tourism and trade. These developments offer great potential to stimulate additional tourism, as well as manufacturing and agriculture, mining and services. However, transportation bottlenecks that have emerged in Phnom Penh and the hinterland connectivity still need considerable development. In addition to improving the basic infrastructure, the government will also need to develop science, technology and innovation (STI) infrastructure if it hopes to stimulate upgrading in NEMs (see Rasiah, 2018).

There are no science parks or incubators in Cambodia to support the scaling of innovations, especially in cassava farming. Similarly, training centres in the country lack coordination and the appraisal capacity to support farm and firm upgrading. Such support will be critical if the government is to realize its ambition to make Cambodia a world-leading producer of cassava.

4. POLICY IMPLICATIONS

Increasing trade and openness to investment within ASEAN offers enormous opportunities for Cambodia in both directions, inward and outward. The Comprehensive and Progressive Agreement for the Trans-Pacific Partnership has already forged ahead, and the Regional Comprehensive Economic Partnership is under negotiation for earlier-than-planned conclusion. These mega-agreements not only deregulate trade further but also increase the attractiveness of ASEAN. ASEAN is among the most open and integrated regions in the world, seeing rapid expansion of trade as well as FDI inflows and outflows.

Within the overall policy framework of NEMs discussed above, the Cambodian government should consider evaluating the state of NEMs and NEM-related operations in the country as the foundation for their promotion. For an evaluation methodology, AJC proposes the checklist in table 8, which is based on the corporate code of conduct of the Tokyo Chamber of Commerce and Industry. It provides direction for the Cambodian government to check whether NEM agreements and operations comply with and are in sync with international standards, taking into account all stakeholders — NEM firms' foreign clients, local NEM-based firms, local NEM subcontracting firms, and local workers.

Typically, firms that are connected to buyer firms owned fully or jointly by foreign TNCs are reliant on export markets, and thus, have been the most vulnerable to external shocks such as those experienced by Malaysia, the Philippines, Singapore and Thailand during the global financial crisis of 2007–2008. The adverse impact of reliance on TNCs has also been felt in terms of the repatriation of profits by TNCs to their home countries. Local NEM firms can help reduce the repatriation of profits by capturing some segments of TNCs' value chains. The development of resilient local NEM firms, especially in contract cassava farming, subcontract garment manufacturing, and hotels using management contracts and franchising, will help build the reservoir of domestic capital that can be mobilized for internationalization.

In addition, fostering NEM firms can create more opportunities to link the country with neighbouring countries (e.g. Thailand, China, the Lao People's Democratic Republic, Viet Nam and Malaysia) through becoming part of value chains. Focusing the country's business objectives on growth areas of the ASEAN region, rather than countries outside the region, is an important and reasonable growth strategy. Hence, government policy should consider the promotion of NEMs as one of the critical economic growth strategies. There are at least eight strategies that the government, TNCs and local NEM firms can consider and coordinate to facilitate rapid economic growth and structural change in Cambodia:

1. Enhancing the capability of local firms
2. Improving investment regulations
3. Promoting and upgrading skills and expertise
4. Enhancing basic infrastructure
5. Building STI infrastructure

6. Promoting connectivity and coordination
7. Promoting integration into global markets
8. Mainstreaming sustainable development

4.1 Enhancing the capability of local firms

Local firms' capabilities in both technological and management skills should be enhanced so that they can meet TNCs' current and potential demand, as well as help spearhead the transformation of the economy from a concentration on low value added activities to a concentration on high value added activities. Once they develop the essential capabilities, they can upgrade them to enjoy higher value addition in their operations, which will then open access to potential customers through TNC networks, as well as domestic firms, and for them to create their own business networks in the long run.

Firm level

At the firm level, the government needs to support the implementation of continuous internal training for employees in local firms. They can appropriate synergies from foreign training bodies, such as the German Technical Cooperation Agency and the Japan International Cooperation Agency, which have deepened their support operations in Cambodia since the late 1990s (Rasiah, 2009a, 2009b). However, local firms must also train their employees for higher-skilled jobs. Direct or indirect financial support for training will help local firms focus on internal training tailored to their own needs to meet demand from their client TNCs.17 The government should consider imposing on firms a levy of a certain percentage of corporate income and offering an equivalent government complement, for example, 1 per cent each, to be used for internal training. The cassava, garment and hotel industries would benefit enormously from such an initiative. In light of the transition to Industry 4.0 across the world, training should also address the potential for the use of digitalization, such as digitally controlled smart robots.

Industrial associations should promote a learning centre where local firms can learn about NEM operations and activities. They need to be collectively aware of changes in demand rather than focusing solely on current operations. The government can support these firms as a facilitator, connecting firms in an industry with the essential organizations and ministries. Programs at the centre should cover all aspects of NEMs in forming, executing and evaluating contracts, as well as NEM operations.

Create an enabling environment for local firms to facilitate their globalization and localization (glocalization) strategies. Local firms need to become familiar with TNCs' changing strategies and to learn customers' strategies. Using its bargaining position as the authorization body, the government can support different types of NEMs by using leveraging strategies to induce TNCs to stimulate the upgrading of local firms. Incentives and preferential access to domestic institutions can be the leveraging instruments.

Industry level

The government should establish and strengthen the environment for competition and cooperation between local firms and foreign TNCs through which local firms in many industries other than

[17] This was the case of the Malaysian electrical and electronics industry in the 1990s (see Rasiah, 1995).

garments can become partners of foreign firms. Local firms need to strengthen their operations and activities, which requires continuous improvements in their capabilities to be able to sustain competitiveness. Competing with local and foreign firms in Cambodia gives local firms the potential to become competitive enough to participate as TNCs' partners or vendors. Therefore, the government should create a positive environment for firms to compete with others while cooperating with one another so that NEM industries as a whole can become more and more competitive over time.

The government should promote local firms to upgrade into higher value added segments of GVCs to stimulate structural change in the country. Shifts in demand by TNCs and changes in TNCs' strategies in Cambodia derive mostly from TNCs' efforts to reduce costs. The government can promote local firm capabilities explicitly through supporting innovation and technical upgrading. Only then can those firms sustain NEM partnerships with foreign TNCs over the long term.

The government should establish an intellectual property rights body in the country to encourage local firms in acquiring technologies required to perform as high value added NEM operators. Competition to become a TNC's NEM partner is high. Some competitors may offer higher-quality services at lower prices. Particularly if the services offered by local firms are standardized and are not required to localize, competition will be much more severe. Innovations flourish only where intellectual property rights are protected (Schumpeter, 1934). The country is still underdeveloped in this respect, classified as stage 1 (the lowest in terms of development) in the World Economic Forum's Global Competitiveness Index 2016–2017. It will also be pertinent for the government to identify and promote geographical indications in labeling so that agricultural products such as cassava can be traded at premium prices.

Shield local employees from unreasonably exploitative conditions. Doing so would also help improve productivity. Local employees need protection through some kind of labour policy for the industry if working environments or conditions are not healthy. As a signatory to the ILO's covenants, Cambodia has in place the general legal environment to shield the labour force from exploitation. However, there is a critical need to ensure that these covenants are enforced to prevent the occurrence of breaches, such as those reported by the GMAC.

4.2 Improving investment regulations

NEMs are used by fully nationally owned firms and by joint ventures with national and foreign equity. Thus, refinement of regulations to attract foreign and domestic investment is necessary to stimulate NEM activities in Cambodia. An active and vibrant environment where NEM firms function alongside foreign firms and joint ventures will be important to foster rapid economic growth and structural change in the country.

A 2014 report by the Economic Research Institute for ASEAN and East Asia (ERIA) noted that regulations on the approval of licenses for small and medium-sized firms in Cambodia are extremely cumbersome and often involve a long and tedious process, thus causing delays. The government should rationalize approvals for these firms to be consistent with its practice for large firms, for which approvals have been expedited. In addition, since large foreign firms are primarily found only in the resource-based and garment industries, it would be useful to attract similar foreign and joint-venture firms to other activities so that they can play an active role in other critical sectors, such as IT and transport. The same NEM arrangements can be found in contract farming of cassava and in franchised hotels and hotels run through management contracts.

4.3 Promoting and upgrading skills and expertise

Economic development in any LDC requires, inter alia, massive upgrading of skills and expertise. Cambodia is no different. Unfortunately, skilled and semi-skilled labour shortages have hampered the activities of garment firms in Cambodia (Rasiah, Gopala and Sanjivee, 2013; Rasiah, Gopala and Ratnavelu, 2015). NEM firms and foreign and joint-venture firms can certainly pursue upgrading strategies if the requisite skills and expertise are in place. The following recommendations can go a long way toward making this possible.

The government should build more schools to make primary education (for children ages 7 to 12) compulsory. Although this is the age group typically targeted for universal education, as recommended by the World Bank, making secondary schooling mandatory will be useful to ensure a strong supply of basic labour that is literate enough to perform semi-skilled jobs. This labour force can be further trained to undertake skilled tasks through learning by doing, in-house training and exposure to training in technical and vocational institutes. Foreign organizations that offer official development assistance – e.g. the Japan International Cooperation Agency and the German Technical Cooperation Agency – can complement national institutes to strengthen these training activities.

Cambodia has seen a significant emigration of skilled and professional personnel, especially to Thailand (Rasiah, Vignes and Sanjivee, 2013). Not only are the languages of Cambodia and Thailand close, but western and northern Cambodia borders Thailand and has a long history of Indo-Chinese linkages. Efforts must be made to bring back skilled personnel through attractive brain gain and brain circulation policies such as those employed in China, the Republic of Korea and Taiwan Province of China. Although the Cambodian diaspora could be offered permanent resident and citizenship status, the government might also consider easing and simplifying work permits for foreign experts as a way to strengthen the management of firms in the country.

4.4 Enhancing basic infrastructure

The growth of NEM-based exports, employment and revenue can be solidified if the government develops the basic infrastructure where NEM firms operate. Ease of registration; access to finance, skilled personnel and water and power; and provision of security are important to lower the cost of doing business and to operate efficiently (ERIA, 2014). Local administrative agencies must help solve the problems that these firms face. For example, the lead time facing garment firms in Cambodia is longer than that facing firms in Bangladesh, China, Malaysia, the Philippines and Viet Nam (Rasiah, Gopala and Sanjivee, 2013).

With good infrastructure, hotels can benefit from an increase in tourist visits to scenic locations, and the cassava, garment and other industries can enjoy low-cost and quick access to essential services. Access to the internet also connects potential customers to hotels and the tourist attractions that surround their locations. The focus on basic infrastructure should not be confined to just road, railway, sea and air transport, but should also include improvements in water and power supply, schools, telecommunication and health centres.

4.5 Building science, technology and innovation infrastructure

Whereas efficient basic infrastructure is critical to boost the efficiency of firms, the development of STI infrastructure is important to stimulate firms' participation in innovative activities, including information and communication technology (ICT) and biotechnology.[18] Cambodia should start by developing the infrastructure for the latter two activities, offering complementary support for a wide range of industries. Not only clothing and agricultural products, but also outsourcing industries as well as a wide range of other industries could benefit strongly from this infrastructure.

In addition, a bioscience park could be developed to support the incubation and enhancement of innovation capabilities in domestic agriculture. The focus should be on rice, cassava, coffee and other important crops for which Cambodia has the potential of raising value added and becoming a world-leading exporter. Selected national universities should also participate in supporting R&D and in training researchers and entrepreneurs to raise value added in farming.

Training centres may focus on raising the skills of workers for the garment industry. Training in cutting-edge skills, such as those proliferating from digitalization and smart machines should become the basis of training modules. Phnom Penh should be the main centre of these training institutes, with subsidiary outlets in Sihanoukville and major cities in other regions.

4.6 Promoting connectivity and coordination

Support for NEM firms from the government and industrial associations is not sufficient to stimulate technological upgrading. There must also be strong connectivity and coordination between basic and STI infrastructure, and the NEM firms. Whereas the emphasis on basic infrastructure will help firms establish more efficient business practices, shorten lead times and lower costs, the development of STI infrastructure – science parks, industry-university linkages and standards organizations – along with good-quality, technically skilled university graduates will help stimulate the generation of innovation synergies in firms. This is critical if firms are to upgrade technologically so as to sustain their competitiveness, and if they are to participate in high value added activities (Rasiah, 2007).

The government and industrial associations need to work together to solve collective action problems in basic and STI infrastructure. The strengthening of connectivity and coordination between firms and the organizations will also stimulate institutional upgrading to accelerate economic development and structural change in Cambodia.

4.7 Promoting integration into global markets

NEM firms can make ASEAN more integrated. The ASEAN Economic Community offers low tariffs of zero to 5 per cent in almost all product lines. Through this arrangement, NEM firms enjoy preferential treatment in ASEAN markets so long as 40 per cent of their cumulative value added is recorded within the region (rule of origin). The same is true for foreign TNCs. In addition, Cambodian NEM firms enjoy preferential trade treatment provided by developed countries through the Everything but Arms clause of the EU[19] and preferential access to the United States market. Efforts to maximize such preferential treatment include reducing bureaucratic red tape in customs controls involving

[18] For a detailed account of STI infrastructure in ASEAN members, see Rasiah (2018).
[19] As of February 2019, this special arrangement was threatened to be terminated.

trade and registering firms that seek to import and export. It is also important for Cambodia to offer employment permits to foreigners who have the requisite qualifications. It may also be worth introducing textile engineering at selected national universities to generate the professionals who are required in order to stimulate upgrading in the country.

4.8 Mainstreaming sustainable development

The adoption of the Sustainable Development Goals by the United Nations provides opportunities for the government to shape the conduct of NEM firms in ways that mainstream such goals. In particular, workers' and human rights, and the environment are key elements that require reshaping. Environmental and labour standards have become important in bilateral trading relationships. Cambodia has already ratified the critical international labour covenants – unionization of workers and freedom of association, among others – which was a condition that the United States imposed in order to enjoy preferential access to its market. Export-oriented NEM firms in the garment industry, such as Pactics, observe labour standards imposed as conditions by TNCs and other buyers.[20] Rasiah (2009a, 2009b) provides evidence that the technological capabilities of garment-exporting firms in Cambodia is quite high. Similarly, established hotel brands require their hosts to observe such standards. Such monitoring by developed country buyers has increased over the years. According to the UN's guidance,[21] human rights due diligence "should cover adverse human rights impacts that the business enterprise may cause or contribute to through its own activities, or which may be directly linked to its operations, products or services by its business relationship" (p. 17).

Pressure on environmental standards has also mounted because of climate change, and Cambodia has ratified the 2015 Paris Accord (and the subsequent time-deferred version of the Marrakech Proclamation in 2016) under the United Nations Framework Convention for Climate Change (Rasiah et al., 2018). Hence, the government should raise awareness, as well as work towards the formation of a major standards organization to coach and certify NEM firms.

To help NEM firms to export, expand employment, and upgrade technologically, the government should consider implementing and strengthening the regulatory framework. This initiative should start with a profound evaluation of the critical policy pillars shown in table 9 as the first step for the Government to decide whether it should establish a policy framework for NEM promotion and, if so, what, how and to what extent.

20 See Support the Guardian (2015), "Cambodian textile firms sewing the seeds of change", downloaded on 10 December 2018 from https://www.theguardian.com/global-development/2015/dec/29/cambodia-textile-firm-garment-industry-workers-rights.

21 United Nations (2011), "Guiding Principles on Business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework", United Nations Human Rights Office of the High Commissioner, New York and Geneva.

Table 9. **Checklist for NEM agreements and operations to maximize benefits and minimize costs**

Government policy on NEMs	Compliance with laws	Whether there is an agreement on contract performance
		Whether there is an agreement on contract terms (durations)
		Whether there is an agreement on contract termination and its process
		Whether there is an agreement on contract arrangements (additional contracts) and its process
	Respect for human rights	Whether there are rules on non-discrimination
		Whether there are rules on basic human rights
		Whether there are rules on harassment (whether a power balance exists between local NEM firms and TNCs)
	Environmental considerations	Whether there are guidelines on air pollution by local NEM firms
		Whether there are guidelines on water contamination by local NEM firms
		Whether there are guidelines on environmentally friendly goods or services by local NEM firms
	Work environment	Whether there are employment rules (laws) on ages under the NEM agreement
		Whether there are employment rules (laws) on gender under the NEM agreement
		Whether there are guidelines on a safe and pleasant work environment for local NEM firms
		Whether there are employment rules (laws) on working environments under the NEM agreement
		Whether there are employment rules (laws) on working conditions under the NEM agreement
		Whether there are employment rules (laws) on working hours under the NEM agreement
		Whether there are employment rules (laws) on taking holidays under the NEM agreement
		Whether there are employment rules (laws) on treatment of absence under the NEM agreement
		Whether there are employment rules (laws) on maternity-related leave under the NEM agreement
		Whether there are guidelines on provision of a support system of childcare and nursing care
		Whether there are employment rules (laws) on terminating employment contracts under the NEM agreement
	For local firms' development	Whether there is a program that local NEM firms can take to improve their technology/capacity
		Whether there is a program that local NEM firms' employees can learn from
		Whether there is a program that local NEM firms can take to understand NEM policy
		Whether there is a program that local NEM firms can take to understand business environment of the industry
	Subcontractors and suppliers	Whether there are guidelines for similar NEM policies for local subcontractors and suppliers

.../

Table 9. **Checklist for NEM agreements and operations to maximize benefits and minimize costs**

For TNCs that the Cambodian government should address	Earning the trust of customers and consumers	Whether there are guidelines for TNCs to provide correct information on their products or services
	Mutual growth with partner companies	Whether there are guidelines for TNCs to respect free and fair trading rules
		Whether there are guidelines for TNCs to provide relevant information required for trading
		Whether there are guidelines for TNCs to develop relationships based on trust with local NEM firms
	Coexistence with local communities	Whether there are guidelines for TNCs to establish and maintain a good relationship with local community where local NEM firms are located

Source: Adapted from "Corporate Code of Conduct, the Third Edition", Tokyo Chamber of Commerce and Industry (2013).

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