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Vietnamese small and medium-sized enterprises: legal and economic issues of development at modern stage

Abstract

In Vietnam, developmental ideologies in general and market economic principles in particular have been changed drastically under the transitional system. To build a good platform for small and medium-sized enterprises, Vietnam had to amend some of its most important laws on business. This adjustment was conducted not only in order to improve the existing legislation, but also to facilitate Vietnamese laws to match with the world system, especially taking into consideration the fact that Vietnam is under the pressure of international integration and regionalisation. The role of the new Vietnamese government is appreciated through the adoption of the amendments. The Vietnamese business environment has become more supporting, especially for small and medium-sized enterprises which accounted for 97.5% of the total number of 700,000 enterprises of Vietnam in 2016. This paper presents the legal adjustment and evaluates how the latest legislative policies on small and medium-sized enterprises are impacting the Vietnamese economy.

Keywords: SME; Vietnamese SMEs; SME Development Policies; Improvement of Business Environment; Vietnam

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В'єтнамські малі та середні підприємства: правові та економічні проблеми розвитку на сучасному етапі

Анотація

У В'єтнамі ідеологія розвитку в цілому та принципи ринкової економіки зокрема були докорінно змінені в рамках перехідної системи. Для того щоб створити дієву платформу для розвитку малих і середніх підприємств, державі В'єтнам довелося внести зміни в деякі з найбільш важливих законів, що стосуються ведення бізнесу. Правки були внесені не тільки для того, щоб поліпшити чинне законодавство країни, але й для того, щоб в'єтнамські закони узгоджувалися зі світовою правовою системою, беручи до уваги той факт, що на розвиток держави В'єтнам впливають процеси міжнародної інтеграції та регіоналізації. Ухвалення відповідних змін у законодавстві країни допоможе дати оцінку діяльності нового уряду держави В'єтнам з урахуванням того, що в'єтнамське ділове середовище стало більш сприятливим для ведення бізнесу, що особливо актуально для малих і середніх підприємств.

У даній статті розглядається правове регулювання ведення бізнесу у В'єтнамі, а також дається оцінка того, яким чином останні законодавчі практики, що стосуються малого і середнього бізнесу, впливають на в'єтнамську економіку.

Ключові слова: МСП; в'єтнамські МСП; політика розвитку МСП; покращення бізнес-середовища.

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**Вьетнамские малые и средние предприятия:
правовые и экономические проблемы развития на современном этапе**

Аннотация

Во Вьетнаме идеология развития в целом и принципы рыночной экономики в частности были коренным образом изменены в рамках переходной системы. Для того чтобы создать действенную платформу для развития малых и средних предприятий, государству Вьетнам пришлось внести изменения в некоторые из наиболее важных законов, касающихся ведения бизнеса. Правки были внесены не только для того, чтобы улучшить действующее законодательство страны, но и для того, чтобы вьетнамские законы согласовывались с мировой правовой системой, принимая во внимание тот факт, что на развитие Вьетнама влияют процессы международной интеграции и регионализации. Принятие соответствующих поправок в законодательстве страны поможет дать оценку деятельности нового правительства государства Вьетнам с учетом того, что вьетнамская деловая среда стала более благоприятной для ведения бизнеса, что особенно актуально для малых и средних предприятий.

В данной статье рассматривается правовое регулирование ведение бизнеса во Вьетнаме и дается оценка, каким образом последние законодательные практики, касающиеся малого и среднего бизнеса, влияют на вьетнамскую экономику.

Ключевые слова: МСП; вьетнамские МСП; политика развития МСП; улучшение бизнес-среды.

1. Introduction and Brief Literature Review

There exist a number of researches on small and medium-sized enterprises (SMEs) and reforms in other countries. In India, the performance of small-scale industries and the focus on the changes in the existing policies have opened new opportunities. The sector of small-scale industries has made good progress in terms of the number of small-scale industry units, production and employment levels. It is recommended to enhance technology development and to strengthen financial infrastructure in order to boost small-scale industries and to achieve the growth target (Singh, 2012). Also, the role of small and medium-sized enterprises in the industrial sector is growing rapidly in India, and they have become a thrust area for future growth. It is emphasised that nurturing the SME sector is essential for the economic well-being of the nation (Venkatesh and Muthiah, 2012).

In Africa, the poor business environment increases the number of obstacles to SMEs, decreasing the prospects of reaching full potential in terms of employment, production and welfare (Katja, 2005). The investment climate reforms have impacted the development of SMEs in South Africa, Cameroon and Nigeria (Nubong Gabila Fohung, 2012).

In China, people management is one of the central themes relevant to the development of SMEs, and the reforms in human resource management has had a significant impact on Chinese SMEs recently (Li Xue Cunningham and Chris Rowley, 2010). In Indonesia, legal amendments have helped to promote small and medium-sized enterprises by using a clustering approach (Tambunan, 2005).

In emerging markets, there are approximately from 365 million to 445 million micro, small and medium-sized enterprises (MSMEs), among which 25-30 million are formal SMEs, 55-70 million are formal microenterprises, while 285-345 million are informal enterprises (IFC, 2015). Definitions of SMEs often vary by country and are usually based on the number of employees, the annual turnover or the value of assets of enterprises (ILO, 2015).

Under the legal document adopted in 2013 (the Circular No. 16/2013/TT-BTC promulgated on 08/12/2013), small and medium-sized enterprises in Vietnam including branches, subsidiaries and financially independent units, cooperatives employing under 200 employees working full time and with annual revenue not exceeding VND 20 billion are considered to be SMEs. The above definition of a SME is used in this research. It includes all types of enterprises, irrespective of their legal form, such as family enterprises, sole proprietorships or cooperatives, or whether they are formal or informal enterprises.

All over the world, particularly in developing countries, SMEs play a major role. According to the IFC (2010), formal SMEs contribute up to 45 percent of total employment and up to 33 percent of national income in emerging economies. These numbers are significantly higher when informal SMEs are included. Thus, the role of SMEs is undeniable. It is believed that targeting SMEs is not considered to be an end in itself but a means to create growth, quality employment and shared prosperity.

An updated survey has revealed that Vietnamese SMEs know how to survive under any circumstances. The problem is how to encourage the discovery of useful knowledge, how to organise and operate capital resources, labour, skills and raw materials, how to continuously create a new output (Hayek, 1960; 1967a; 1967b; 1973-79a; Eucken, [1940] 1992; Buchanan, 1991; Casson, 1993; Berggren et al, 2002. Cited by Kasper, W., Streit, M. E., Boettke P. J., 2012). Further, the improved institutional priorities become a necessary condition; however the fulfilment of this condition alone is insufficient to ensure growth. Entrepreneurs and other people should also promote honest cooperation and law enforcement, which should be recognised and respected. Institutional efficiency is a set of rules to help individuals / enterprises to secure full development of their potential (full growth to mature), which provides inclusive development in the long term (N. V. Khoi, 2013).

2. Results

The booming development of SMEs in Vietnam

Small businesses are characterised by fast decision-making mechanism, small scale, flexibility, adaptability and changeability before the fluctuations of the market, especially after the economic crisis. Schumacher (1973) argued that «small is beautiful». At the same time, if a country has only micro and small-sized enterprises, it will be hard for such a country to compete with other nations. Worldwide studies have shown that small businesses operate primarily in the domestic market, especially in niche markets, while medium-sized and large enterprises, which are leading enterprises, lead other businesses and provide the development of the economy.

The number of SMEs in Vietnam has increased. Within 10 years, since joining the World Trade Organisation in 2007, more than 50,000 enterprises are established annually. The data from the Vietnam Association of Small and Medium Enterprises (2016) show that the number of SMEs has increased remarkably in recent years in Vietnam: 20,510 businesses entered the market in the first 9 months of 2016, which is over 59.6% compared to the same period last year. If we consider 81,451 businesses registered within 9 months of 2016, the total number of new business is nearly 102,000, with 370 new businesses established per day. The newly registered capital increased by 49.5% compared to the same period in 2015. The average registered capital has increased by 25.4%. On the whole, there are about 600,000 SMEs, which accounted for 97.5% of the total number of enterprises (700,000) in 2016.

Talking about economic sectors, SMEs represent wholesale, retail, processing, manufacturing, including some areas predominated by the state enterprises, namely, electricity, gas, water supply, mining, information and communication, etc. In the public service sector, SMEs account for about 5% of activities in education, health and others. In 2016, SMEs have contributed to over 40% of GDP, 61% of employment, 31% of exports, approximately 30% of budget revenues and 38% of social investment. The capital turnover rate on productivity, which indicates the effectiveness of SMEs, is 0.7 times higher on average compared to foreign investments, and it is 2.3 times higher than the relevant rate of state-owned enterprises (Vietnam Association of Small and Medium Enterprises, 2015).

However, SMEs are not strong enough and active. SMEs were increasingly shrunken in terms of their operation. The number of people working at SMEs decreased from 79 employees to 32 employees per enterprise. This is particularly relevant for individual business, nearly 50% of which has only 1 employee, with the number of employees ranging from 2 to 4 employees in other cases (Vietnam Association of Small and Medium Enterprises, 2015). Being smaller at the production scale, SMEs are still very weak in the creation of value-added products and market connectivity. Most SMEs are concentrated in the fields of trade and small service. In the manufacturing sector, which is an area with a higher degree of cohesion with the international market, the SMEs' proportion is not high as well. Moreover, such businesses have no linkages with other sectors of the economy. The competitiveness of Vietnam businesses is low because of their scale.

According to the classification of SMEs in terms of the scale of labour under Decree No. 56/2009/ND-CP, the rate of small-scale enterprises and microenterprises was rising during the period 2002-2012 from 90% to 95.8%. Approximately 2/3 of Vietnam's enterprises are microenterprises with less than 10 employees. The share of microenterprises increased from 53.1% to 66.8% in 2002 and 2012, respectively. Despite the fact that microenterprises have always dominated the Vietnamese economy, a number of employees at such enterprises is very small. The share of medium and large-scale enterprises remains low and tends to decrease. In 2012, Vietnam had only 2% of medium-sized enterprises and 2.3% of large-scale enterprises (see the exact data on distribution of the enterprises in Vietnam by their size, labour and capital proportion in 2002, 2012, and 2016 in Table 1).

Tab. 1: Distribution of the enterprises in Vietnam by their size, labour and capital proportion in 2002-2016

Enterprise type	In total, % of enterprises			Labour proportion, %			Capital proportion, %		
	2002	2012	2016	2002	2012	2016	2002	2012	2016
Micro	53.1	66.8	71.5	4.2	10.4	83.04	3.3	11.1	89.07
Small	36.9	29.0	24.61	21.2	29.8	16.26	14.3	23.4	9.51
Medium	3.5	2.0	1.82	7.3	7.8	0.44	6.6	7.3	1.42
Large	6.5	2.3	2.07	67.3	52.0	0.26	75.8	58.2	0
Total	100	100	100	100	100	100	100	100	100

Source: General Statistics Office of Viet Nam (2017)

Hence, it could be summed-up that predomination of SMEs in Vietnamese economy creates barriers to absorption of innovations and participation in the internationalisation processes, mainly because of the small investment inflows and inability to create economy of scale to which globalisation makes favourable conditions.

Constraints to SMEs in Vietnam

International Labour Organization (2015) report outlines the three biggest constraints to SMEs' growth across countries, namely: access to finance, to electricity, and competition from the part of informal enterprises. In Vietnam, additional limitations to SMEs to be mentioned from the previous researches, due to our previous analysis (Dang Thi Phuong Hoa, 2016), are: a lack of knowledge and skills of employees (Clarke and Gibson, 1998; Ntsika, 2001); a lack of management capabilities (Megginson, Byrd and Meginnson, 2003; Kuratko and Welsch, 2004; Rwigema and Venter, 2004), as well as limited access to markets and restrictions on capital and market shares (Ntsika, 2001). The limitation in financial resources is one of the major barriers for SMEs in terms of integration (Vo, Narjoko and Oum, 2010). Capital restrictions make SMEs unable to invest in infrastructure, mastering newer technologies in order to expand their production or enhance their export (Rundh, 2007; Zhang, Sarker and Sarker, 2008; Wengel and Rodriguez, 2006) to achieve high efficiency (Rahman and Ramos, 2013).

It is worth mentioning that Vietnamese entrepreneurs have very limited legal knowledge which is fundamental in business (Thi Thanh Hai Tran, 2015), which has led to a great number of commercial business disputes (NCSEIF, 2015). SMEs' prestige, their capacity and competitive edge are much affected due to frequent trading disputes, lawsuits, court proceedings or losing trademark copyrights, information scam related to the evaluation of the legal status and financial status of foreign partners because of the lack of information either about them or their representatives (Dang Thi Phuong Hoa, 2016).

The abovementioned problems of Vietnam's SMEs lead to many other obstacles to the market-entering capacity package, which results in business risks in the market.

Support for Vietnamese SMEs¹

Vietnam's policy concerning SMEs is quite full of packages. The SME Development Plan 2011-2015 launched 8 SME development groups of solutions, including the legal framework for entering the market, operating and exiting; accessing to finance and credit support; technological innovation and application; human resources development focusing on capacity building; forming clusters linkages; information support and marketing promotion; building systems of aid organisations supported in managing and implementing the SME Development Plan.

Addressing innovation, development, and improvement of the SMEs efficiency in terms of economic restructuring under the Government policies as of May 2012, the State Bank of Vietnam has set ceiling of lending interest rate in VND for the priority sectors, including SMEs, which is lower by 1-2% per year compared with the regular lending rate. Accordingly,

¹ The sections «Support for Vietnamese SMEs» and «Recent legislative changes: new government's efforts» of the paper represent a part of the author's previous research: Dang Thi Phuong Hoa (2016). Legislative policies in support of Vietnam SMEs. 2016 KTRA's International Conference «Globalization of SMEs and Capacity Building in the TPP Era», October 21, 2016. (pp. 537-556).

the maximum interest rate was lowered from 15% per year to 7% per year (about 40% of the interest rate for the second half of 2011, and lower than the interest rate for the period of 2005-2006).

The products and services associated with credit operations for SMEs are being increasingly diversified; SMEs' granting credit processes and procedures are becoming simple, enabling SMEs to easy get access to capital. At the same time, credit institutions also actively consult SMEs regarding production, business and loan networks under a closed production - collection - processing chain and consumption of products. So far, Vietnam has developed 14 programs to support information management, 15 programs to support the development of technology and 8 support programs in financial tax. In addition, there are other capital funds for SMEs.

Although commercial banks are very interested and consider the small and medium-sized enterprises sector as a potential market, in risk preventing, their loan packages depend largely on the loan guarantee conditions. As a result, 70% of the credit packages are for approximately 2% of large enterprises; medium enterprises enjoy 5%, while 95% of micro and small enterprises enjoy from 20% to 25% of credit packages. In fact, the proportion of bad loans in the SME sector is low; however, due to small initial legal capital, SMEs are lack the conditions to be guaranteed, whereas banks possess sufficient capital supplies but lack confidence in credit relations.

However, it is essential to note that authorities are only interested in developing supporting policies but not in implementing them. On the other hand, such supporting policies are not targeted at protecting enterprises' rights and interests. This creates loopholes in the implementation of such policies. So far, Vietnam has not assessed the impact of those policies².

Under new free trade agreements, a number of seminars on the competitive capacity of the SME sector have been held. Nevertheless, solutions to each specific problem are quite rare.

According to the Institutional Quality Index by the World Bank, Vietnam's Institutional Quality Index for the period of 2007-2012 had no improvement, except for the indicator of political stability, which has always been above the world average and improved slightly in recent years). The government effectiveness index has always been below the world average and has a downward trend. This indicator shows the quality of public services, the quality of the activities of government agencies, the quality of the policy and the effectiveness of policy implementation. The credibility of the government's commitments for the period of 2007-2012 was low and below average. Similarly, regulatory quality indicators were also low in the same period. It shows low capacity to implement the policies for private sector development and growth.

There are two indicators used by the World Bank, however, which show a clear improvement. They are the control of corruption indicator and the indicator of voice and accountability. Nevertheless, Vietnam is still in the end of the world rankings.

² <http://business.gov.vn/Gi%E1%BA%A5yph%C3%A9p/tabid/203/catid/826/item/13891/khai-quat-tinh-hinh-doanh-nghi%E1%BB%87p-va-tr%E1%BB%A3-giup-phat-tri%E1%BB%83n-dnnv-n%C4%83m-2014.aspx>

Recent legislative changes: new government's efforts

The strategy defined by the Prime Minister of Vietnam is aimed at removing difficulties in doing business. He suggested in 2017 Resolution No. 35/NQ-CP which focuses on the most important issues related to the creation of a good business environment in the long term.

Under the new law, SMEs shall be given credit, finance, technology, office, promotion and market expansion services, business information and advice, human resources development and other supporting services.

The new law on SMEs defines three types of funds, including the SME development fund, the credit guarantee fund and the start-up fund to support local creative activities.

Regarding financial support, the law stipulates a lower tax rate of 3% for SMEs; a tax rate lower than 5% is applied with regard to microenterprises compared with the corporate income tax provisions in corporate income tax law. Many businesses believe that they are still facing tax rate problems. However, according to the data obtained from the Doing Business 2016 report by the World Bank, compared with other countries in the region, Vietnam is a country with the lowest corporate tax rate, after Hong Kong and Singapore.

Relating business land ground, industrial parks, high-tech zones and economic zones will be beneficiaries in land rent; also, 50% reduction of corporate income tax for revenue from SMEs' fee in the case of lending SMEs for more than 30% of its industrial ground will be provided for bigger enterprises. Within industrial clusters, if the SMEs' lease area counts for over 50% of the corporate income tax, the tax on the share of rental revenues from SMEs will also be reduced up to 50%.

The government made a commitment to 12 businesses to add three more laws on specialised customs inspection for amendment. These are the biggest hurdles to SMEs³.

Being given the government's guidelines and the Central Bank's direction to remove difficulties that restrict enterprises, production and business development, as of 15 October 2016, the Joint Stock Commercial Bank for Foreign Trade of Vietnam and some other commercial banks agreed to reduce the short-term lending rate to a maximum of 6% per year (which indicates a decrease of 1% per year compared with the current rate in VND) in 5 priority areas and start-up businesses, which are agricultural and rural development; export plan implementation; small and medium-sized enterprises' production; supporting industries development; high technology manufacturing enterprises). The short-term lending rates are also applicable to start-up businesses in order to encourage and support applied research results, technical solutions, as well as technology and management solutions, to improve productivity, quality and value-added products⁴.

In order to concretize the legal system, besides Resolution No. 19/NQ-CP on renewal of the business investment climate, the government has issued national start-up ecosystem content. Hanoi and Ho Chi Minh City are discussing the establishment of an entrepreneurship support centre, following the Public Private Partnership (PPP) model. Enterprises will be supported with land and finance; in return, they will be charged a service fee aimed at business facilitation, so that they can easily enter/exit the market. On 22 September 2016,

³ Specialized customs inspection checks the content of chemicals, the import and export of which is prohibited by the Circular 37/2015 / TT-BCT on limits and checks, dated 30/10/2015 by the Ministry of Industry and Trade.

The overlap in professional inspection management is also quite a common situation when a commodity is regulated by legislation (laws, decrees, circulars) in the same field or in other fields, which requires involvement of various ministries or different bodies. A single item may be under control of different units of the same ministry. In many cases (e.g. import goods are subject to quality inspection), the assessment (testing, inspection, testing, certification) is done only by the specialised ministry, which leads to its status of monopoly, hence specialised test time is prolonged, for example it takes 13.6 days (78%) at the customs in Can Tho, 19 days at Da Nang. The average is 18 days. Some items undergo a quality control test, which takes more time, e.g. 40 days for medical devices. Energy performance test lasts 43 days, while the quality inspection of fire trucks or ambulances take 79 days.

⁴ <http://cafefbiz.vn/tin-vui-startup-doanh-nghiep-smes-cong-nghie-cao-se-duoc-vay-von-rat-re-chi-6-nam-ca-du-no-cu-lan-vay-moi-20161015181607504.chn>

21 provinces signed business agreements, creating a favourable investment and business environment.

The Enterprise Development Fund was established in mid-May 2016 to improve the business environment, to promote private sector development, to maximise enterprises' potential, to focus on the small business sector in terms of both manufacturing and product processing with innovative and creative products.

To assess the policy, the Vietnam Chamber of Commerce and Industry (VCCI), the national organisation that gathers and represents business community, employers and business associations in Vietnam, considers recent reform efforts creating confidence for the business community.

The Central Institute for Economic Management (CIEM)⁵ gave an estimation that reducing administrative procedures and custom procedures for imported goods can help businesses save USD 1 billion annually.

The Government of Vietnam implements not only the Resolution 19/NQ-CP and Resolution 35/NQ-CP, but also has recently consolidated the National Trade Facilitation Committee, which will bring 80% of administrative procedures to the National Single Window (NSW) and the ASEAN Single Window (ASW)⁶.

Returning of trust in business

Resulting from the abovementioned efforts, the Doing Business report for 2016 by the World Bank ranks Vietnam the 90th out of 189 countries in the business environment rankings. Vietnam entered the top 5 countries with the best business environment in Southeast Asia after Singapore, Malaysia (18th), Thailand (49th) and Brunei (84th). Thus, Vietnam's business environment is 3 positions up if compared with the previous year. The business environment of Vietnam has also improved in terms of helping investors to access electricity and in reforming the tax procedures. Vietnam has improved its 2015 ranking by five more criteria. Its business start-up index rose from 125 to 119 compared to 2014. The electricity index increased sharply by 22 positions, from 130 to 108; the credit index increased by 8 positions, from 36 to 28; the index of tax procedure increased by 4 positions, from 172 to 168. However, some indicators have dropped if compared to the last year's ranking. The border trade index is 1 position down, it dropped from 99 to 98; the investor protection index dropped 1 position, from 121 down to 122. Many other indicators are unchanged, such as the building license index, property rights protection, contract performance.

As for the report by the General Statistics Office of Vietnam for 2016, there was a positive sign observed with regard to the business community. Businesses feel positive about the issues which improve from quarter to quarter.

In the third quarter of the year 2016, 38.8% out of 80.3% of the processing industry companies assessed the production as improving; 41.5% of businesses defined it as stable, whereas 19.7% of the companies viewed it to be difficult. In 2016, a number of newly established enterprises in Vietnam exceeded 102,000 businesses. At the end of the third quarter of 2016, 20,510 enterprises returned to the market. The number of new businesses increased in most of the sectors over the same period of last year. In some industries, those enterprises increased both in quantity and registered capital. This will help to create hundreds of thousands of jobs, to improve the competitiveness of existing companies and to simultaneously increase tax revenues. It takes time to achieve this, yet the business ecosystem in Vietnam is currently in the phase of growth⁷.

⁵ Initially called the Institute for Economic Management of the Party Central Committee established under Decision No. 209 NQ-NS/TW dated 14/07/1977 of the Politburo. The Institute serves to carry out research on building up and developing economic management science in Vietnam, to propose policies of renovating economic management mechanisms appropriate with each socio-economic development period and is an important and reliable economic think tank for the Party, the state and the government.

⁶ http://vccinews.com/news_detail.asp?news_id=34844&parent_id=0&cate_id=15

⁷ <http://vneconomy.vn/doanh-nhan/thu-tuong-phat-dong-3-dong-hanh-5-ho-tro-voi-doanh-nghiep-20161011100230803.htm>

3. Conclusions

The amendment of Vietnamese laws is a starting point, redefining the role of the government and their efforts to secure a more effective administration of the issues connected with SMEs. The increasing trust of the communities is the first positive sign. This confirms that the institutional theory is one of the most relevant in order to study strategic business development in emerging economies, and in particular, in Vietnam. In the countries where formal institutions, e.g. the legal framework and law enforcement, are at the nascent stage, informal institutions appear to be very important.

While local authorities may not have legal power concerning the establishment of businesses, their knowledge and attitude towards businesses affect the way they understand and implement the law. Their actions reflect the quality of the institutions. Hence, it would be useful to analyse how the Vietnamese government amends the legal system to support small and medium-sized enterprises. This experience is essential for SMEs in terms of their transformation from small to medium and large enterprises to compete with foreign companies in the region in the context of globalisation and economic integration.

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