PRIVATE SECTOR ASSESSMENT (SUMMARY)[1]

A. Structure of the Private Sector[2]

1. **Small and medium-sized enterprises.** Since the enactment of the Enterprise Law, 2000, nearly 400,000 new enterprises have been registered in Viet Nam.[3] From 85% to 90% of them are considered small and medium-sized enterprises (SMEs), meaning that they have a registered capital not exceeding D10 billion or an annual average permanent workforce of fewer than 300.[4] The average amount of start-up capital increased sharply from D1.29 billion in 2001 to D11.6 billion in 2008.[5] The largest urban centers, Ha Noi and Ho Chi Minh City, together account for nearly 50% of start-ups and for 42% of their combined registered value. However, a number of provinces have distinguished themselves by enabling a good environment for business creation despite their small size.[6] Although data varies greatly depending on the source, as of 2007 the survival rate of registered businesses was about 50%, which would place the current number of active enterprises at around 200,000. This is a reasonable number for Viet Nam's stage of private sector development.

2. The domestic private sector has accounted since 2010for 90% of total employment, while the state sector accounted for 9%. The share of employment provided by foreign direct investment was 1% in 2000, growing to nearly 4% by the end of the decade. The distribution of employment by industry shows that manufacturing is the largest employment generator, with 51% of employees at end of 2007, followed by construction (14%), trading (11%), and transportation (7%). Despite accounting for most employment, manufacturing falls well below trade in terms of its share of registered enterprises by industry (19.9% versus 39.9%) and in terms of business turnover.

3. **Public–private partnership.[7]** Despite gradual progress in privatization and official pronouncements supporting deregulation and liberalization, suspicion of private enterprise among some in the bureaucracy, political circles, and finance institutions in Viet Nam remains a challenge. This affects the enabling environment for public–private partnership (PPP). Still, the public sector has filled a significantly shrinking role in economic output in recent years. There has been some opening of power generation and telecommunications to foreign participation.

4. Under the terms of Viet Nam's accession to the World Trade Organization in 2007, state-owned enterprises (SOEs) are committed to conducting commercial business without government interference. Although the government has steadily removed formal subsidies to the SOEs, it continues what the World Bank identifies as "subsidy-like budget expenditures" for SOEs. Viet Nam prefers to maintain government majority control of SOEs by using a form of partial privatization that it calls "equitization," in which the government transforms SOEs into joint-stock companies and then distributes or sells shares in them. Foreign investors may buy strategic shares in equitized firms. The combined equity stake of all foreign

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[1] This summary is based on Private Sector Assessment Summary and Public–Private Partnership Assessment (Summary). Available on request.
[2] This section is largely based on Ministry of Planning and Investment. 2009. *White Paper on Small and Medium-Sized Enterprises in Viet Nam*. Ha Noi.
[3] Adjusted in 2005 to simplify business registration and align corporate governance across sectors.
[4] Ministry of Planning and Investment. 2009. *White Paper on Small and Medium-Sized Enterprises in Vietnam*. Ha Noi.
[5] Central Institute for Economic Management, Ministry of Planning and Investment, Asia Competitiveness Institute, National University of Singapore. 2010. *Viet Nam Competitiveness Report*. Ha Noi. .
[6] These includes Binh Duong, Da Nang, Dong Nai, and Vung Tau. The provincial competitiveness index, a measure of economic governance for private sector development, shows the first two provinces in this group as the top performers in creating an enabling environment for entrepreneurs.
[7] This section is largely based on J. Lindborg. 2010. *Assessment of Public-Private Partnerships (PPPs) in Viet Nam: Constraints and Opportunities*. ADB–Agence Française de Développement. Ha Noi.

investors in an SOE (except a bank) may not exceed 49%. Still, equitization is important in terms of making SOEs more efficient and streamlining Viet Nam's large state-controlled sector. At present, SOEs provide 40% of Viet Nam's economic output.

B. The Government's Private Sector Policy and Planning Framework

5. The Government of Viet Nam's guiding principles in facilitating SME development are in the Socio-Economic Development Plan (SEDP), 2006-2010, which cites the need to redefine the role of the state in economic management and facilitate a growing role for the private sector in creating employment and improving living standards. The current regulatory framework for the domestic private sector is anchored on the Enterprise Law and Investment Law, 2005. Since then, significant additional reforms have been implemented to establish an even playing field for business development. These include Decision 55/2009, which allows foreigners to own up to 49% of a public company, and the implementation of the Master Plan on Simplifying Administrative Procedures, 2007, which reviews and simplifies or abolishes cumbersome administrative procedures to reduce compliance costs.

6. At the institutional level, the SME Promotion Council advises the prime minister, including both private and public sector representatives. Under the Ministry of Planning and Investment (MPI), the Agency for SME Development reviews all SME development policies, oversees the implementation of all government-funded SME support programs, and acts as the counterpart in projects funded with official development assistance. The provincial departments of the MPI and other specialized government agencies complete the government's SME regulatory fabric. Viet Nam benefits from the active participation of well-established private sector and civil society organizations.

7. Regulatory conditions and market access for foreign investors are improving. The Government of Viet Nam is developing an improved enabling environment for PPP, acting to address legal, regulatory, institutional, and financial constraints. In January 2010, the MPI issued a new PPP decree (Decree 108), which regulates investment in infrastructure projects built under build–operate–transfer, build–transfer–operate, and build–transfer contracts. In January 2011, Decree 108 was completed as Decision 71 provided a framework for moving forward with the government's PPP pilot program.[8] It also centralizes the PPP program in the MPI. Once the elements of the PPP framework are in place, pilot projects will be selected for the program. As of June 2001, MPI had achieved a number of important milestones in operationalizing Decision 71, spearheading various efforts to build broader support for PPP in other national government ministries and provincial and/or local government agencies. The PPP Interministerial Task Force was established with the MPI as chair and the Ministry of Finance, Ministry of Justice, State Bank of Viet Nam, Ministry of Industry and Trade, Ministry of Construction, and Ministry of Transport as members. The smaller core PPP Task Force in the MPI is now operational and responsible for the day-to-day implementation of the PPP piloting initiative. In consultation with authorized state agencies at the line ministry and provincial levels, the MPI has compiled an initial list of 24 projects for potential screening as PPPs.

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[8] The new regulation is much more general in its approach, setting a broad framework for PPP. It defines a PPP as a "form of investment in which the state and the investor coordinate to implement [an] infrastructure development or public service supply project on the basis of the Project Contract." The state's contribution can be capital, investment preferences, or subsidies as regulated by related financial laws and policies, or land and resettlement-related costs, but not equity. The total value of the state contribution shall not exceed 30% of the total project investment except as otherwise decided by the government.

C. Key Constraints and Challenges[9]

8. **Constraints on private sector growth and development.** The Enterprise Law triggered an unprecedented increase in new business registrations, but second-generation reforms to improve the depth and quality of the domestic private sector are still required. Access to capital remains the major constraint on developing new and existing businesses, especially as local companies increasingly compete in the globalized economy. In addition, local entrepreneurs' limited business and finance management capacity constrains opportunities to evolve from labor-intensive ventures to those driven by knowledge and capital. Market distortions that block domestic private sector development include the overwhelming predominance of SOEs in industry and services, the presence of cumbersome administrative procedures for business operations, and extremely profitable real estate speculation that has crowded out of the credit market technology and other productive investments to improve competitiveness (footnote 5).

9. **Investment climate challenges.** Despite substantial investment, public infrastructure in Viet Nam is still inadequate. The provincial competitiveness index reports that dissatisfaction extends to transport infrastructure, logistics and communications, and basic services like water supply and sanitation. The gap between the financial effort exerted by the government and perceived results may be attributed to unclear criteria by which to prioritize infrastructure projects and inefficient project implementation. The use of PPP for infrastructure is expected to improve the rate of return on investment in the medium term. State-owned commercial banks still dominate the market, limiting competition. Despite their importance, sound financial audit mechanisms for these banks are still largely missing, leaving the extent of liabilities in the finance sector unknown. Vietnamese and international investors increasingly voice concern about the difficulties encountered identifying and recruiting skilled labor. Despite progress in simplifying administrative procedures for business registration and operations, administrative compliance costs are still large.

10. **State-owned enterprises.** Local private financing of infrastructure in Viet Nam is reported to have been widespread for many years. These projects are small and generally involve direct appointment and/or negotiation by the government of project investors, involving mainly SOEs. Design and service standards are usually inadequately defined or enforced and contracts inadequately regulated. The lack of a systematic approach to structuring these transactions makes it difficult for local authorities to clearly see the benefits or value added to the public sector and the overall cost-effectiveness of the investment. Historically, significant investment by SOEs in infrastructure projects has tended to crowd out the private sector, which is further complicated by SOEs' weak governance structures. Government approvals and support have been uncertain. There are so far only limited major public investments involving foreign investors and even fewer cases of PPP with foreign investors.

11. **Land issues.** There is no system of private land ownership in Viet Nam. The state owns the land, and residents and investors buy and sell rights to use it with a type of freehold title. Land-use rights can be bought, sold, inherited, and used as collateral for loans, but the state can reclaim any land at any time.

12. **Lenders' security and step-in rights for public–private partnership projects.** In PPP projects, a lender's step-in rights must be approved in advance by the authorized state body as the counterparty. However, legal experts note that, in practice, it may be difficult for lenders to obtain consent to cover all circumstances in which a lender may wish to step into

[9] This section derives largely on the *Viet Nam Competitiveness Report* (footnote 5); World Bank. 2011. *Doing Business*. Washington, D,C,; *and Assessment of Public-Private Partnerships (PPPs) in Viet Nam: Constraints and Opportunities* (footnote 7).

a project in distress. Another concern is the inability of foreign lenders to take security over land-use rights or structures on the land constructed by a project company unless they have a bank branch in Viet Nam.

13. **Legal issues.** Investors note concerns with respect to dispute resolution and arbitration. The government recognizes the need to amend the provisions of various laws to strengthen arbitration procedures. However, arbitration, either international or domestic, is not yet a popular choice for settling disputes in Viet Nam.

14. **Financing issues.** Many potential PPP projects' lack of financial viability without special arrangements and the lack of local long-term sources of capital, including long-term debt-financing instruments, constrain the development of bankable PPPs in Viet Nam. The generally poor financial viability of potential PPP projects stems from the widespread existence of low tariffs in Viet Nam for project outputs, which usually renders cash flow inadequate to support the revenue stream investors need in utility-type projects. Exchange risk also has to be addressed. Many PPPs would generate revenue in dong, while a substantial part of their debt would be in foreign currencies. Potential private sector sponsors call for an exchange guarantee mechanism provided by the public partner.

D. ADB's Role in Private Sector Development and Private Sector Operations

15. ADB has supported SME reform through program loans and technical assistance. The first cluster program loan included two subprograms for a total of $80 million, with cofinancing from Agence Française de Développement and KfW of €55 million, while the first subprogram of a second cluster program loan was approved by the ADB Board in October 2010 for $40 million. Subprogram 2 is scheduled for 2013.

16. Policy actions for the current subprogram include (i) continued improvements to the policy and planning framework for SME development, (ii) strengthening the framework for competition policy,[10] and (iii) enhanced access to finance.[11]

17. ADB proposed in July 2011 the Public–Private Partnership Support Program to further engage the government in policy dialogue to address PPP issues and support its initiative to promote a more conducive environment for PPP and use PPP to catalyze broader sector reforms. Policy dialogue, support for reforms to strengthen the legal and regulatory framework for PPP, a mechanism to support project preparation, and a facility to provide financial cover for viability gaps will be required to develop bankable and commercially viable PPP projects. The project will have three phases anchored on the government's infrastructure reform agenda. The policy actions are allocated to three phases: January 2010–March 2011 for $20 million phase 1, June 2011–March 2013 for $120 million phase 2, and April 2013–March 2015 for $200 million phase 3. The medium-term reform agenda and its timing will be reviewed in light of the accomplishments of phase 1 and possible changes in the policy environment, then modified if necessary under phases 2 and 3.

[10] By simplifying administrative procedures, implementing competition policy and regulatory impact assessments, and strengthening trade policy with an emphasis on customs administration.

[11] By implementing a unified national registration agency of secured transactions, revising the legal framework for credit guarantee schemes, and improving provisions for investor protection and standards for financial disclosure.