



FINANCIAL SOLUTIONS FOR SMALL AND MEDIUM ENTERPRISES IN VIETNAM IN THE COMING YEARS

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Small and medium enterprises (SME) have flooded most developing countries, especially in ASEAN ones, as a new model, and Vietnam is no exception.

SMEs can operate with a small capital and get adjusted easily to changes in the market, and prove to be appropriate to level of managerial skills of most Vietnamese businesspersons. At present, however, they are facing many difficulties from both the inside (managerial skill, technologies employed, and shortage of capital, etc.) and the outside. To survive, develop and make some profit, SMEs need help and financial support from the State and banking institutions. This paper estimates current financial solutions to SME problems and suggests new solutions for the coming years.

Methods employed here are generalization, analysis, and comparison. In addition, statistics, induction, and deduction are also used. Based on these methods and estimates of application of financial solutions to the SMEs in Vietnam in the past few years, the paper suggests new financial solutions for the coming years.

1. Financial solutions to SMEs in the past

In the past few years, the State, commercial banks and Credit Guarantee Fund have had many financial solutions to SME problems in order to

provide them with sources of capital, and help them carry out business plans timely; replace their facilities; modernize the technologies and run their businesses more effectively.

a. Solutions taken by the State:

Many policies not only encourage commercial banks to support the SMEs, but also provide the SMEs with preferential rates of interest and tax incentives.

- Interest rate: The PM issued Decision 131/QĐ-TTg on subsidized interest rate for organizations and businesspersons on Jan. 23, 2009 and Decision 333/QĐ-TTg on March 10, 2009 on the additional list of classes of borrowers who are entitled to the subsidized rates of interest. According to these Decisions, entitled organizations can enjoy the subsidized rate of interest within eight months at most for lending contracts signed and implemented in the period from Feb.1, 2009 to Dec. 31, 2009. The subsidized rate is 4% a year for actual loans and maturity within the said period. Thus, SMEs have a very great chance to get access to cheap capital. The present market rate is 10%, organizations can now pay only 6% when 4% is covered by the State. If they are included in preferential treatment programs offered by commercial banks to traditional customers, the interest rate they pay may reduce to 2% or even 0.5%.

Such sources of cheap capital can help organizations, especially SMEs, expand their business, cut production cost, and recruit more laborers.

According to the SBV, total loan at subsidized rate of interest up to mid- March 2009 amounted to VND144,312 billion, increasing VND30,604 billion, or 26.9%, over the previous week. Of this figure, loan supplied by state-owned commercial banks and Central People's Credit Fund equaled VND114,537 billion representing 79.37% while the loan supplied by joint stock banks was VND26,837 billion, or 18.6%.

- Tax incentives: On Dec. 11, 2008, the Decree 30/2008/NQ-CP introducing urgent measures to prevent recession, maintain economic growth and ensure social welfare was issued. To provide guidelines on implementation of the Decree, on Jan. 13, 2009, Ministry of Finance issued Circular 03/2009/TT-BTC on a cut of 30% on corporate income tax for SMEs, and delay of tax payment for companies in difficulty. This Circular allows SMEs to enjoy a 30% cut on the corporate income tax for the fourth quarter of 2008 and the whole year of 2009. When declaring the corporate income tax paid for the fourth quarter of 2008 and the year 2009, the company determines itself the cut tax payment equaling 30% of the payment temporarily made in the quarter. When balancing the tax payment for the fourth quarter of 2008 and the year 2009, the company calculates and declares the tax payment to be exempted. If the company is in a period entitled to tax incentives set by the tax law, the 30% cut applies to the remaining tax payment after taking away the value of incentive allowed by the tax law. Moreover, companies are allowed to delay their payments for the corporate income tax. Namely, SMEs can delay their tax payments for nine months after the deadline set by the Tax Control Law. The tax advance for the first quarter of 2009 can be delayed until Jan. 29, 2010, the tax advance for the second quarter of 2009 can be delayed until April 29, 2010; the tax advance for the third quarter of 2009 until July 30, 2010; and the tax advance for the fourth quarter of 2009 until Oct. 29, 2010.

b. Solutions taken by commercial banks:

Securing loans from commercial banks is a possibility all companies desire. In the globalization, bank credit becomes increasingly important. And it is much more important to survival and devel-

opment of SMEs because the bank is the place where the government can intervene most easily and quickly to produce impact on the SMEs.

According to the SBV, the present banking system of Vietnam comprises four state-owned commercial banks (not including the Bank for Social Policy, and Bank for Development), 38 joint stock banks, five banking joint ventures, and 42 branches and 54 rep offices of foreign banks. As the banking system develops, it's easier for SMEs to get access to sources of finance and become important customers of commercial banks.

Up to the end of the third quarter of 2008, there were 163,673 concerns, equaling over 50% of SMEs with total working capital of VND482,092 billion, are bank customers. Of this total working capital, 36.25% was owners' capital; 45.31% was loan capital; and 18.44% were from other sources. By July 31, 2008, the average owners' capital was estimated at VND1.33 billion; and average loan capital supplied by banks was VND1.79 billion.

Total loan from commercial banks to SMEs was VND289,100 billion: 49.05% of this figure (or VND141,816 billion) was from state-owned banks; 48.37% (139,837 billion) from joint stock banks; and 2.58% (7,447 billion) from branches of foreign banks and banking joint ventures.

Outstanding loan to SMEs up to July 31, 2008 was VND299,472 billion equaling 27.3% of total outstanding loan from bank to all classes of customers, increasing by 16.65% compared with the end of 2007. Of this sum, short-term loan accounted for 73.05% and medium-term 26.95%. With an outstanding loan of VND170,481 billion equaling 56.93% of the total outstanding loan, state-owned commercial banks became the biggest suppliers of capital for SMEs. They were followed by joint stock banks with outstanding loan of VND120,936 billion, or 40.38% of the total. Banking joint ventures and branches of foreign banks supplied VND8,055 billion, or 2.69%.

Bad debt caused by SME for the banking system amounted to VND10,888 billion equaling 3.64%, increasing by 1% over 2007. Of this figure, doubtful debt was VND4,064 billion, or 37.4% of the total bad debt of the banking system. More exactly, this percentage was 4.59% among state-owned commercial banks; 2.44% among joint stock banks and 1.45% among foreign-invested banks.

At present, 23% of SMEs that have relations with commercial banks are making some profit; 73.2% gain performance of medium level; and 3.8% are facing difficulties (and 1.42% of them are default). Generally, commercial banks have paid more attention to SMEs in recent years. Their sales and loans to SMEs are on the increase. SMEs account for 70% of outstanding loan in many commercial banks. This figure has reached 95% in certain branches of state-owned commercial banks (source: Report by SBV Department of Credit).

c. Bank guarantee:

Besides getting secured loans from commercial banks, SMEs can get guarantee from Vietnam Development Bank (VDB) and Credit Guarantee Fund to secure more loans from commercial banks.

- Credit Guarantee Funds for SME: Acting as a bridge between banks and SMEs, such funds are established by provincial and municipal governments to give guarantee for bank loans. Fund authorities also act as supervisors who evaluate borrowing projects and safety of loans, and help companies complete borrowing documents.

To get entitled for help from such funds, the company should produce feasible plan and some assets as security that are equal to 30% of the intended loan, and the fund only guarantees 80% of the difference between the loan and security given by the company. To get guarantee, the company should pay a fee that is equal to 0.8% of the loan extended every year. Such conditions, along with small chartered capital (some VND30 billion), make only a handful of companies entitled for the guarantee offered by such funds.

Thus, seven years after the Decree 90/2001/NĐ-CP on the official support for SMEs, the establishment of such credit guarantee funds didn't produce intended results. Their performance is not good enough. To save the situation, the VDB has made plan to form a central guarantee fund and bring it into operation in 2009. The central fund will re-guarantee loans guaranteed by local funds and manage sources of capital and support from foreign organizations.

- Vietnam Development Bank: Due to shortcomings of credit guarantee funds, VDB has been allowed to provide companies with guarantee for their bank loans.

The VDB is developed from the Development

Support Fund based on Banking Institutions Law and National Budget Law. VDB is a state-owned and non-profit financial institution that receives no deposit from the public. It prioritizes loans to projects with high degrees of risk that investors from the private and foreign sectors refuse to engage in, especially the ones in depressed areas. Although free from profit-making task, ADB only supplies capital to projects that promise high efficiency. It offers lower interest rate as compared with commercial banks because its interest rate is based on international standard that equals the rate on 5-year government bond plus a fixed fee (about 1% a year). Moreover, VDB supplies long-term loans with maturity from 10 to 15 years – a class of loans only a few banks can provide.

On Jan. 21, 2009, the PM issued Decision 14/2009/QĐ-TTg on statute of bank guarantee for SMEs allowing companies from all sectors, including cooperatives, that have investment projects worth at least VND100 million, owe no overdue debt to any banking institutions or tax arrears, have owner's capital equaling at least 10% of the project value, and put 100% of the secured loan from banks into the project, to get entitled to guarantee from VDB. According to this statute, companies that have the chartered capital of VND20 billion at most and employ 500 laborers at most are also entitled to VDB guarantee. Thus, this statute offers a solution to shortage of assets used as security for banks or mortgage, and allows SMEs to get better access to bank loans.

To implement this Decision, VDB and Vietnam International Bank (VIB) signed an agreement on supply of loans and bank guarantee to companies in February 2009. According to this agreement, VDB guarantees loans at preferential interest rate supplied by VIB to SMEs that have the chartered capital of VND20 billion at most and employ 500 laborers at most. VDB carries out this program all over the country to ensure the possibly quickest supply of capital to some 1,000 companies whose need in 2009 is estimated at VND8,000 billion.. By the end of March 2009, VDB has entered into agreements with 27 banks to provide companies with its guarantee. Up to now, 52 companies have secured over VND500 billion from banks with VDB guarantee, and 13 of them have been provided with guarantee bonds that can help them to secure bank loans.

2. Estimate of implementation of financial solutions to SME problems

a. Achievements:

- SME shortage of capital has been solved. Many SMEs have modernized their facilities, carried out their projects timely and expanded their businesses successfully.

- Solving the SME shortage of capital is also a way of maintaining sources of budget income. By doing so, the State liberates potentials of the public and plays well its role in the socioeconomic development. Moreover, this effort also deals with social problems, such as employment and personal income.

b. Shortcomings:

- Attitude of banks towards SMEs: Most banks are reluctant to supply loans to small and scattered projects, and newly established companies because of their lack of track records.

- Limited sources of finance: Most SMEs need long- and medium-term loans needed for their initial stages of development (buying or renting land, building factories, buying machines and equipment, etc.), but most banks tend to supply short-term loans used as working capital instead of long-term loans.

- Poor competence of loan officers: When handling application for loans from SME, loan officers are very cautious and usually reject the application, or only agree small loans. This practice helps limit risks for banks but causes difficulties for SMEs and the economy as a whole.

- Time-consuming handling of application: Another difficulty facing SME is the time the bank handles their applications. In fact, the time is prolonged too much. When an application is approved, most SMEs have to mortgage their assets to banks, and the work of having documents of their assets signed by notaries public consumes a lot of time, especially documents of assets acquired with loan capital.

c. Causes of shortcomings:

- Supplying the capital to SME is considered as one of targets for commercial banks but there is no official document that ensures preferential treatment to banks that do so. The Government still encourages banks to provide SMEs with loans but banking regulations are not adjusted accordingly, and as a result, all banks have to observe

the regulations, manage business risks and ensure their performance and fail to offer preferential treatment to SMEs.

- Owner's capital and retained profit of commercial banks and other banking institutions are not large enough to satisfy demand for loans by companies. More importantly, proportion of long-term deposit is very small, which prevent banks from financing long-term investment projects.

- Keen competition among commercial banks forces them to open branches in all provinces. This situation requires recruitment of new employees and appointment of skilled officials to new branches. And as a result, their armies of loan officers are not good and well-trained enough to serve existing customers and attract the new ones.

- SME labor force is not well-trained enough to help the companies to integrate into regional and international markets. Small capital and size prevent SMEs from investing in training courses for their laborers.

- Account books and financial statements of SMEs are not exact, sufficient and transparent enough to persuade loan officers when evaluating their applications.

- Assets of owners of SME and corporate assets are not well separated, which makes it difficult for loan officers to estimate customer's financial strength.

3. Financial solutions for the coming years

a. From the State:

Firstly, the State must establish a legal infrastructure including regulations relating to SMEs and regulations for this class of company alone. In the near future, an SMEs Law and a Law on Bank Guarantee for SMEs must be made and promulgated along with guidelines and preferential treatment to banking institutions that supply loans to SMEs.

Secondly, besides Credit Guarantee Fund, the State should establish a fund for SME development. Capital for this fund may comprise contributions from SMEs and investment from the State, and it can be used for supporting SMEs in difficulty.

Thirdly, the State can encourage banking institutions to provide SMEs with advisory service and methods of managing investment and making business plans in order to help them get access to

sources of finance when such services have not developed in Vietnam.

b. For commercial banks:

Firstly, commercial banks can invest in, or establish joint ventures with, SMEs. This practice allows banks to increase their sales, grasp strengths and weaknesses of customers, control strictly the use of loans, and earn some income from this investment. As for companies, advice and support by banks can help them improve their performance and reduce risks. This practice, in short, is effective, feasible, and within reach of banks because most SMEs and their operations are of a small size.

Secondly, commercial banks can make plan to supply fiduciary loans by degrees. To achieve this aim, banks should improve their ability to evaluate application and supervise implementation of business plans by their customers; and enhance skill and work ethics of their employees.

Thirdly, commercial banks can introduce some kinds of preferential treatment to SMEs in terms of interest rate, bank charge, borrowing or mortgaging conditions, and right to purchase and sale of foreign exchange, etc. For example, customers with good track record can enjoy lower interest rate, and new customers may be exempted from bank charges.

Fourthly, commercial banks may offer selective banking products and services appropriate to SMEs' needs. SMEs can get loans based on their receivables or value of their goods and services, feasibility of their business plans and competitiveness of their products.

c. From SMEs:

SMEs should enhance their public image and trustworthiness by: (1) making books, invoices, contracts and reports exact, clear and transparent as required by laws; (2) making financial statements clear and reliable instead of producing statements with a view to dealing with tax authority; and (3) enhancing competence of accountants with a view to observing properly all regulations and producing exact and honest numerical data about corporate finance and operations.

4. Conclusion

At present, SMEs represent a large body of the economy and contribute a lot to the economic growth. SMEs enjoy certain advantages because

of their small and medium sizes but they also face the shortage of capital. In the past few years, the State and commercial banks have actively supported the SMEs but their efforts couldn't solve the shortage of capital for SMEs. To support them more effectively in the coming years, the State, commercial banks and SMEs should try their best to implement policies adopted by the Government, and handle carefully difficulties and obstacles arising from the implementing process in order to smooth flows of capital to SMEs. As for SMEs, they must enhance quality of their human resource and capacity in order to get full access to, and make the best use of, formal sources of finance. Their joint efforts must aim at developing SMEs with good financial strength and human resource that can compete successfully against foreign rivals, find firm footholds in foreign markets, and contribute more actively to the economic growth.

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