

When Vietnam prepares to join the AFTA and WTO, Vietnamese companies, including small and medium enterprises (SME) are facing a lot of difficulties and challenges. In such a situation, SMEs are badly in need of support and direction from the government, besides their own efforts, to survive, compete against foreign rivals, and enter the world market.

I. PRESENT SITUATION OF SMEs IN VIETNAM

1. Role and position of SMEs in the Vietnamese economy

Vietnam is a developing country where 80% of the population earn a meager income from farming business, many farmers are idle during the year because they go short of farming land. That is why SMEs have an important role because they

can create a lot of new jobs and help change the structure of industry in rural areas.

Vietnamese SMEs account for 90% of economic concerns, 25% of the GDP and 31% of industrial output. They employ some eight million laborers, that is, 79.2% of non-farming labor force or 22.5% of the working population.

In the industrialization strategy, SMEs in Vietnam help with the exploitation of local resources, create many jobs at low costs and ensure the sustainable development without depending on foreign resources.

2. Situation of SMEs in Vietnam

According to the Institute of Economic Management, 82.2% of concerns in Vietnam, 89.5% of local companies and 33.6% of foreign-invested ones are SMEs because their capital is under VND5 billion. Regarding the

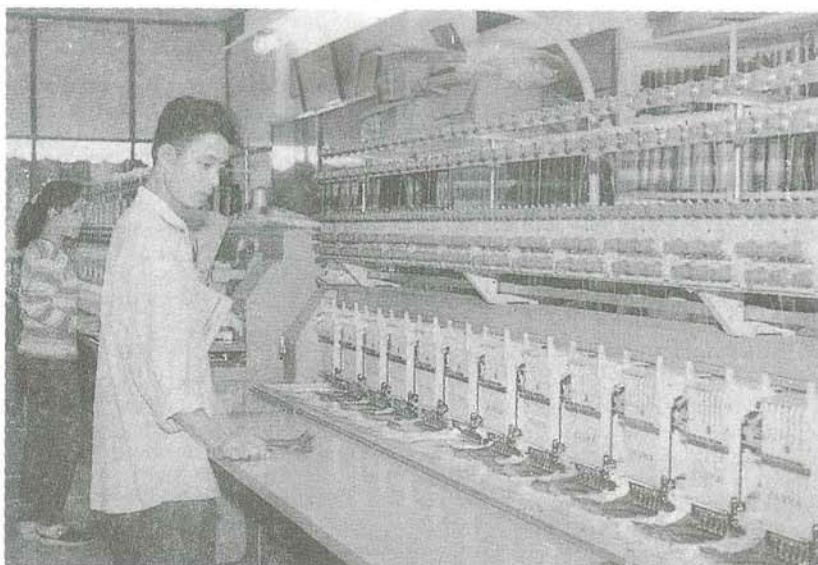
labor force employed as a standard (under 200 laborers in an SME), 95% of companies in Vietnam, either foreign-invested or local ones, are SMEs. Thus, from 80% to 90% of companies in Vietnam are SMEs in terms of capital or labor force. Of these companies, there are some 4,000 state-run and over 35,000 privately-run ones. Regarding their operation, 46.2% of them operate in the trading sector, 18% in construction and manufacturing sector and some 10% in transport and other services. Over 55% of SMEs are based in Eastern South and the Mekong Delta; 18.1% in the Hồng Delta and 10.1% in the Central Vietnam.

One of the greatest difficulties facing Vietnamese SMEs when Vietnam adjusts its economic structure as required by the WTO and AFTA is competition from foreign companies, especially multinationals. Their poor

SMALL AND MEDIUM ENTERPRISES AND THE INTEGRATION INTO THE WORLD ECONOMY

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competitiveness originates from both internal and external factors.

a. **SME performance:** According to a survey conducted by the Vietnamese Chamber of Industry and Commerce, the business performance of most SMEs has been poor in recent years. The causes of this situation are many: inflation, falls in the exchange rate and failure of SMEs to work out feasible business strategy; enter new markets and secure necessary factor inputs.

b. **Shortage of capital:** Some 55% of SMEs are facing this difficulty because they had to depend too much on informal sources of finance (mostly from friends and relatives). Moreover, most SMEs aren't qualified for membership of the stock market. They also meet with difficulties in getting access to formal sources of finance (lack of collateral or guarantee by financial institutions, high interest rate, complicated procedures, inaccessibility of long-term loans, etc.)

c. **Narrowing market:** Most SMEs have no stable market for their output, especially foreign ones because of their poor competitiveness and the recent financial crisis in Asian economies.

d. **Machinery and technology:** The shortage of capital prevents SMEs from replacing their capital goods and importing modern technologies (only 10% of their machinery is replaced every year). Generally, the machinery and technologies employed by SMEs are very obsolete.

e. **Human resource:** According to a rough estimate, some 45% of laborers and owners of SMEs have just finished the secondary education, some 70% of laborers aren't trained, and only a handful of SME owners have a university degree.

f. **Working place:** Most SMEs have no proper working place. They usually use the owners' houses or rented buildings as either offices or shop-floor. In addition, financial difficulties prevent them from equipping their shop floor with proper waste treatment systems.

3. Impacts of economic policies on SMEs

a. **Trade policy:** In an effort to integrate into the world economy, the foreign trade has been deregulated gradually, all companies are allowed to export and import goods. However, there are still many obstacles to companies engaging in foreign trade: certain items are still monopoly of some companies; the import and export list is changeable, the tariffs are still high, etc.

In addition, many supporting policies are still lacking: price support to export and import, credits for production of exports, financial support for companies taking part in international trade fairs, etc.

b. **Industrial policy:** The protectionism has distorted the domestic market. High tariffs on some imports caused companies importing materials to suffer high production cost and poor competitiveness. SMEs that engaging in heavy industries receive no preferential treatment. Private companies are facing keen competition from contraband goods and discrimination in favor of state-run companies from authorities.

c. **Financial policy:**

- Many policies have been adopted to mobilize sources of capital (tax incentives, interest rate, encouragement to domestic investment, etc.) making saving and investment increase remarkably in recent years. In the years 1995-1999, the gross in-

vestment amounted to some VND445,000 billion, and 23.5% of which came from the private sector. In 1999, the estimated gross investment was VND104,000 billion and 21,000 billion came from the private sector.

But the policy on capital mobilization is of little service to SMEs. In principle, all companies are allowed to get fiduciary loans but in fact, no SME can get such loans without guarantee from financial institutions while they have no valuable property to mortgage to banks and there is no bank specialized in supporting SMEs. The lending procedures of state banks still discriminate against non-state companies. These factors make it difficult for SMEs to get medium- and long-term loans from formal sources of finance.

- As for the tax policy, in spite of many recent improvements it still poses many problems for SMEs. Many SME managers even think that they will suffer losses if they pay all taxes. That is why tax evasion is so common among privately-run companies.

Tax regulations are complicated and ambiguous. In certain cases, there exists double taxation and tax discrimination. For example, regulations on corporation tax allow preferential treatment to certain economic activities with the result that local companies have to pay higher tax rates in comparison with foreign-invested ones.

Tax relief regulations fail to encourage taxpayers, and as a result, many of them would rather avoid tax payment than apply for tax relief.

- In implementing monetary policies, identical interest rates are charged on loans to companies of all sectors but there are still many problems with policies on interest rate: in 1999, the lending rate was reduced many times and caused losses to banks because the interest rate was cut before banks could turn all deposits into loans; cuts in interest rates on loans in domestic currency and unchanged rates on loans in foreign ones failed to attract new borrowers with the result that banks were glutted with deposits, etc.

- The economic reform has facilitated the capital accumulation (it increased from 7.4% of the GDP in 1990 to 20.1% in 1997 and fell to 18% in 1999), especially in the private sector, but both saving and investment are still low. Private SMEs, in comparison with state-run ones, had fewer chances to get access to both

foreign and domestic financial resources.

- Public and private organizations specializing in supporting SMEs failed to offer good services and bring them within reach of SMEs, that is why most SMEs never look for help from these organizations although they are badly in need of information and knowledge, and as a result, they couldn't improve their machinery and business performance.

III. MEASURES TO SUPPORT AND ENCOURAGE SMEs

1. Legal infrastructure

In many foreign countries, there is a law on SME. This law is more urgent in Vietnam now. For the time being the Government had better perfect rules dealing with this type of companies and improve enforcement of these rules. In making an SME law, foreign corresponding laws, especially from ASEAN countries, are worth studying.

Besides the SME law, the bulk of subordinate legislation is also necessary to ensure the law is enforced properly. Stable and reasonable legal infrastructure is the most important factor that encourage SME owners to develop their business.

2. Administrative procedures

In reforming the administrative procedures, full attention should be given to the four following issues that affect greatly the operation of SMEs: procedures for establishing and registering new companies, for renting land, for securing medium- and long-term loans, and for exporting and importing goods.

3. SME management organization

As in foreign countries, SMEs in Vietnam need an organization that serves as their representative to work with governmental bodies at different levels and present their opinions or petitions. The Government had better establish such an organization instead of assigning this task to a ministry.

4. Supply of services to SMEs

The presence of organizations supplying information and other services to SMEs has become an urgent need because these services could help SMEs improve their performance.

At present, there are many domestic and foreign organizations undertaking this business. However, they work for a profit and give no help to the Government in making plans to develop SMEs or enforcing

rules dealing with SMEs. To solve this problem, the Government could set regulations on operation of these organizations with a view to making use of existing resources and encouraging SMEs to consume these services.

III. SOME SUGGESTIONS ABOUT MACROECONOMIC POLICIES

1. Industrial and commercial policies

- Offering equal opportunities for companies of all sectors.

- Giving price support to SMEs making exports to help them find footholds in foreign markets.

- Using protectionist measures to help SMEs control the domestic market, produce import substitutes and exports, keep state-run companies from holding monopolies, and struggling against smuggling activities and production of fake products.

- Developing business incubators to provide SMEs with services and other support at their first stage of development.

These incubators could be built, in a pilot scheme, in such big cities as HCMC and Hà Nội.

- Encouraging and facilitating cooperation between local and foreign SMEs, especially those from APEC and ASEAN countries, and participation in international trade fairs.

2. Financial policies

- Requiring state banks to give equal treatment to both state-run and privately-run companies, and removing all favors in terms of credits and debt settlement given to state-run companies.

- Encouraging hire-purchase business and supplying medium- and long-term loans to SMEs that are newly established or want to replace their machinery.

- Establishing an official organization specializing in offering guarantee and insurance services to SMEs: Fund for this organization could come from the national treasury, foreign NGOs and SMEs themselves. This organization will supply credit to SMEs with feasible business projects but short of capital.

- Simplifying procedures for getting medium- and long-term loans because they mean a great waste of time and money to SMEs.

3. Tax policies

- Avoiding all cases of double taxation and tax discrimination, and making tax rules and regulations clearer and more stable.

- Using tax incentives as regulatory instruments for ensuring equal opportunities for all companies and laborers instead of as an instrument for favoring the public sector.

- Giving cuts in profit tax to banks supplying long-term loans to SMEs, and allowing the amount reduced to be put in contingency reserve.

4. Policies on technology and training

The Government should give tax reduction to SME plans to replace technologies and machinery. In the long run, financial support could be offered to such plans.

As for training programs, the Government could help SMEs cooperate with universities and economics institutes in training laborers and managers in modern skills and knowledge. In the long run, the education system should be reformed basically to meet requirements by SMEs in their process of integrating into the world market.

5. Investment policy

To encourage fixed investment, the Government could carry out projects to develop infrastructure, especially to build waste treatment plants which are beyond reach of SMEs.

6. Market policy

All of above-mentioned measures will become meaningless if SMEs fail to find out markets for their output. The Government can encourage the public, and require all governmental bodies, to consume local goods. In addition, the two following measures could be taken for this purpose:

- The Government, through its embassies and trade promotion offices in foreign countries, can carry out programs to market Vietnamese goods and supply information about foreign markets to SMEs.

- The Government creates favorable conditions for SMEs to take part in publicly-financed infrastructure projects. This measure can help SMEs cooperate with, and get new technologies transferred by, large-scale companies.

In the long run, a master plan to develop SMEs based on cooperation between ministries and local governments is necessary but the decisive factor is efforts of SMEs themselves. However, the plan should be carried out step by step in a way appropriate to different stages of the economic development. ■