

Sector Assessment (Summary): Small and Medium-Sized Enterprise and Private Sector Development

A. Recent Economic Developments

1. The government's continued reform efforts have produced remarkable progress in promoting the development of business and small and medium-sized enterprises (SMEs). The annual number of newly registered enterprises increased from 27,700 in 2003 to 58,900 in 2009 (Figure 1[a]). Credit to the private sector has expanded by about 34% annually since 2005. The 2008 provincial competitiveness index suggests that access to land has improved—81% of business respondents surveyed have formal land-use right certificates, up from 55% in 2006. Domestic sector exports increased by about 25% during the last 4 years. The contribution of the private sector to employment and gross domestic product also increased rapidly as the sector generated almost all new employment created since 2003. Sustained and relatively equitable growth in employment and income has helped to reduce poverty incidence from about 58.1% in 1993 to 16.0% in 2006; it was estimated to be 15.4% in 2008.

2. **Enterprise developments.** The number of businesses registered each year has continued to increase rapidly since 2000 with the enactment of the first Enterprise Law.¹ The strongest growth in business numbers has been in limited liability companies. The number of joint stock companies has also increased rapidly. The average registered capital of enterprises, especially limited liability and joint stock companies, increased substantially in 2007. However, since 2008, capital has declined due to macroeconomic instability and uncertainty related to the global financial crisis (Figure 1[b]).

3. **Employment and productivity.** Viet Nam has made impressive steps forward in terms of creating better jobs for a significant proportion of the population in the past two decades, and in raising wages and increasing productivity of most workers. SMEs and the private sector have created most of the new jobs. The share of state employment declined from nearly 60% of the total formally employed workers in 2000 to less than 24% in 2007 (Figure 1[c]). Employment generated by the domestic private sector increased rapidly and its share expanded from 29% to more than 53% in 2007. The share of employment in foreign-owned enterprises also doubled to 23% during the same period and foreign investment sector average labor productivity increased by 2.8 times, from D11.7 million per worker in 2000 to D32.9 million per worker in 2008 (Figure 1[d]).

4. **Enterprise density and dynamic.** A rapid increase in the number of newly registered enterprises in the last 4 years represents remarkable progress. The number, however, overstates enterprise growth and dynamic. A large number of newly registered enterprises are mainly due to formalization of existing enterprises, driven by simplification of business registration procedures. Despite a rapid increase in the number of registered enterprises, the enterprise density in Viet Nam is still relatively low. Viet Nam has only 15 enterprises per 10,000 population as compared with 137 in Thailand. This suggests that the number of enterprises could increase. Another useful way of looking at enterprises in a dynamic way is by examining the evolution of the size of enterprises over time. This can be traced by using a longitudinal survey of the same set of enterprises like the one jointly conducted by the Central Institute for Economic

¹ Approved by the National Assembly in 1999.

Management (CIEM) and the Institute of Labour Science and Social Affairs (ILSSA).² The CIEM-ILSSA survey, which focuses on the manufacturing sector, reveals some constraints for enterprises to grow over time. Despite high economic growth during 2005–2007, enterprises on average tended to become smaller (Table). Of the 2,170 enterprises surveyed across provinces in Viet Nam, more enterprises moved down in size from small to micro (169) than the reverse (94). The share of microenterprises increased from 63.3% to 67.1% during the same period. The same trend was true for medium-sized enterprises. Since larger enterprises are generally more productive than the micro ones, the tendency for enterprises to get smaller may represent a loss of opportunity to improve productivity. The initial finding from a more recent survey suggests that this trend has not changed significantly.

Table: Employment Transition Matrix

Item	Micro 07	Small 07	Medium 07	Total	Percent
Micro 05	1,280.0	94.0	0.0	1,374.0	63.3
Small 05	169.0	433.0	36.0	638.0	29.4
Medium 05	6.0	52.0	100.0	158.0	7.3
Total	1,455.0	579.0	136.0	2,170.0	100.0
Percent	67.1	26.7	6.3	100.0	

Micro = enterprises with less than 10 employees, small = enterprises with 10 to 50 employees, medium = enterprises with 50 to 300 employees.

Source: Central Institute for Economic and Management.

5. Constraints for growth of small and medium-sized enterprises and the private sector. The findings of the CIEM-ILSSA survey suggest that the business environment needs to be developed to provide good rates of return for enterprises when they start up, to allow them to maintain the returns as they expand. In this context, the CIEM-ILSSA survey identifies four areas where the government could best help in removing constraints for further growth: (i) access to finance, (ii) access to land and premise, (iii) private sector policy, and (iv) bureaucratic impediments. Other surveys identify labor issues, macroeconomic instability, and infrastructure as important constraints for private sector growth.

B. Medium-Term Reform Issues

6. The challenge for Viet Nam is to sustain a high economic growth rate to create productive jobs for an estimated 1.7 million young workers entering the labor market annually. The experience in the last 2 years suggests that this is becoming more difficult. Economic overheating and the global financial crisis present significant challenges to SMEs and the private sector. At the same time, the external market has become increasingly more competitive and other countries much more active in enlarging their market share. The government recognizes that increasing the role of SMEs and the private sector is crucial in achieving its medium-term economic growth and poverty reduction target. This will require accelerated reforms to address existing constraints by enhancing the policy-making process, enhancing the business environment, and improving the country's competitiveness. In the short term, however, mitigating the impacts of the global financial crisis on SMEs and private sector growth will be critical.

² Financed by Danish International Development Assistance's Business Sector Programme Support.

1. Framework for Promoting the Development of Small and Medium-Sized Enterprises

7. An enabling environment for the development of SMEs and the private sector requires a supportive framework of legal, labor, fiscal, and monetary policies that promote the foundations for competitive markets by fully involving all stakeholders. An effective medium-term policy framework is required to coordinate and integrate government priorities, policies, and plans in creating competitive markets essential for SMEs. The government approved the 5-year SME Development Plan 2006–2010 after extensive dialogue and consultation with SME stakeholders and in coordination with Viet Nam's development partners. To facilitate dissemination of information and regulations relevant to SMEs and the private sector, the Ministry of Planning and Investment maintains an SME business portal (www.business.gov.vn). The portal provides development policies and regulations on SMEs, business registration and licensing procedures, and requirements and guidelines.

8. The stakeholder involvement mechanisms have been very useful in strengthening support and dialogue between the business community and relevant authorities. This process will need to be strengthened. With increasing decentralization, local governments are also responsible for the issuance, implementation, and/or enforcement of many regulations that impact SMEs. The participation of local governments and their capacity to participate in the stakeholder consultation process will need to be strengthened.

2. Improving Competitiveness

9. The government places high priority on improving business-related regulations and has issued many legal documents in the past 5 years. The Investment Law and Enterprise Law, together with other business-related policy and institutional reforms have produced numerous positive changes to the business environment. However, the results have been uneven. A recent review of implementation of the Enterprise Law and Investment Law points out that although the regulatory environment has improved, the lack of clarity and inconsistencies in the increasing volume of implementing regulations and some cumbersome administrative procedures still generate significant uncertainties in the business environment.³ The CIEM-ILSSA survey suggests that the number of enterprises lacking knowledge on key business regulations increased in the last 3 years. While the number of enterprises making informal payments to get public services declined significantly, those making informal payments for other unspecified purposes increased markedly (Figure 2[a]). While the time required for business registration has been reduced significantly, other procedures beyond registration remain cumbersome (Figure 2[b]).

10. The government recognizes these shortcomings and intends to develop a more systematic and comprehensive approach to address these issues as part of its strategy to create a more competitive business environment.⁴ One part of the strategy is to enhance implementation of the Competition Policy Law and to strengthen the capacity of the Viet

³ Nguyen Dinh Cung. 2008. Implementation of Viet Nam's Enterprise Law and Investment Law: A Regulatory Reform Perspective. *Viet Nam Economic Management Review*. Ha Noi.

⁴ Ministry of Planning and Investment. 2009. *Results-Based Mid-Term Review Report for Implementation of the Five-Year Socio-Economic Development Plan 2006–2010*. Ha Noi.

Nam Competition Administration Department to ensure fair competition among all economic players. A bigger part of the strategy is to implement broader competition policy by improving the business regulatory environment. These efforts include continuing administrative simplification, keeping close control of the promulgation of new regulations, and implementing regulatory impact assessments for all new regulations. Upgrading labor market regulations and labor relations will be an important part of efforts to improve the business environment.

3. Access to Finance for Small and Medium-Sized Enterprises

11. SME access to finance has improved considerably in the last 5 years. Traditionally, state-owned commercial banks have focused more on larger state-owned enterprises and foreign banks tended to serve foreign-invested enterprises and multinational enterprises. Joint stock banks have been the main provider for domestic private enterprises and SMEs. More recently, state-owned commercial banks have begun to recognize the potential of rapidly growing local SMEs. Despite the progress, however, access to finance remains as entrepreneurs' top constraint for growth. The intensity of the constraint, however, is different for different sizes of enterprises. Smaller SMEs and new entrants still face significant access constraints to finance. A recent World Bank study finds that about 45% of small firms indicate that access to finance is a major constraint for growth (Figure 3[a]). Non-collateral forms of debt financing such as leasing remain constrained by (i) the absence of a supportive regulatory framework and infrastructure, and (ii) apparent difficulties faced by leasing companies in mobilizing sufficient long-term funding. Established and larger enterprises are more constrained by the size and tenor of loans. The commercial banks in Viet Nam are very conservative in valuing collateral and the tenor of most loans to SMEs tends to be short (1 year or less). This makes debt-financing for expansionary investment needs problematic. This is consistent with the finding of the CIEM-ILSSA survey, which suggests that the number of enterprises investing for growth has not been growing significantly (Figure 3[b]). Based on initial data, the trend is not changing much and most businesses rely more on self-financing for investment needs. This may partly explain the slow movement of enterprises from small to medium size (Table 1).

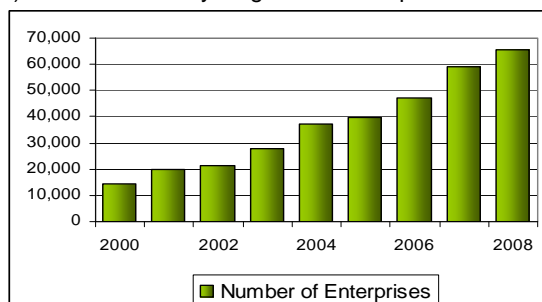
12. As constraints across SMEs are not uniform, the challenge is to ensure the availability of various products to meet their various needs. Smaller SMEs and new entrants are more constrained by collateral and capacity to borrow. Therefore, simplification of land use right certificate procedure, development of the leasing industry, and improved capacity of financial institutions in dealing with SMEs would help improve access to finance for these enterprises. The current interest rate cap on commercial bank loans to businesses helps reduce interest rate costs for some eligible enterprises.⁵ At the same time, however, it constrains banks in pricing risks for smaller and new enterprises. Established SMEs needing to expand are more constrained by loan size and the tenor of the loan. The newly introduced nationwide credit guarantee system designed to specifically support commercial bank investment lending to SMEs will help ease part of this constraint. However, the credit guarantee system provided through Viet Nam Development Bank offers a guarantee for 100% of the loan amount. This policy needs to be reviewed to ensure the sustainability of the program. International experience on credit guarantees suggests that a partial guarantee provides a more

⁵ Lending rate cannot exceed 105% of the State Bank of Viet Nam's base rate.

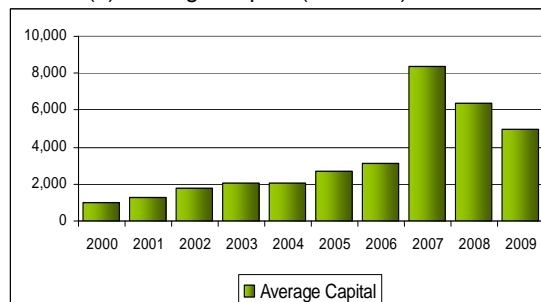
balance incentive for each party to ensure sustainability of the system. Equity finance is another viable option for larger SMEs. The Unlisted Public Company Market, launched in June 2009, permits the entry of any public company with 100 or more external shareholders and chartered capital of D10 billion or more, and thus is open to larger SMEs. To support this effort, corporate governance practices in Viet Nam need to be advanced, with particular emphasis on minority investor protection and financial transparency issues.

Figure 1: Key Indicators

(a) Number of Newly Registered Enterprises



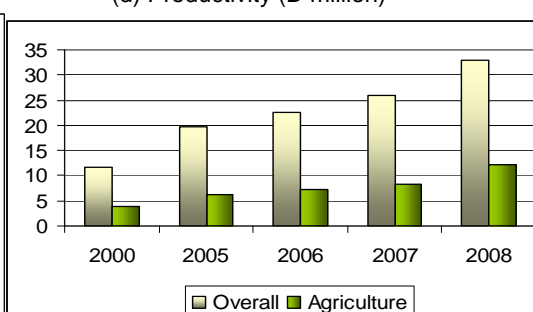
(b) Average Capital (D million)



(c) Share of Employment (%)



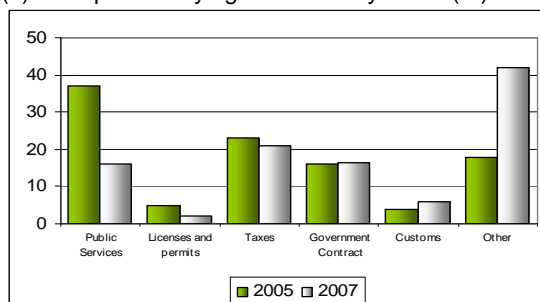
(d) Productivity (D million)



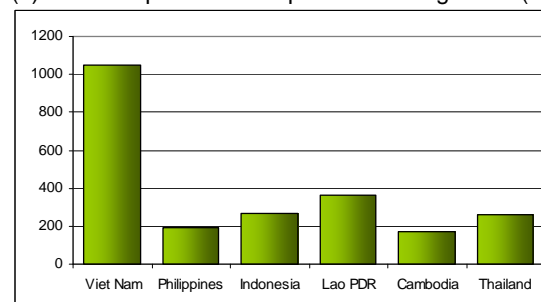
Sources: State Bank of Viet Nam, General Statistics Office, and Asian Development Bank estimates.

Figure 2: Costs of Regulatory Compliance

(a) Enterprises Paying Informal Payments (%)



(b) Time Required to Complete Tax Obligations (hour)

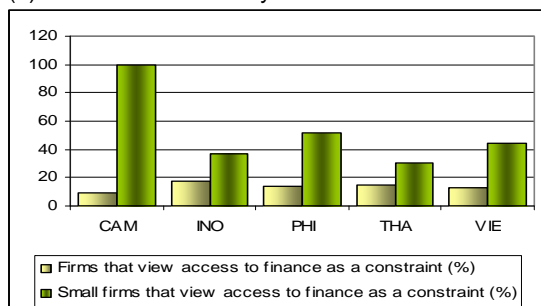


LAO PDR = Lao People's Democratic Republic.

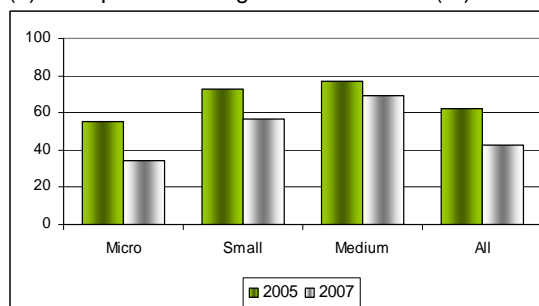
Sources: Central Institute for Economic Management-Institute of Labour Science and Social Affairs survey and the World Bank's Doing Business.

Figure 3: Bank Lending and Small and Medium-Sized Enterprises Constraint

(a) Access to Finance by Firm Size



(b) Enterprises Making New Investment (%)



CAM = Kingdom of Cambodia, INO = Republic of Indonesia, PHI = Republic of the Philippines, THA = Kingdom of Thailand, VIE = Socialist Republic of Viet Nam.

Sources: World Bank and Central Institute for Economic Management-Institute of Labour Science and Social Affairs survey