Policy Recommendations to Enhance Vietnamese SMEs’ Ability to Access Venture Capital

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Received: December 21, 2021
Revised: March 15, 2022; Accepted: April 25, 2022

Abstract: Small and medium enterprises, which form a large part of the entity of the domestic private sector, play a vital role in economic growth, socio-economic development and the international integration process. However, SME groups in developing countries are underdeveloped and face a lot of difficulties in growth due to the absence of sufficient finance. Profoundly, venture capital is typically a suitable and sustainable external source of finance for Vietnamese SMEs with high growth potential. This study provides an overview of the venture capital market and its role in SMEs’ performance in Vietnam. This research also found that one of the reasons why foreign investment funds are not interested in the Vietnamese market is that they have not seen safe and sustainable opportunities for investment. This study not only contributes to the existing literature, because this topic in Vietnam has not received much attention and evidence is not available, but also gives policymakers, in developing countries in general and Vietnam in particular, some recommendations to determine areas of improvement in regulatory and policy aspects enabling increased responsible SME access to venture capital.

Keywords: Venture capital, SMEs, Vietnam.

1. Introduction

For both developed and developing countries, the miracle growth in quantity, scale, and internal strengths of Small and Medium Enterprises (SMEs) exerts a great impact on the development of their economies. This sector is the driving force of economic growth, development and innovation [1]. Because of their small scale, SMEs are relatively flexible and require less financial support. Thus, SMEs can easily adapt to the changing business environment compared to big companies and corporations. SMEs also contribute to the fight against unemployment, thanks to their significant job creation ability [2]. However,
SME groups in developing countries are under-developed and are facing a lot of difficulties in growth due to the absence of sufficient finance [1, 2]. The lack of finance has been cited as a major reason for the failure of SMEs in developing and emerging economies [2-5]. SMEs, due to their newness and small scale, encounter difficulties in securing sufficient external finance such as venture capital [4]. This limits the development of young entrepreneurs, who have vision, creativity and breakthrough ideas. From the perspective of commercial banks, SMEs are considered risky lenders, especially in developing countries, due to an underdeveloped legal and institutional environment [6]. Though venture capital is known as crucial business finance for SMEs in developed countries [2, 7-11], it is very limited in developing countries. One of the reasons is not many SMEs have a good awareness of this finance source and the way of approach to access it.

In Vietnam, the venture capital market in recent years has witnessed a revolution, attracting a huge amount of venture capital money thanks to the strong growth of Vietnamese enterprises from a variety of industries such as trucking, fintech and other high-tech apps. Not only providing financial support to SMEs, venture capital funds also assist them in identifying the most suitable market approach and in providing connections with regional and global partners. Venture capital also assists SMEs in internal business operations, especially in policy formulation [12]. However, the Vietnam venture capital market is underdeveloped in contrast to the phenomenal economic growth and the development of its technology sector [13]. The number of venture capital funds is only 1% of the number of startups, and this is just a very modest number compared to the number of SMEs in Vietnam. SMEs also appear to face far greater difficulties in accessing this finance source. As a result, this research concentrates on the SME sector in Vietnam, their shortage of finance and investment, and barriers to accessing venture capital. The research result will support policymakers to formulate and implement priorities to enhance the ability to access venture capital.

2. Literature review

Although the topic of venture capital has been well researched, there is little convincing evidence of its contribution to the success of SMEs in developing and emerging countries [1, 14-19]. Especially, SMEs raising venture capital in Asia have received little research attention in the top five journals in the area of “small business management”. This is because most of the research has largely been focused on developed countries, where the venture capital market is matured and has achieved tremendous success. Using a longitudinal dataset of high tech SMEs in Italy, Bertoni et al. [20] exposed a significantly positive impact of venture capital on SMEs regarding sales growth and job creation. In the same direction, Croce et al. [21] surveyed a large sample of 700 companies in the technology industry in six countries from Europe; the results showed a productivity growth of firms getting venture capital compared with firms without venture capital. In this respect, all findings disclosed that venture capital is an accessible and sustainable financing source for potential companies in the technology industry. Other research on the role of venture capital in other areas such as the agriculture, food and biotechnology industries also confirmed the positive effect of getting venture capital funding on company performance, innovation and development [9, 22]. Brandt and Stefansson [23] explored in more detail what personality traits venture capitalists look for in an entrepreneur by using the data of venture capital firms in Sweden and Iceland. The authors decided to conduct face-to-face interviews to get insight data from venture capitalists about their selection of founders and the evaluation of their personalities. Investment managers and managing directors of seven venture capital firms were the target population. This research found that venture capital may prefer founders who have a similar background or who have a
greater sympathy towards the venture capital. The big-five model, which is the most important model to evaluate one’s personality, can also be applied to entrepreneurs.

Regarding venture capital research in developing countries, some empirical research examined the influence of venture capital financing on the performance of SMEs in developing and emerging countries [12, 24-26]. Although using different methods, all the results disclosed that venture capital financed SMEs reported exceedingly better performance than non-venture capital financed SMEs. Particularly, they achieved an increase in sales revenue, job creation, business growth and expansion. Using the data of 200 venture capital financed SMEs in Kenya, Mamba et al. [12] found that the use of venture capital can bring more profit for Kenyan SMEs, even in an unstable political environment. The positive impact has been realized on both economic and social-economic factors. In terms of the economic impact of venture capital, SMEs in Kenya have gained growth in sales, profits and assets; as well as improvement in financial and other resource management; while the social-economic impact is exposed in the ability for job creation, which supports employees to improve living conditions. In the line of this research, Esbo and Verhoef [27] showed that SMEs in developing economies have an inferior implementation of venture capital financing comparing large firms due to a lack of information and awareness of available venture capital opportunities. Using non-probability sampling and a sample population of 40 Nigerian SMEs, Walter et al. [28] examined the effect of venture capital on the development and expansion of SMEs in Nigeria. They found that firms receiving venture capital financing, not only grow in sales, net assets and other performance indexes, but also increased their opportunity and ability to access other funding sources. Having similar findings, Dacic et al. [2] also concluded that venture capital financing allows SMEs to finance their businesses and increase their competitiveness, which directly contributes to economic growth and total employment. Recent research of Kato [1] provides a comprehensive literature review of venture capital financing from six emerging countries in Africa, which is an empirical study underpinning the influence of venture capital on SMEs’ growth in emerging countries. This study also builds a ground for future research agendas.

In Vietnam, this concept has not received much attention; there is only a little evidence documenting the role of venture capital on the growth of SMEs in Vietnam. Very early research about venture capital by Sack and McKenzie [29] sponsored by the Mekong Project Development Facility took a preliminary look at the feasibility of building a commercially viable venture capital market in Vietnam. This study disclosed that venture capital is an appropriate institutional partner for Vietnamese SMEs because it not only provides capital for SMEs but also supports them in strengthening management, building assets and enhancing the ability to access other financing sources. Later researchers have begun to pay more attention to develop this topic deeper. Implementing an exploratory case-study method, Scheela and Nguyen Van Dinh [30] investigated five venture capital firms in Vietnam to examine the growth of the Vietnam venture capital market. This research uses the Institutional theory as the theoretical framework to explore the impact of the underdeveloped institutional environment in Vietnam and the challenges facing investors in this developing country. This research also determined similarities and differences between venture capitalists operating in the US and Vietnam. Unlike venture capitalists in the US, venture capital funds operating in Vietnam must strictly supervise and monitor their portfolio companies due to undeveloped institutions. Venture capitalists must build and strengthen networking with the government and authorities in Vietnam. This research identified differences in operations and policy formulations between venture capital funds operating in developed and developing countries. The research of Dao Nhat Minh [31] entitled “Legal reforms on venture capital industry in Vietnam” examined the legal
framework for the venture capital industry of Vietnam and proposed some major legal reforms to develop this market. This study indicated that there is a lack of a comprehensive legal framework set for the venture capital market. Thus, most of the investors have no confidence in their investing decisions. However, this study just works as a policy review, while this topic needs to be studied thoroughly by applying a suitable research method to draw conclusions and in-depth implications for policymakers. There is a lack of comprehensive and thorough research about the venture capital market in Vietnam and the relating issues. Especially, no previous research has examined the role of this funding in the development of the SME sector. Studies aimed at identifying characteristics of Vietnamese SMEs that venture capitalists look for also need to be undertaken.

Access to venture capital finance is important but challenging for Vietnamese SMEs. Based on the literature, there is a lack of research investigating the Vietnam venture capital market and its role in the performance of Vietnamese SMEs. Especially, no previous research has raised policy recommendations to enhance the ability of SMEs in Vietnam to access venture capital. This limitation prevents SMEs from raising their awareness of venture capital and enhancing their ability to access this potential finance. From the government perspective, the little evidence documented on the venture capital market also brings a lot of difficulties for the government in supporting the development of the Vietnam venture capital market; and for SMEs involved in this market. To shed light on the raising venture capital of SMEs in this developing market, research is needed. Therefore, the author has decided to research the role of venture capital funding on the development of Vietnamese SMEs. The study concludes with some priorities for policymakers to create support for SMEs to access venture capital. To the best of our (my) knowledge, such a study has not been undertaken before.

3. Research methodology

As this topic in Vietnam has not received much attention and evidence is not available, this research is exploratory in nature. An exploratory study best deals with an unknown, understudied or undocumented topic [32]. It provides “richer” and “deeper” insights into complicated and new issues by focusing on the “what” not the “why” questions. Vietnam is an understudied country regarding this topic with an insufficient dataset. A qualitative case study using semi-structured interviews is the most appropriate methodological approach for this kind of exploratory research project. The interviews will be semi-structured with largely open-ended questions The interviewees are SME owners and managers and personnel from venture capital funds. Interview questions will focus on the “how” and “why” venture capital had an impact on SMEs’ performance, and what policies might change for the future.

- Do you have a plan to raise venture capital? If yes, at what stage are you at in preparing for this and what problems are your business facing? If not, why don’t you think about access to venture capital?
- What are the barriers that prevent Vietnamese SMEs from accessing this capital?
- What are the implications for policymakers and SME owners and managers to enhance the ability of SMEs to access venture capital and to develop the Vietnam venture capital market in the next coming years?

Eight interviewers are participating in this interview. They are SMEs located in Hanoi, Vietnam and working in real estate, marketing and technical service solutions. They are including MTK Nguyen Hoang Co., Ltd, AZ Land Real Estate Survey Company Limited, Wine Agency, Fin. Production, IM ENTERTAINMENT, THQ Medical, Wedia, SmartHub Vietnam. Interviews will be recorded and transcribed.
4. Research results

All interviewees believed that raising capital from venture capital funds has certain advantages in helping businesses to have a significant amount of money to serve their business innovation and development and expansion, especially for SMEs. However, most SMEs in Vietnam are not able to access this capital for some reason. Answering the question of “What are the barriers that prevent Vietnamese SMEs from accessing this capital?” some interviewees said that “The biggest problem in this market is that information relating to venture capital has not been disseminated. The result is that few Vietnamese SMEs have known about and accessed venture capital.” The information lacking includes available venture capital funds, preparation and the application process. The lack of information leads to a misperception about the company's ability and suitability to raise capital. Some SMEs share that their business type is considered unsuitable for accessing venture capital. Specifically, they work in a traditional sector (fundamental construction) with little innovation and average rates of return, which may seem less attractive to venture capital funds. Venture capital funds are often more interested in services or products containing high technology content such as games and biotechnology. Even businesses in traditional fields can attract venture capital as long as they demonstrate their suitability and potential for future growth. Enhanced awareness of SME owners of venture capital is an important mission to support this group’s development.

That the legal framework of SMEs is a barrier is indicated by some SME managers. Regarding the institutional environment in Vietnam, some interviewees said that procedures, financial institutions and mechanisms in Vietnam are still complicated and conservative, especially for SMEs. This also prevents SMEs from accessing potential external sources of capital such as venture capital. In terms of SMEs, the legal framework of Vietnamese SMEs is generally very weak. While applying venture capital requires transparency of information, business owners are not willing to publicize 100% of a company’s information such as the number of employees, salary fund, and social insurance issues. That is one of the reasons why Vietnamese SMEs are not confident enough to access any professional funds. From the perspective of investors, many foreign investment funds are not interested in the Vietnamese market because they have not seen safe and sustainable opportunities for investment.

Besides, business owners’ fear of losing control is a big reason why they hesitate to raise capital, especially for SMEs with a shareholder structure. All the interviewed managers admitted that they feared control problems after raising capital. However, they think this will be solved if policies of SMEs and laws on venture capital in Vietnam are made clearer and stricter. Regarding capital disbursement, one interviewee said that raising capital requires a long time for fundraising, signing and disbursing, so if the disbursement is not done immediately, it will not resolve the current financial difficulties of SMEs. The fundraising may not serve or support current business strategies. Therefore, it is necessary to have strict and clear regulations on the time, rights and obligations of the parties in the capital-raising process.

A barrier comes from the internal ability of SMEs to attract venture capital. One interviewee said, “SMEs are also limited in accessing qualified labour resources and innovative technologies because of their small-level capital and business scale. Digitalising SMEs should be the key focus to enhance the innovation capability of SMEs, which supports SMEs to create attraction to venture capital funds.” Concerning the high number of Vietnamese SMEs and the adaption to the 4th Industrial Revolution, digitalising SMEs is an urgent need for strengthening and promoting the ability of SMEs to access venture capital.
5. Policy recommendations to enhance access to venture capital for Vietnamese SMEs

The findings from this study determine areas of improvement in regulatory and policy aspects enabling responsible SME increased access to venture capital. To overcome the problem of lack of information, the government should build a general information block about venture capital funds to communicate to Vietnamese SMEs. Firstly, it is necessary to create a National Portal on supporting SMEs to apply venture capital funds, which categorizes and makes a framework for each segment of SMEs. SMEs can access such a National Portal to get information and learn how to process and apply venture capital funds. Second, the government and Venture Capital funds need to coordinate in organizing forums for information exchange between competent authorities, venture capital funds and SMEs. This needs to be done intensively, methodically and continuously for at least two years to ensure that SMEs in Vietnam know and understand how to raise capital from venture capital funds. Third, the government should support and promote the establishment of consulting agencies in this aspect. Many SMEs that lack operating and investment capital need to access venture capital. But they are lacking information on the way to raising capital and do not have enough resources to reach venture capital funds by themselves. These consulting agencies would advise SMEs with the necessary information for the process of raising capital from venture capitals such as building a profile and suggesting how to reform the business to suit the venture capital funds’ requirements.

Regarding SME policies and financial support mechanisms, the most important thing is to change to flexible SME policies and renew financial support mechanisms so that SMEs have a stable and friendly development environment. The policy supports could be tax support policies and invisible sub-licenses in finance-raising activities. The government needs to implement supporting policies for initiatives such as developing an enabling environment, designing and setting up credit guarantee schemes, and improving credit infrastructure. In a country with underdeveloped financial institutions like Vietnam, these improvements are important to build up and strengthen the financial institutional environment, which will lead to greater SME access to an external fund like venture capital.

In terms of enhancing SMEs’ ability to attract investors from venture capital funds, it is important to digitalise SME finance such as e-lending platforms, e-invoicing, e-factoring and e-supply chain financing. The interview result of one venture capital manager confirms that venture capital funds frequently are attracted by SMEs with highly innovative abilities. Thus, digitalisation could help SMEs to improve their innovation process and attract more attention from venture capital investors [33]. Furthermore, digital innovation can support SMEs to actively and easily seek financial sources such as venture capital. Digitalisation offers new opportunities, but also challenges, both for policymakers and SMEs seeking finance.

Finally, equity financing such as venture capital and business angels are considered as a continuing priority of SMEs’ financial support in many countries [34]. Thus, fostering the development of the venture capital market should be the key focus of SME financing support policies in Vietnam in the upcoming year. To bring more opportunities for Vietnamese SMEs to access venture capital at a global level, the government needs to take action to attract foreign investors to join the Vietnam venture capital market by creating favourable conditions for this market and the government needs to transform legal environment regulations and related policies.

6. Conclusion

This study makes an important contribution to the existing literature because this topic in Vietnam has not received much attention and evidence is not available. Most previous research focuses on the financial issues of SMEs in more developed countries. Compared to counterparts in the developed countries, this group in the
emerging and developing countries faces many difficulties in accessing venture capital for their business strategies. The main reasons for this come from the underdeveloped financial institutional framework and business information systems. The research findings potentially improve the understanding of the venture capital market in Vietnam. Based on this, the government can formulate and implement suitable financing support policies for SMEs in Vietnam and other developing countries in Asia. The research can offer guidance on the scale of finance and capital failures confronting SMEs in Vietnam and other developing countries, the refining of government and regulatory policy, and the nature of SMEs and the entrepreneurial response needed in achieving strategic development and transformation.

References


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