Access to Sources of Finance for Vietnamese Small and Medium Enterprises

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This paper presents three principal problems: (1) An overview of financial situation of small and medium enterprises (SMEs) in Vietnam; (2) Their ability to get access to sources of finance; and (3) Remarks on financial consequences to SMEs and suggested measures to improve their financial strength. The paper employs secondary data from the General Bureau of Statistics, and first hand data from sampled surveys of local SMEs conducted in various projects under author's direction in 2005-2006 (a survey of 230 manufacturing concerns in Bình Dương, Tiền Giang and HCMC; and a survey of 200 manufacturing SMEs in HCMC). Surveyed SMEs have at least three years of operation. Frequency analysis is used for analyzing gathered data in order to calculate certain financial indicators and ability to get access to bank credit and preferential credit from state-run financial funds by SMEs in the private sector. Results of the calculations will be compared with ones for state-owned and large-scale foreign-invested companies.

1. An overview of financial situation of SMEs

The Decree 91/2001/CP issued in 2001 by the PM considers concerns with a workforce of under 300 employees and a legal capital of under VND10 billion as SMEs. These criteria, especially the one of capital, turn most private concerns into SMEs as shown in the following Table 1 based on data provided by the General Bureau of Statistics on Dec. 31, 2005.

Table 1: Vietnamese concerns by workforce, capital and sector up to Dec. 31, 2005

Concerns by sector	Number of concerns		Concerns with a 300-person workforce	Concerns with a VND10-billion capital	Proportion of SMEs by workforce	Proportion of SMEs by capital
	Number	As % of total				
Total number of companies	112,952	100.00%	109,338	98,233	96.80%	86.97%
State-owned companies	4,086	3.60%	2,675	873	65.47%	21.36%
Private companies	105,169	93.11%	96,179	96,179	98.70%	91.45%
Foreign-invested companies	3,697	3.27%	3,697	1,181	77.6%	31.94%

Source: General Bureau of Statistics, *Niên giám thống kê Việt Nam* (Vietnam's Statistical yearbook), 2006

The Table 1 shows that some 98% of SMEs by their capital are in the private sector. This means that data gathered from this group represent all local SMEs, and indicators surveyed in these SMEs could be compared with one gathered from state-owned and foreign-invested companies of much larger scale.

According to a general investigation of companies carried out by the General Bureau of Statistics in 2005, state-owned companies accounted for only 3.6% of the number of companies but they represented some 55% of total working capital, and these figures were 3.2% and 20% respectively in the foreign sector and 93% and 24.94% respectively in SME sector. The average working capital for a company in the years 2000-05 are shown in the Table 2.

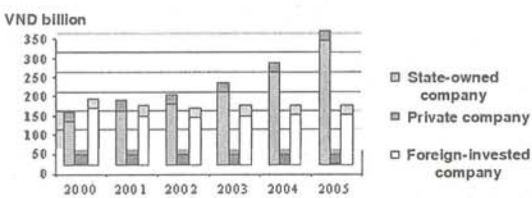
Table 2: Average working capital by sector in 2000-2005 (VND billion)

Size of capital	Average capital of a state-owned company	Average capital of a private company	Average capital of a foreign-invested company
2000	116.38	2.81	150.72
2001	145.98	3.21	130.34
2002	160.09	3.66	126.14
2003	192.56	4.49	130.49
2004	245.54	5.03	131.43
2005	327.52	5.77	132.41

Source: Calculations based on data from *Niên Giám Thống Kê Việt Nam*, 2006

The data show that the average working capital of a private company in 2000-05 was too small. It rose from VND2.81 billion in 2000 to 5.77 billion in 2005. The average capital of a state-owned is of the highest level. It increased from VND116.38 billion in 2000 to 327.52 billion in 2005; 41.4 times higher the average capital of a private company in 2005 and some 57 time higher than the one in 2005. The average capital of a foreign-invested company is rather big: VND150.72 billion in 2000 and 132.41 billion in 2005, from 23 to 53.6 times higher than the average capital of a private company (see Figure 1). All of these data show that the size of working capital of private companies is very small, and they all constitute the SME sector in Vietnam.

Figure 1: Average capital of a company by sector



In spite of their small size, SMEs in the private sector represented a big share in the GDP (45.61% in 2005) and created a lot of new jobs (88.9% in 2005; 52% of which is in the agricultural production and 36.9% in industrial and trading concerns). Role of SME in creating new jobs and contributing to the GDP in recent years is shown in the Figure 2.

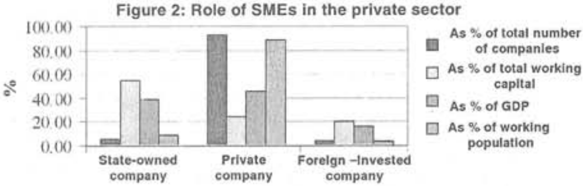
Structure of capital sources of SMEs and results of my recent survey of 200 manufacturing concerns in HCMC and Bình Dương in 2006 are shown in the Table 3.

Table 3: Structure of sources of capital of surveyed SMEs

Source	As %
Owner's capital	33.9
Retained profit	21.9
Bank loan	18.9
Retained payable	12.1
Loans from relatives and friends	6.7
Loans from employees	2.3
Others	4.3

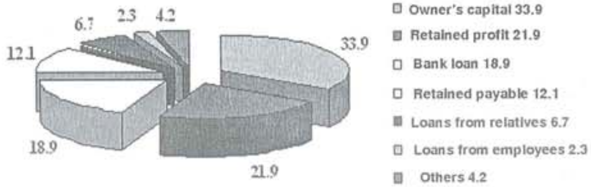
Source: Survey of SME ability to get access to sources of credit, 2006

Figure 2: Role of SMEs in the private sector



The Table 3 shows that SME employed various source of capital, and capital held by owners (initial capital and retained profit) accounted for some 55%, while bank loans accounted for 18.9% and retained payable 12.1%. SMEs could employ any sources of loans from relatives, friends, families or employees if need be (see Figure 3).

Figure 3: Structure of sources of capital of SMEs



Statistics and surveyed data show that the size of capital of Vietnamese SMEs is very small and they depend on owner's capital, and retained profit and payable, or loans from acquaintances while bank loans represent only a small proportion. This proves that they meet some difficulties in securing formal credits.

2. SME ability to get access to sources of finance

Unlike state-owned companies, SMEs have a limited ability to get access to loans from commercial banks. The following Table 4 compares average bank loans secured by private and state-owned companies.

Table 4: Average bank loans secured by private and state-owned companies

Source of credit	Average loan per surveyed company (VND million)		Proportion of companies acquiring bank loan	
	State-owned company	Private company	State-owned company	Private company
State-owned commercial bank	7,471.6	589.1	100%	62.5%
Joint stock commercial bank	2,674.9	525.6		

Source: Results of author's surveys of SME ability to get access to sources of credit, 2005 and 2006

According to the Table 4, 62.5% of surveyed private SMEs could get bank loans while 100% of surveyed state-owned companies could do the same. Regarding the size of loan, surveyed state-owned companies could secure loans that were 10 times bigger than the ones secured by private companies.

What limited the SME ability to get bank loans is the small value of assets they could mortgage, and lack of professional and social relations between SMEs and banks. Intensive interviews with high-ranking staff of commercial banks show that besides the lack of valuable assets to mortgage, SMEs lack a good "professional relations" with banks. When submitting requests for bank loans, SME owners lacked transparent information, from financial statement for example, that could help bank officials feel they were trustworthy. In addition, my surveys proved that most SMEs failed to establish good social relations or acquaintanceship with bank managers or officials. My surveys also showed that a high proportion of SMEs didn't trust bank officials. Their opinions about loan officials are shown in the Table 5.

Table 5: Relation between SMEs and loan officials

Opinions from SMEs	Approval from other SMEs (%)	Non approval or slight approval (%)
1. Loan officials are always ready to help you	52.9%	47.1%
2. You believe in advice from loan officials	51.1%	48.9%
3. You think loan official understand your concern	52.4%	47.7%
4. You don't want to meet loan officials	29.1%	70.9%
5. Loan officials pay no attention to your concern	45.4%	54.6%
6. You feel loan officials cause difficulties for you	72.1%	27.9%

Source: Survey of SME ability to get access to sources of credit, 2006

The Table 5 shows that the first three opinions have something to do with confidence of surveyed companies in loan officials. Some 50% of respondents didn't have, nor had only little, trust in loan officials. Although 70.9% of surveyed companies want to work with loan officials, the last two opinions show that they thought loan officials paid no attention to, or caused difficulties for, their concerns. Regarding approval from other SMEs for all six items, most SMEs express their lack of trust in loan officials. And this situation prevents them from becoming trustworthy customers, thereby securing necessary loans easier.

Of banking services, SMEs mostly use bank accounts, money transfer, and payment through banks. Results of my survey of banking services used by 200 SMEs in 2006 are as follows.

Table 6: Banking services used by SMEs

Banking service	Number of SMEs buying banking services	As % of the total
1. Bank account	186	93
2. Money transfer	160	80
3. Making payments	140	70
4. Securing loans	125	62.5
5. Opening L/C	56	28
6. Getting receivables	37	18.5
7. Getting bank guarantee	2	1
Number of surveyed companies	**200**	

Source: Survey of SME ability to get access to sources of credit, 2006

Data from the Table 6 show that only a small proportion of surveyed SMEs (1%) could get bank guarantee; a handful of them (18.5%) opened L/Cs to pay foreign partners. When asked about the financial leasing service, all SMEs said they didn't use this form of credit. Reasons why they didn't employ this service are shown in the Table 7.

Table 7: Reasons for failure to use the financial leasing service

Reason	As %
1. Know nothing about this service	28.6%
2. Know nothing about financial leasing procedure	32.0%
3. Know nothing about benefits of this service	17.5%
4. Complicated procedures	35.7%
5. High costs	31.6%
6. Availability of more favorable sources of credit	33.3%
7. Others	5.4%

Source: Survey of SME ability to get access to sources of credit, 2006

Results in the Table 7 show that most surveyed SMEs didn't use the financial leasing service because they knew nothing about it (this service, its procedures and benefits). If they had some knowledge of this service, they would think procedures were complicated and costs were high.

Besides commercial banks that supply credits and other services, there are state-run credit unions that provide low-interest loans to certain preferential industries or fields. Results of my survey of 230 companies in 2005 – 2006 for the study "Supporting credit for SMEs in Vietnam" under the research project "Vietnam's Competitiveness Initiative" show that state-owned companies in general could get access to sources of preferential credits easier than private companies. All of 230 surveyed companies were operating in preferential industries where they could secure low-interest loans from public funds. Of this group, 115 companies have secured such loans while the rest didn't or refused to receive such preferential treatment. Results of my survey proved that big companies, such as state-owned ones, could get preferential loans easier than SMEs from the private sector.

The Table 8 presents the size and sources of capital of two groups of surveyed companies: (1) companies receiving preferential loans (most of them are state-owned ones); and (2) companies in the same industries (most of them are private ones) not receiving such loans. Data gathered during the survey show that the average capital of companies provided with preferential loans was VND89.99 billion while that of companies not provided with such loans was VND24.04 billion. The difference in capital between them was 3.74 times.

Table 8: Average capital and sources of capital of companies with and without preferential loans

Working capital and sources	Size (VND bn.)	As %
Total working capital of companies with preferential loan	89.99	100.00
Loan capital of companies with preferential loan (lent by supporting funds and commercial banks)	38.53	42.81
Total working capital of companies without preferential loan	24.04	100.00
Loan capital of companies without preferential loan (lent by commercial banks)	7.41	3083

Source: VNCI Project: Survey of companies with and without preferential loan, 2005 – 2006

Loan capital of big companies with preferential loan came from the Development Assistant Fund (now Vietnam Bank for Development) and commercial banks. Regarding the size of preferential and commercial loans and their share in the working capital of big companies (the group with preferential loan), they were much bigger than the same indicators in small companies (the group without preferential loan). In my survey, the average size of loan capital of a company with preferential loan was VND38.53 billion while this average size of a company without such loan was only VND7.41 billion. Thus, the average size of loan capital of the former was 5.2 times bigger than that of the latter.

Regarding the relative value, the share of loan capital in the working capital of the first group was bigger than that of the second one: 42.81% compared with 30.83%.

In short, local SMEs met with more difficulties than big companies (mostly state-owned ones) in getting access to formal sources of finance, including sources of low-interest and commercial loans.

3. Consequences of the shortage of working capital in SMEs and suggestions about improvements in their financial strength

Just because of the shortage of capital, local SMEs meet with difficulties in doing business: (1) failure to buy new technologies needed for bigger output and market shares; (2) Limited access to sources of finance and land stock; (3) Limited access to business information. These are causes of their poor performance and low profit.

Although the small size allows them to modernize their technologies, establish better managing machinery, and change their business strategies to cope with fluctuations in the market demand, they frequently face the shortage of working capital needed for expansion of market shares and improvements in their competitiveness. This shortage, along with lack of access to formal sources of loans, prevents them from replacing their technologies quickly. According to a survey of technologies employed by HCMC-based concerns conducted by the HCMC Bureau of Statistics in 2005, only 8.4% of private concerns employed modern technologies compared with the average of 13.9% of the manufacturing industry. This figure was 20.6% in industrial state-owned companies and 48.9% in foreign-invested companies. The best part of SMEs (61.6%) employed technologies of medium level and 12.7% applied old and obsolete technologies (this figure was higher than the average of the whole industry. These results show that the technological level of private SMEs is very low, and much lower than the ones found in big companies in the public and foreign sectors. This factor makes it difficult for SMEs to improve their product quality, performance and competitiveness.

The small working capital also prevents SMEs from buying land needed for expansion of their factory buildings. My survey of 450 companies in 2003 shows that 58.4% of them rent a part of or whole area needed for their production from state-owned companies and other organizations and individuals, and pay for it be market prices. This factor reduces their profit and competitiveness.

Due to these factors, financial performance of private SMEs is very low: a big proportion of them suffered losses and their average ROA is low. My survey shows that some 13% of private SMEs suffered losses (compared with 2.6% of state-owned companies) while 85.9% of them gained some profit (compared with 97.4% of state-owned companies). The average ROA of big companies surveyed in 2005 was 13.76% while this figure among private SMEs was 7.75%.

As stated above, private SMEs have contributed a lot to the economic growth, especially in creating new jobs (36.9% of the working population are employed by SMEs. Their biggest limit is the shortage of capital that leads to high production cost and poor performance. The above analyses allow us to work out measures to improve their financial strength.

4. Suggested measures

a. After its accession to the WTO, Vietnam has to remove all support on forms of tax or interest rate, which makes it more difficult to help SMEs get access formal sources of finance without violating WTO rules. Foreign experience shows that the government can take part in organizations that provide SMEs with some kind of credit guarantee. Assets of low market prices, as stated above, prevent SMEs from getting bank loans. These organizations can act as guarantors for SMEs or provide part of the loan for SMEs through banks. This cooperation allows banks to share risk with the guarantors and receive some bank charge when supplying loans to SMEs, so the banks can get readier to provide SMEs with loans. This practice may lead to reduction in – but not elimination of – the demand for some assets as security from SMEs. The best part of such credit guarantee system (CGS) is established as state-run or privately-run organizations although they sometimes are formed as commercial concerns. The CGS usually supply 'retail' guarantee services (guarantee provided on a case-by case basis) but some of them may act as guarantors for any SMEs in certain regions or industries. The guarantees credit usually equals from 50% to 100% of the loan (principal only, not including interest rate).

Development of an economic concern depends on a series of external and internal factors. One of the most important factors is the access to sources of finance that could be turned into working capital (short-term capital) and fixed capital (long-term one).

When SMEs couldn't get access to formal sources of finance, they have to depend on informal ones (relatives, friends or customers). Some SMEs could get such access but the loans they get are usually small and of short term. No concern can develop well when they can't get enough input factors, and capital is a very important one.

Governments and sponsors are increasingly aware of importance of SMEs to local communities and the economy as well. Even developed economies as Singapore and South Korea where most resources are traditionally used for developing large-scale companies (GLCs in Singapore and chaebols in South Korea) have recently adopted new policies to encourage SMEs because they are sources of new jobs and have potentials to become future large-scale companies. Simply speaking, SMEs usually account for the majority of the corporate community (up to 95% or bigger) in most countries. This fact forces policy makers to concentrate more energy in supporting SMEs by introducing interventions in forms of policies and legal infrastructure and economic instruments, including financial support.

There is a lot of experience about interventions and supporting instruments for SMEs, so it is easy to decide what instrument or intervention is effective and sustainable. This is true to interventions needed for the development of the SMEs in general and initiatives in financing SMEs in particular.

In Vietnam, Decree 90 issued in November 2001 aims at establishing credit guarantee funds in commercial banks to support SMEs without valuable assets to mortgage[1]. According to the Decree, these funds are to be established in all big cities and provinces as non-profit organizations run by provincial governments. Capital of the fund amounts to some VND30 billion with 30% from the provincial budget income and the rest from banks, trade associations and economic concerns. Each fund has its own board of directors, board of supervisors and board of managers, under management of the branch of the Development Assistance Fund (now Vietnam Development Bank) and the fund may charge some fee for its services[2]. Up to now, however, only one of these funds has come into operation in Vietnam. It is the Credit Guarantee Fund for SMEs under the HCMC Investment Fund for Urban Development (HIFU) established in late 2007.

From foreign experience and reality in Vietnam, I suggest accelerating the establishment of credit guarantee system for SMEs and other economic concerns with the leading role played by the DAF (now VDB). With this service, the VDB should avoid supplying loans directly (that is, avoiding competing against commercial banks), and aim at supporting commercial banks in supplying loans to economic concerns that have no valuable assets to mortgage. For example, this system can help commercial banks supply loans of longer terms to large and time-consuming investment projects.

b. SMEs also face shortage of land and it can be considered as an asset to mortgage to banks. To help them deal with this problem, the Government should ensure equal opportunity to use land for both private and state-owned companies. Due to policies in the past, state-owned companies were granted many big lots of land while private ones should buy or rent it at market prices after dealing with a lot of complicated procedures and red tape. To help them cut costs, the best way is to simplify administrative procedures and offer equal treatment to companies of all sectors when granting land or allowing them to exchange pieces of land in different districts.

c. As for shortcomings of SMEs in their efforts to enhance their financial strength and cut costs, the greatest one is the lack of transparency in financial statements, which is one of reasons why banks refuse to provide them with loans. Thus, SMEs should pay more attention to training in finance and accounting for their key employees so they can prepare transparent financial statements and good feasible studies used for applying for bank loans. In addition, SMEs should develop good relations with the business circles and corporate communities, including commercial banks. By taking part in workshops or conferences, SMEs can gather information about possible sources of finance and banking services appropriate to their businesses, thereby starting some kind of relation with banking people.

As my survey proved, many SMEs knew nothing about preferential credits or financial leasing service. To deal with this shortcoming, SMEs should make plan to get access to different sources of useful information needed for their businesses. Joining trade associations is also a useful way to gather and exchange information needed for their efforts to overcome difficulties to their companies ■

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Notes

(1) Decree 90 is supported by Decision 193 (December 2001) made by the PM, Circular 42 (May 2002) issued by Ministry of Finance, and Circular 6 (April 2003) by the SBV.

()2 DAF was established in 2000 by Decree 50 issued in July 1999 with an initial capital of VND5,000 billion. Its main function as a non-profit organization is to mobilize sources of finance to carry out or support government's policies and programs.