

## THE IMPACT OF GOVERNMENT POLICIES ON THE DEVELOPMENT OF SMALL AND MEDIUM -SIZED ENTERPRISES (SMEs) IN VIETNAM

Pham Quynh Anh

*Faculty of Economics - VNU*

### INTRODUCTION

With the support of the international community, promoting small and medium-sized enterprises (SMEs) has been being paid attention by Vietnamese government policy makers and economists for five recent years. However, there have not yet an official statistic of SMEs in Vietnam, thus the following figures are the result of a draft calculation made by Ministry of Planning and Investment (MPI). In terms of capital, labour skill, technology current Vietnamese SMEs reveal bigger limitations compared to large counterparts. But SMEs initially prove their advantages in unit capital efficiency, a real investment growth rate and mobilisation of domestic sources. It should be emphasised that the weakness of current SMEs principally are the consequences of government policies toward that kind of business. Therefore on the basis of analysing SMEs characteristics, I will focus on analysing the SME's economic advantages and role for economic development in Vietnam, especially at the present stage. The article then points out the policy barriers for developing SMEs in Vietnam and makes logical recommendations that aim at adjusting such policies to promote SMEs. (This article is the addition and adjustment of papers delivered by the author on the International Conference organised by IFEAMA and Vietnam National University, Hanoi, October 1998).

### **Small and medium sized enterprises (SMEs) in Vietnam: The characteristics and role for socio-economic development**

*Quantities:* If the criterion is capital of below 5 billions Vietnam Dong (approximately to 360.000 USA dollars) and labours of below 200 people as defined by Vietnamese government in June 1998, SMEs account for 88,2% (1) of the total enterprises in Vietnam. The number of SME increased sharply for ten first years (1986-1996) of Renovation-Doimoi process. Nevertheless, the SMEs' growth rate has usually been slower compared to large enterprises (LEs) most of which are State owned Enterprises (SOEs).

*Ownership structure:* In Vietnam, in many cases, even in economic newspapers and journals, SMEs have been understood and used as a substitute word for non-state enterprises (non-SOEs). This is not exact because SMEs account for 99,4% of private enterprises, 94,6% limited companies but only 42,3% of joint-stock companies. Moreover, LEs still represent around 70% of the total SOEs.

*Production resources:* Despite the fact that SMEs represent for a great number of enterprises, SMEs only occupy around 20% the total capital. This justifies why the

capital of below 360 thousands dollars is very smaller in comparison with those SMEs in developed countries but SMEs represent a high rate of total enterprises especially non-SOEs in Vietnam.

With such a small capital, unsurprisingly, SMEs' technologies are generally backward between 10 and 20 years compared to counterparts over the world. The number of labours working in SMEs is approximately 7,8 millions people, counting around 25-26% of the labour force.

*Industrial and regional structure:* Far from the reality in industrial countries where SMEs operate in all regions and many industries, in Vietnam most of SMEs just concentrate in large cities and operate in industries such as trading, services, food processing and small construction. A co-operation with large enterprises and subcontracting ones is quite limited. The growth of small industry in rural areas has been being slow.

The two last characteristics reveal the principal limitations of SMEs in Vietnam. Based on these, there exist an official opinion that emphasises the economic weakness and competitiveness of SMEs, so under-evaluate the role of SMEs for economic development. The SMEs' only significant role, according to them, is a social effect of creating many job opportunities and contributing to the reduction of the high unemployment rate in Vietnam.

However, in fact the social impact of SMEs in term of creating jobs has been quite limited. As mentioned earlier, the rate of 27% of labour force is obviously much lower than the average level of around 70% of that in the developed countries. Moreover, statistics of SMEs in the past ten years prove that SMEs actually have many greater economic advantages and roles for Vietnam's economic development.

Firstly, a survey made by statistical offices of 12 provinces in 1994 initially pointed out that in terms of capital unit efficiency, SMEs are twice as efficient and contribute to the budget 1.5 times bigger than LEs. This is due to the three following reasons. Firstly, SMEs in Vietnam also avoid a high bureaucracy cost caused by many administrative levels in large counterparts. In other words, SMEs have many advantages in administration cost terms. This is especially appropriate for enhancing the efficiency of enterprises in Vietnam where most of managers lack both knowledge and experiences of managing enterprises in a market mechanism and management tools are poor. Secondly, most of SMEs have private ownership that, according to experiences of all countries, usually delivers higher efficiency than public one existing in most of large enterprises in Vietnam. Thirdly, SMEs' training labour cost is much lower than large SOE counterparts. With such a higher profit ratio, undoubtedly if the current capital access barrier is removed, SMEs sustainably contribute a greater part to the State budget and GDP than a current moderate share of 25%.

Secondly, with a legally simple way of capital mobilisation, flexible operation and higher profit ratio, promoting SMEs turns out to be an effective solution for mobilising capital at the initial stages of developing economy, especially at the time of the financial-banking crisis. As pointed out in the Vietnam economy, in the year 1997 the Asian financial-monetary crisis resulted in sharply declining FDI that is obviously the key reason for the fall from 9% to 5,8% of GDP (2). Vietnam Dong depreciated

arly 30% and therefore its deposit has been flown in to the commercial banks much more than that of USA dollars. The stock market has not operated actually. Large domestic enterprises a real investment rate is very limited as 70% are lost making profit. The others are being indirectly subsidised by lower interest rate and the opportunity cost of extended loans. In such a situation promotion of SMEs has been an ineffective investment way compared to the others. Nodoubtingly, developing IEs is an appropriate and important instrument to mobilise domestic capital, especially in rural areas where 76% of Vietnam population is living.

Thirdly, developing SMEs leads to two possibilities. In the first case, a number of IEs become independent, competitive companies for current large counterparts and therefore reduce monopoly risk in most of key industries of Vietnamese economy. This is because in 1994 government decided to emerge all central SOEs companies within 18 industries into 18 large state-owned companies called 90,91 corporations. But as shown in the reality of developed countries, developing SMEs both requires and contributes to the forming the competitive markets and lower prices in many industries. In the second case, SME will be subcontractors for LEs, creating subcontracting network that delivers high quality, lower cost. In any case, accordingly, operation efficiency of social production resources would be delivered.

Based on the earlier analysis, it could be said that developing SMEs will be an essential strategy to develop Vietnamese economy. Diseconomy of small business scale is not the decisive barrier as it exists in SMEs in developed countries. The very basic reason is government policies toward SMEs. The experiences of countries in which IEs develop strongly such as Japan or Taiwan pointed that government policies play an important role to support SMEs which were weak in the first period of development, especially after the war. But in Vietnam, government made the heavily subsidising policy toward large SOEs and forbidding policy for non-SOEs especially in the North for a prolonged time. This caused the problem that non-state owned SMEs have faced unfavourable production conditions. Further more, even after the Doi moi began, as a non-SOE, most of SME still have to struggle within an discriminating government policy environment. That's why it is very difficult for SMEs' to renovate technology and expand production.

Such unfavourable policies toward SMEs in Vietnam can be justified by two fundamental reasons. For one thing, Vietnam policy makers had over-focus on economy of large production scale or large enterprises. This opinion is the result of the most prolonged strong impact of production theory and model of Soviet Union's in the North Vietnam and South Korea's very large corporations (chaebol) later, especially before the collapse of a number of chaebols in the recent financial crisis. For another, a doctrine that forbids or over-discriminates private enterprises has been a theoretical source of policies toward such enterprises most of which are SMEs. The above cases are really two economic examples of an thinking way that is overemphasising one side of event, issue in Vietnam.

### **The impacts of principle government policies on SMEs and some commendations**

*The impacts:* The policies that have permitted private investment in Vietnam, generally created the new establishment and the fast growth of SMEs most of which

are private ones during the first ten years of Doimoi process. However, there has yet any policy supporting specially to SMEs, even specific section for SMEs in all policies, laws. In fact, criterion of SMEs in Vietnam was only defined by government on 20 June this year (this explains why there has not yet figures of SMEs publicly given by static office). Therefore, SMEs have not only received any preference from government but most of them, as non-SOEs, have suffered from discriminatory government policies that can be rank as the followings.

*Credit policy:* A survey on SMEs managers' opinions in Haiphong city has revealed that biggest barrier for SMEs is the supplementary capital for business expansion and technology renovation. This is because credit is the field in which SMEs have to suffer policy discrimination most. Though the situation has been improved compared to state-owned SMEs, non-state SMEs have to borrow at higher interest rate decided by four largest State commercial banks that hold around 85% of the credit volume in Vietnam. Moreover, most SMEs have no access to official medium-term and long-term loans at normal interest rate because as non-SOEs, they are restricted by very hard collateral conditions which are usually beyond their financial capacity. That's why credit from banks only takes around 17% of total credit for SMEs compared to 90% of SOEs most of which are LEs (3). This is a vicious circle hindering the development of the majority of SMEs.

*Land policy:* Land discrimination can be rank second as non-state SMEs receive much less land benefits compared to SOEs. While the rent is quite expensive compared to not only ASEAN countries but developed ones, SOEs are provided land free of charge but SMEs have to buy or rent. Moreover, after SMEs struggle to get their own land it is difficult for them to use it as collateral because most of them have not yet been given certificate of using land (under Vietnamese constitution land is not private assets). There has not yet industrial zone for SMEs or a lower rent for SMEs though the utilizing capacity of current industrial zones are low and most SMEs have to till the land around for production ground.

*Investment policy:* In comparison with the Law on Encouraging Domestic Investment promulgated in 1992, the amended one at April 1998 may be assessed as a great attempt of Vietnamese government to create more favourable business environment for domestic enterprises. These are manifested in the some following main points:

+ A range of preferential regions and goods are significantly extended. This means the number of preferential enterprises including SMEs would be greater no matter they belong to SOEs or not.

+ For the first time, credit investment guarantee fund shall be established to deliver credit preference for the enterprises doing business on preferential goods helping non-state owned SMEs producing that goods escape from the credit vicious circle as mentioned earlier.

+ Export-relating and newly established enterprises including SMEs enjoy exemption on purchasing fixed asset.

However, in term of promoting SMEs', this Law possesses some limitations:

- Preferential investment criterion still has not SMEs but items and regions. By, though the list of preferential enterprises is lengthened, SMEs beyond the list have been facing capital barriers. Even in the section 30, all enterprises enjoy tax exemption except SMEs employing below 100 labours.

- Enterprises are entitled to credit support if they lend only from state commercial banks. This causes not only inconveniences for borrowing enterprises but inhibition for the development of non-state banks including non-state SMEs.

*Tax policy:* All enterprises including SMEs enjoy only company income tax exemption for two first years. There is no a lower tax rate or complete tax exemption for SMEs, thus they have to pay VAT even in the initial period of establishment. This is a burden of high average cost for SMEs as in that period they have to bear the high cost of penetrating market and fixed cost but the number of products and revenue are small. Germany statistic posed that a half of SMEs break down in the first business year. Furthermore, the common income tax rate for domestic enterprises is higher than their foreign counterparts by around 7%(32%-25%). It is accepted that a dilemma for policy makers is they have to both encourage domestic enterprises and ensure attractive tax rate for foreign investment. Such a high tax rate plus difficult access to formal credit as analysed earlier is a capital barrier for SMEs to renovate technology, not mention that SMEs and other domestic enterprises might have to compete with much stronger MNCs in a number of industries.

*Market and competition policy:* As analysed in the first part, the market structures in Vietnam are mainly unnatural monopoly. The misuse of market power can be identified in jumped prices of cement, airfares... or persistently high prices of electricity, telephone, Internet. That goods all are produced by 90,91 corporations. However, it is anticipated that government regulation to control monopoly power of these corporations in Vietnam would be very limited. The first reason is the government has no experience in regulation of public monopoly corporations even occurred in developed countries like the United Kingdom, Australia since the 80 years and recently this has opened for large private commercial banks in Japan, chaebols in South Korea. Secondly, most of Vietnamese bureaucrats have not been trained in management as well as policy-making for market economy and receive very low official monthly wage that is only much adequate to live for a week. Given such situation, especially while there has not yet the anti-monopoly law, it is generally difficult for a part of Vietnamese SMEs to enter, expand business scale and earn profits in a market dominated by such corporations. On the other hand, government has not yet made policies to encourage SMEs and large ones have co-operation so that SMEs can specialise in producing semi-products for LEs, receive assistance of LEs, especially in a stable market.

#### *Some policy recommendations*

Based on the earlier analyse of policy barriers for SMEs in Vietnam and the experiences of developed countries, it can be said that promotion of SMEs and the important economic role for socio-economic development just would be enhanced by a feasible promoting policy package that has to satisfy both conditions as below.

*The first* can be seen as the necessary condition which requires the policies supporting directly for SMEs:

Program creating credit guarantee fund for SME should be implemented fully and actually come to effect as soon as possible.

The Law on Promoting SMEs should be enacted. A government department for SMEs should be established to be responsible for collecting more sufficient information of SMEs as well as anticipating SMEs-relating matters so that this department can be able to actively, directly propose and make government policies supporting SMEs.

Giving the complete tax exemption for all newly established SMEs at least two first years.

Speeding up the procedure of providing SMEs with the certificates of land utilisation right.

There should be policies encouraging LE to assist and use SMEs and subcontractors.

*The second* is the sufficient condition that means policies creating the favourable business environment for all enterprises including SMEs.

A clear, concrete competition policy should be made to create conditions for SMEs to enter many industries. Restructuring the 18 corporations should be based mainly on scientific evaluation on both their business and allocative efficiency.

Excluding decisively discrimination policies toward non-SOEs most of which are being SMEs. Upgrading policy-making capacity for bureaucrats through training programs of policy making firstly in the developed countries and then in Vietnam.

Wage policy reform should be made to guarantee that government bureaucrats can live on their wages in order to reduce government-large business collusion that certainly will cause big damages for public interest and restrict the development of SMEs as shown in Asian financial-monetary crisis.

## CONCLUSION

Although current SMEs in Vietnam have disadvantages in capital, technology, management and labour skill, their competitiveness is not too weak as they have advantages in terms of management, labour cost, clear responsibility, benefits and therefore capital unit efficiency. SMEs also contribute much in actually mobilising domestic capital, enhance competition and efficient co-operation. The weakness of SMEs is in large part due to discriminating policies toward non-state enterprises most of which are SMEs. Therefore, if SMEs operate in more favourable policy environment they will develop, play greater role and contribute much more to higher economic growth rate of Vietnam.

## REFERENCES

- [1] All numbers of characteristics of SMEs are selected from Report of SMEs in Vietnam, *Industrial Department*, MPI, 1998.

All numbers of the development of Vietnam economy come from The Government Annual Reports delivered in the Congress meetings in the recent years *Enterprise Department*, MPI.

Surveys of 36 SMEs. *Central Research Institute of Economic Management*, 1996.

David Begg and other authors, *Economic*. Education Press, Hanoi, 1992.

Yoshiaki Kawakami. Japanese Subcontracting SMEs. *Fukuoka University Review of Commercial Sciences*, September 1997.

William Baumol, Alan Gunther. *Economics, Principles and Policy*. Second Australian Edition. 1995.

CHI KHOA HỌC ĐHQGHN, KHXH, LXVI, N<sup>o</sup>1, 2000

## NHỮNG TÁC ĐỘNG CỦA CÁC CHÍNH SÁCH NHÀ NƯỚC ĐỐI VỚI SỰ PHÁT TRIỂN CỦA CÁC DOANH NGHIỆP VỪA VÀ NHỎ VIỆT NAM

Phạm Quỳnh Anh

*Khoa Kinh tế - Đại học Quốc gia Hà Nội*

(Bài viết này là kết quả của sự chỉnh lý và bổ sung bản tham luận của tác giả tại thảo luận Quốc tế về xúc tiến doanh nghiệp vừa và nhỏ do Hiệp hội Quản lý Kinh tế Phát triển Bản phối hợp với Đại học Quốc gia Hà Nội tổ chức tháng 10/1998)

Trong một số năm gần đây vai trò của DN vừa & nhỏ bắt đầu được chú ý nhiều ở Việt Nam. Tuy nhiên lợi thế kinh tế của DN vừa & nhỏ so với doanh nghiệp lớn vai trò đối với sự phát triển kinh tế của chúng chưa được phân tích sâu sắc. Bài viết đề cập khái quát các đặc trưng chính và hạn chế của DN vừa & nhỏ Việt Nam trên tổng diện số lượng, vốn, trình độ công nghệ, lao động. Tuy nhiên để đánh giá một cách khách quan, đầy đủ hơn tính kinh tế của DN vừa và nhỏ và cũng là đồng thời nhận diện lại một quan niệm rất phổ biến về tính cạnh tranh kinh tế yếu của loại hình doanh nghiệp này, tác giả phân tích các lợi thế kinh tế của DN vừa & nhỏ Việt Nam hiện nay như chi phí quản lý, đào tạo lao động thấp, dẫn đến hiệu quả sử dụng vốn của chúng cao hơn các doanh nghiệp lớn. Từ đó bài viết cũng cố gắng lý giải vai trò của việc phát triển DN vừa & nhỏ trong việc thúc đẩy tỷ lệ tăng trưởng thực của đầu tư trong nước, khai thác nội lực, nâng cao tính cạnh tranh của nền kinh tế và sử dụng nguồn lực một cách hiệu quả. Vai trò đó chưa được phát huy nhiều một phần quan trọng là do chính sách phân biệt đối xử của Chính phủ vì trong khi các chính sách này thường ưu tiên cho doanh nghiệp lớn công cộng thì tuyệt đại bộ phận doanh nghiệp vừa & nhỏ ở Việt Nam lại có đặc điểm ngược lại. Phần 2 tác giả phân tích tác động của các chính sách kinh tế cản trở đến sự phát triển của SME ở Việt Nam như chính sách tín dụng, đất đai, thuế, cạnh tranh và thị trường xếp theo thứ tự của mức độ ảnh hưởng. Trên cơ sở đó kiến nghị nhóm giải pháp chính sách và chương trình trực tiếp hỗ trợ cho SME và điều kiện cần và nhóm hỗ trợ gián tiếp như điều kiện đủ.