

# Financial Solutions to SME's Development and Competitiveness

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## 1. An overview of small and medium enterprises (SMEs)

SMEs of Vietnam have an important role to play in the country's industrialization and modernization process. The process of economic reform in Vietnam, during the last few years, has directly impacted and resulted in SMEs and has promoted the comprehensive development and diversification of trade, organization form and business areas. The development however, is still limited in many aspects especially market constraints and the SMEs' internal physical limitation such as capital shortage, old and slowly renewed equipment, outdated technology, poor diversification of product sample and lack of good skills and management experience. SMEs have not reached their full potential. In addition, the lack of specific policies and strategies for the development of SMEs also restricts their development.

Vietnam has been implementing a large number of measures to further encourage and support the development of SMEs. They are: step by step creating a favorable legal environment to ensure all the business activities are doing well; providing favorite and promotion policies for SMEs in sectors such as textile and clothing, shoe and leather, consumer goods and export production, parts and spare parts manufacturing, food and foodstuff processing, electrical and electronics and information technology; receiving and implementing a number of technical assistance projects of in-

ternational organizations and countries to develop SMEs; establishing centers for consulting and supporting SMEs in sectors, cities and provinces; looking for and expanding internal and external markets.

Vietnam welcomes and encourages internal and external companies, as well as persons, to invest capital and technology in building, developing, co-operating and setting up joint ventures with SMEs in any economic sector on the basis of observance of its laws, equality and mutual benefits.

At present in Vietnam, SMEs exist and are developing in all economic fields and areas, under various forms of enterprise such as state-owned enterprise, private enterprise, corporate enterprise, joint stock company, limited company, foreign-owned company, joint venture company. These forms differ from that in the past when under a prevailing command economy, SMEs mainly existed in two forms: state owned enterprise and co-operative.

Most of countries classify enterprises into three categories: large, medium and small enterprises based on labor, capital and sales with a view to giving appropriate policies and supports for each kind of businesses.

According to Government Decree 90/N dated November 23, 2001, SMEs are independent entities which register their business in compliance with applicable laws, and own a capital of not more than VND10 billion or employ an annual labor force of not over 300 persons (previous regulation: capital

under VND5 billion, labor under 200 persons).

Therefore, the classification of Vietnam's business size depends on two criteria of capital and labor.

Businesses owning over VND10 billion and employing more than 300 workers are called large corporations, the rest are SMEs. As a result, SMEs include:

- SMEs are established and operating in compliance with the Law on State-owned Enterprises.

- SMEs are established and operating in compliance with the Law on Enterprise.

- Small and medium co-operatives are established and operating in the Law on Cooperatives.

SMEs have contributed significantly to the economic development of the country and have resolved many social problems during the last 10 years of economic renovation.

Vietnam's SMEs account for 97% of the total number of enterprises. Just because of this, they play an extremely important role in the economy, especially for Vietnam. This role is implemented in the following areas:

First, they produce large portions of necessary consumer goods and services whose values represent 26% of GDP. This is a great contribution of SMEs to the economy. SMEs operate in most of the country's provinces and industries including mining, electricity, gas, water, hotel, restaurant, farming, forestry, aquaculture, trading, service, construction, processing and so on. They are absent in only a few key industries. This is very significant to the national

mobilization of all resources for its economic development.

Second, SMEs help to offer jobs to millions of workers and thus stabilize the social order. Most of the governments in the world give priority to the reduction of unemployment because high unemployment rate will lead to social evils and unrests. SMEs attract much more labor because they do not require high skilled profession; even unskilled labor can be employed, especially in labor intensive industries such as textile and garment or construction. With these advantages, SMEs have generated employment to 15 million workers across the country. This is a significant contribution of SMEs to the national socio-economic development.

Third, SMEs help mobilize a large of investment capital from the people for local economic development.

Unlike large corporations, SMEs are widely established in most of provinces and localities. This is a favorable condition for the people to invest their money in this kind of business. They are suitable to every capital source, so they can attract small capital sources from the people for local economic growth.

Fourth, SMEs carry out an important part in maintaining and increasing revenues for the state budget, especially local budget.

Although they are of small and medium size, they make up a large quantity and lion share in total number of Vietnam's businesses. Just because of this, they both diversify

products and services and create important revenues for the local government budget.

In Vietnam, big cities and provinces are large economic hubs, alluring most of large corporations. SMEs are scattered in most of provinces in the delta, midland, coastal and mountainous areas. These establishments make financial contributions to the local budget, and help to balance it, particularly in mountainous and coastal provinces.

Nevertheless, SMEs are facing a lot of difficulties and challenges, mainly in capital and technology; their inadequacy and limitations are major obstacles to SMEs' expansion.

Although SMEs account for 97% of total businesses, their capital scale remains too low (their working capital represents only 25-30% of the country's total business capital. On average, an SME owns only about VND1,200-1,500 million, this is a too low figure. Such a low working capital will surely affects an SME's production equipment and technology. They will find it very hard to access advanced technologies. So they are usually reluctant to accept obsolete equipment and technologies. This is the largest shortcoming of SMEs requiring attentions and supports from the government.

## 2. Financial solutions to SME's development

To help SMEs grow and enhance their competitiveness, the top priority is to address financial problems. The solutions must be practical and feasible, they include:

- Expanding medium and long-term loans for SMEs.

Because SMEs are badly in need of capital, banks should increase their loans to SMEs so that they can realize investment projects to ren-

vate and expand their business and production, upgrade and modernize their production line and equipment. Their demand for investment is very huge. If they receive financial supports from commercial banks, they are given favorable conditions for reducing product costs and increasing product quality as well as their competitiveness.

- Applying the form of finance leasing to assist SMEs.

Finance leasing is the kind of medium and long term credit which is very suitable to SMEs due to the following reasons:

- First, as leaseholders, SMEs will take the initiative in seeking or selecting necessary equipment and technologies which are appropriate to their technical and financial capability.

- Second, in finance leasing, leasing companies are owners of assets, SMEs are not required to own a large initial capital, even leasing companies can meet 100% of SMEs' demand by their financial supports.

- Third, based on their income and payment capability, SMEs can choose suitable time of leasing. If their financial capability is high, they need only medium-term leasing (from one to five years) with a view to rapidly establishing their ownership over the leased assets, if their financial strength is limited, they can choose a longer leasing period (more than five years), the lease paid in many years will reduce financial burdens to SMEs.

Finance leasing supports have a lot of advantages; however, this form is still fresh in Vietnam, so most of SMEs get less information and no access to this kind of support. Just because of this, this financial support should be widely made known so that SMEs can apply this support.

- Increasing loans by overdraft to SMEs.

Overdraft is a kind of credit supply to the bank's customers. The bank allows its customers to spend money in excess of their account balance. This form of lending has a lot of benefits:

- Saving costs for both the bank and its customers because using this form of lending, the bank will not incur relevant costs in credit assessment, management, and records. SMEs will not pay costs in taking a new loan.

- The lending procedure is very simple and implemented one time in a fiscal period. If SMEs want to receive this form of support, all they are required is to open an account at the bank and regularly make transactions via this account. Based on their stable business and production, SMEs will be given overdraft lending and the bank will determine a line of overdraft at the beginning of the period (a quarter or a year). When given this line, SMEs are allowed to make overdrafts for their payments.

The overdraft lending will help SMEs meet their payment requirements on time at low costs.

- Extending the JBIC Small and Medium Enterprises Finance Program:

This program is funded by the Japan Bank for International Cooperation (JBIC), and facilitated by both the Ministry of Planning and Investment (MPI) and the State Bank of Vietnam (SBV). Started in July 2002, the program is expected to last for 4.5 years. The objective of the program is to provide medium and long term loans to SMEs through local intermediary banks, including Industrial and Commercial Bank (ICB), Bank of Industry and Development in Vietnam (BIDV), East Asia Commercial Bank (EAB) and Asia Commercial Bank

(ACB). These banks directly lend money to eligible SMEs. The total budget for the program is Yen 4 billion (approximately \$33 million).

The loan terms and eligibility criteria are as follows:

- All SMEs less than 300 employees and charter capital of less than 10 billion VND can apply through participating banks.

- Borrowers must be located in Hà Nội, Hải Phòng, Đà Nẵng, or HCMC.

- The maximum size of a single loan can be up to VND 20 billion. The term of the loan can be up to 10 years, including a grace period, at the lowest interest rate allowed by the SBV.

The financing structure for individual projects is: a maximum of 65% of the project costs is lent by JBIC, at least 20% must be lent by participating financial institutions, and the SME must contribute at least 15% from internal sources.

The implementation of JBIC SME Finance Program has recorded a lot of promising achievements. Until July 2004, total disbursed funds reached VND210 billion or 42% of the total value of the fund, including VND70 billion from ICB; VND60 billion from BIDV; VND50 billion from and VND30 billion from EAB. The disbursement of the program continues to rise and so far account for 75% of the total fund. Nevertheless, the rest is still large, more than VND125 billion, SMEs should apply for this program assistance.

In addition, the Government is required to seek other programs like JBIC SME Finance Program with such partners as Canada, South Korea, Australia, France, the UK, Germany to promote financial supports to SMEs. ■