

SECTOR ASSESSMENT (SUMMARY): FINANCE (Small and Medium-Sized Enterprises Finance and Leasing)¹

Sector Road Map

1. Sector Performance, Problems and Opportunities

1. Buoyed by the expansion of international trade and tangible improvements in the investment climate, Viet Nam's private sector expanded rapidly, and has outpaced the public sector by every measure since 2000 (output, investment, and employment). While the private sector accounted in 2012 for over 60% of gross domestic product (GDP, including domestic (46% of GDP) and foreign enterprises), over 30% of total invested capital, and more than 80% of the total workforce, its potential for wealth creation is still largely undeveloped, as Viet Nam remains one of the lowest per capita income countries in Southeast Asia. Viet Nam also maintains a large informal economy, which is estimated to contribute about 20% of GDP and provide over 80% of employment.² Incentives to remain informal persist, from discriminatory tax rates and regulations to costly licensing and permit regimes in the formal sector. In the process of integrating with the global economy, Viet Nam has transitioned from an economy in government ownership to one where the private sector is playing an increasingly important role but state-owned enterprises (SOEs) remain dominant in many sectors of the economy. The number of SOEs has declined as a result of the equitization³ but the state sector has shrunk in terms of scale because it has been reconsolidated into conglomerates and refinanced to create economies of scale. SOEs still account for 40% of fixed assets, 45% of total bank credit, and 30% of total employment.⁴ Private firms generate proportionally more revenue and jobs relative to capital. Continued private sector development requires Viet Nam to provide an environment in which a more balanced mix of state-owned, private, and foreign companies characterizes the economy. Competition between these groups needs to be on equal terms, enabling those that make the strongest contribution to Vietnamese prosperity to gain ground.

2. **Small and medium-sized enterprises.** Since the enactment of the Enterprise Law in 2000, over 500,000 new enterprises have been registered in Viet Nam. Some 97% of enterprises in Viet Nam are considered small and medium-sized enterprises (SMEs), that is, they have a registered capital not exceeding D100 billion or an annual average number of less than 300 permanent workers. The average start-up capital has also increased sharply, from D3.2 billion in 2001 to D17.6 billion in 2009. The largest urban centers, Ha Noi and Ho Chi Minh, account for the largest share of start-ups (nearly 50% combined) and registered capital (about 42% of total value). However, a number of provinces have distinguished themselves in the creation of a good environment for business creation despite their relatively small size. Although data vary greatly depending on the source, as of 2007 the survival rate of registered businesses was about 60%, which would place the number of active enterprises at some 318,000 in 2012,—a reasonable level for Viet Nam's stage of private sector development by international standards. SMEs contributed 31.6% of tax and other budget revenues contributed by enterprises as of 2011.⁵ On average, the domestic private sector has accounted since 2005 for about 90% of total employment, while the state sector has constituted about 9%. The foreign

¹ This summary is based on ADB. 2012. Private Sector Assessment. Viet Nam: Country Partnership Strategy 2012–2015. Manila. {<http://www.adb.org/sites/default/files/cps-vie-2012-2015-psa.pdf>}

² International Labour Organization (ILO). *Informal Economy in Viet Nam*. Ha Noi.

³ Partial privatization.

⁴ General Statistical Office 2010. Annual Statistical Yearbook. Ha Noi.

⁵ Ministry of Planning and Investment. 2012. White Paper on Small and Medium Sized Enterprises in Viet Nam 2011. Ha Noi.

direct investment sector share of total employment was about 1% in 2000, growing to nearly 4% by 2010.

3. **Unequal playing field for private sector development.** Favorable policy treatment undermines the efficiency of SOEs in the long run as they are not motivated to strive for better performance. Under the perception that SOEs may be “too big to fail,” SOEs may be incentivized to take extra risks and enter into highly speculative areas in a quest for short-term profitability. This imposes great allocative efficiency costs on other more efficient segments of the economy by having them compete for much scarcer resources. These conditions limit the capacity of other business entities to pursue productive opportunities within the domestic economy. SOEs are sheltered from competition and market discipline that other economic segments are obliged to comply with. In addition, the uncertainty of the existing stock of regulations (in terms of legal consistency, applicability, or even necessity) is likely to entail unnecessary costs for businesses when trying to find the right regulation to comply with. It also creates an opportunity for rent-seeking. Such an uncertain environment is not business-friendly.

4. **Limitations on women entrepreneurs.** In spite of good progress in this area, women entrepreneurs still face important challenges in new enterprise development and operations. Their participation in consultative planning and policy formulation processes needs to be improved to reflect their priorities adequately. Cumbersome administrative procedures have been shown to pose greater constraints on smaller, female-led entrepreneurs, who generally display lower managerial skills. Access to credit has been improved with the incorporation of women’s names on land use certificates, but resort to more sophisticated financing alternatives such as leasing or equity financing is very limited. As such, targeted programs to develop women entrepreneurs’ skills will continue to be a priority.

5. **Competition policy coverage and enforcement.** Competition policy relies heavily on market share as one of the principal indicators of dominant position. Thus, business agreements that restrict competition are prohibited only where the participating parties have a combined market share of 30% or more of the relevant market. Below the 30% threshold, agreements among firms are not prohibited, even if they end up restraining competition. Viet Nam’s experience with the full application of the Competition Law is limited.

6. **Administrative burden.** The total number of regulations in Viet Nam that affect businesses has increased in recent years. During 2005–2009, Viet Nam issued more legal normative documents that affected businesses (17,164) than during the previous 18 years put together (1987–2004).⁶ According to the 2013 Doing Business rankings, on average, a company has to spend over 1,000 hours per year to deal with administrative procedures for paying taxes, while closing a business takes 5 years. These figures are well above regional averages. The government has made very substantive progress toward the simplification of administrative procedures, and has created the Administrative Procedures Control Agency (APCA) to lead this process. However, still more work is needed to avoid the reappearance of eliminated administrative procedures in different forms, and to remove equally costly regulations for businesses at the provincial and local levels of administration.

7. **Limited role in policy dialogue and advocacy.** The involvement of the private sector in designing and executing policies remains inadequate. The policy making process in Viet Nam is often restricted to the government, with little involvement of other stakeholders. The majority

⁶ Quang, Phan Vinh and John Bentley (2009), “Codification: A New Approach to Reforming Vietnam’s Legal System”. Viet Nam Law and Legal Forum, Issue No. 185-186, pp. 28-32. Ha Noi.

of smaller companies have yet to play active roles in policy advocacy, either because they do not have the opportunity to participate or because their level of awareness and interest in the broad policy spectrum is still limited. Among 493 National Assembly deputies, only about 30 are engaged in private sector ventures.

8. **Access to capital.** The rapid growth of Viet Nam's financial sector has not benefited all segments of the economy equally. SMEs accounted for some 30% of banks' total outstanding loans in 2012. According to latest 2012 survey, 59% enterprises expressed demand for bank credit, and 82% of those could access loans. The remaining enterprises could not do so because of lack of collateral, high interest rates or transaction cost, or unfeasible business plans. The lending practices of state-owned commercial banks still tend to favor SOEs. In spite of substantial efforts to implement a number of policy actions, and recent progress in the reduction of banks' interest rates, access to finance remains a long-standing limitation for SME development. SMEs still have limited access to conventional bank lending and a shortage of alternative financial services. They face several constraints in accessing bank credit, including their small size, lower reputation, low managerial capacity, lower competitiveness of their products, lack of collateral, lack of reliable information on SME performance, and inadequate capacity to develop feasible business plans.

2. Government's Sector Strategy

9. **Constitution and national plans.** Viet Nam's private sector is not yet treated on equal terms with the state-owned sector. Although the state-owned sector accounts for only one-third of the GDP, its leading role in Viet Nam's economy is still protected by the Constitution. Viet Nam is currently seeking constitutional revision to support further economic reform. One of the proposed changes that is causing strong debate is to repeal such provisions to ensure equal treatment for all economic sectors. The Socio-Economic Development Plan (SEDP), 2011–2015 prioritizes SOE reform, with a focus on restructuring large state-owned conglomerates, as one of the three top policy priorities.⁷ It also calls for policy measures that would help non-state sector companies strengthen their business efficiency and competitiveness.

10. **SME Development Plan, 2011–2015.** The Government of Viet Nam's strategic policy framework for SME development is in the second SME Development Plan, 2011–2015, which was developed under a broad participatory process and incorporates specific programs in support of the development of skills of women entrepreneurs. At the institutional level, the SME Promotion Council is the Prime Minister's advisory council, including both private and public representation. Under the Ministry of Planning and Investment (MPI), the Enterprise Development Agency (EDA, formerly ASMED) serves as the focal point for the review of all SME development policies. The provincial departments of MPI and other specialized government agencies complete the government's regulatory fabric in the sector. In addition, Viet Nam benefits from the active participation of well-established private sector and civil society organizations such as the Viet Nam Chamber of Commerce and Industry (VCCI), the SME Association, the Young Entrepreneurs Association, and a network of universities and research centers. The government also maintains regular policy dialogue with the business community through the Viet Nam Business Forum (VBF), which is currently chaired by VCCI and a representative of foreign and local chambers of commerce.

⁷ Resolution 10/2011/QH13 issued on 8 November 2011 by the National Assembly. The other priorities are reforms in financial sector and public investment.

11. **Enterprise Law.** The Enterprise Law, 2000 eased restrictions and conditions on formal market entry, allowing a rapid increase in the number of registered enterprises. The Enterprise Law was amended in 2005 to simplify business registration procedures and to allow companies of all sectors to operate under the same forms of governance. Since 2005, significant reforms have been implemented with the objective of establishing an even playing field for business development. This includes implementation of the Master Plan on Simplifying Administrative Procedures, 2007-2010, which reviews, simplifies, or abolishes cumbersome administrative procedures to reduce compliance costs. The Enterprise Law is under review and a draft amended text is expected to be submitted to the National Assembly in the last quarter of 2013.

12. **Competition Law.** The National Assembly adopted the country's Competition Law in December 2004 and it entered into force in July 2005. The law applies to all enterprises: domestic private, SOEs, and foreign owned enterprises. The law created the Vietnam Competition Authority (VCA)⁸ with a broad scope of responsibilities—restraint of competition, unfair competition, management of competition, anti-dumping, consumer protection, and international cooperation. In 2013, a 5-year enforcement review of the Competition Law has been completed, which will serve as the basis for amendment of the law, expected by 2014.

3. ADB Sector Experience and Assistance Program

13. ADB's country partnership strategy, 2012–2015⁹ recognizes the importance of the private sector in the development process, its role in the economy, and its potential to finance Viet Nam's significant development needs, including infrastructure and selected social services. Private sector development is an integral part of ADB's country partnership strategy, while interventions have concentrated on SME operations and development. ADB has supported private sector development in Viet Nam through various loan programs and technical assistance (TA). The first cluster program loan included two subprograms for a total of \$80 million (with cofinancing from Agence Française de Développement [AFD] and German development cooperation through KfW of €55 million), while the first subprogram of a second cluster program loan was approved by ADB's Board of Directors in October 2010 for \$40 million.¹⁰

14. In October 2012, ADB approved the Public–Private Partnership Support Project¹¹ to develop commercially viable PPP projects, engage the government in policy dialogue to address PPP issues, support the Government's initiative to promote a more conducive environment for PPPs, and utilize PPPs as a catalyst for broader sector reforms. Under the project, ADB will provide funding for the establishment and operation of a project development facility as a funding mechanism to support PPP project preparation activities.

⁸ The Vietnam Competition Authority (VCA) is an organization under the Ministry of Industry and Trade with the major functions of assisting the Ministry of Industry and Trade in state administration over competition, consumer protection, and trade remedies concerning imported goods into Vietnam.

⁹ ADB. 2012. *Viet Nam: Country Partnership Strategy 2012-2015*. Manila.

¹⁰ ADB. 2004. Report and Recommendation of the President to the Board of Directors: Proposed Loan Cluster and Technical Assistance Grant to the Socialist Republic of Viet Nam for the Small and Medium-Sized Enterprise Development Program. Manila (Loan 2095-VIE [\$60 million] and TA 4418-VIE). ADB. 2006. Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Socialist Republic of Viet Nam for Subprogram II of the Small and Medium Enterprise Development Program Cluster and Progress of Subprogram I. Manila. (Loan 2284-VIE [\$20 million]), ADB. 2010. Report and Recommendations of the President to the Board of Directors: Proposed Program Cluster and Loan for Subprogram 1. Socialist Republic of Viet Nam: Second Small and Medium-Sized Enterprises Development Program. Manila (Loan 2680-VIE [\$40 million]).

¹¹ ADB. 2012. Report and Recommendations of the President to the Board of Directors: Private-Public Partnerships Support Project. Manila (Loan 2920-VIE [\$20 million]).

PROBLEM TREE

Unsustainable growth pattern on low productivity and low wages

Business environment undermines competitiveness of SMEs and private sector.

Weak strategic policy and planning framework

Inefficient bureaucratic systems

Lack of access to finance

Weak regulatory framework for competition

Weak statistical base for policy formulation

Absence of consultation mechanism for policy design

Burdensome administrative registration and operations procedures

Fledging legal support services

Limited financing alternatives

Limited access to bank credit

Low quality of legal documents

Incomplete Competition Law

Sector Results Framework (Finance, 2012–2015)

Country Sector Outcomes		Country Sector Outputs		ADB Sector Operations	
Sector Outcome with ADB Contribution	Indicators with Targets and Baselines	Sector Outputs with ADB Contribution	Indicators with Incremental Targets	Planned and Ongoing ADB Interventions	Main Outputs Expected from ADB Interventions
<p>Nonbank finance markets provide an increased share of financing to support domestic investment .</p> <p>Increased access for poor and low-income households to sustainable and affordable microfinance services</p>	<p>Share of nonbank finance sector assets to total financial sector assets increasing from 15% in 2010 to 25%–30% in 2015</p> <p>Increase in the size of the local currency debt market to 20% of GDP in 2015 from 15% in 2010</p> <p>Increase in combined stock market capitalization to 45% of GDP in 2015 from 38% in 2010</p> <p>Number of microfinance borrowers increasing by 10% in 2014, (2010 baseline: 12.5 million)</p> <p>Number of savings accounts increasing by 10% in 2014 (2010 baseline: 9.7 million)</p>	<p>Alternative channels of market-based nonbank financial intermediation developed</p> <p>Microfinance services expanded</p>	<p>Increase in short-term debt papers of various maturities of less than 1 year</p> <p>Increase in the proportion of government bonds with maturity of 3–5 years to more than 25% of the total government bonds outstanding by 2014</p> <p>Decline in the bid–ask spread of government bonds to below 10% starting in 2014 from 13% in 2010</p> <p>At least 15% decline in the number of government issuances by 2014</p> <p>Increase in the number of staff trained by about 15% from 2010 to 2015</p> <p>Increase in the number of licensed microfinance institutions from 2 in 2012 to 5 in 2014</p> <p>Increase in the number of trained regulators by 30% from 2012 to 2014</p> <p>Improvement of operational self-sufficiency in the VBSP to 90% in 2014 from 77% in 2010</p> <p>A microfinance center established by 2014</p>	<p>(i) Planned key activity areas Capital market development Microfinance</p> <p>(ii) Pipeline projects FSDP (2012, \$50 million; 2014, \$75 million)</p> <p>Microfinance Development Program loan: Subprogram 1 of ADF \$40 million Subprogram 2 of ADF \$50 million (indicative) Supporting Microfinance Development Program (ADB PATA of \$0.5 million) Strengthening Microfinance Operation and Regulation (ADB CDTA, \$1 million) Preparing Microfinance Development Program Subprogram 2 (ADB PPTA, \$0.6 million)^e</p> <p>(iii) Ongoing projects Preparing Microfinance Sector Development Program (ADB PPTA, \$0.5 million) Formalizing Microfinance Institutions (ADB JFPR, \$1.5 million) TFSP (PPTA, \$1 million) FSDP (PPTA, \$0.6 million)</p>	<p>(i) Planned key activity areas Enhanced capital market size and liquidity, increased insurance coverage and old-age protection, strengthened institutional framework and market infrastructure, enhanced legal and regulatory framework, and better staff capacity</p> <p>(ii) Pipeline projects A well-functioning money market, deeper and more liquid financial market, and improved institutional capacity Microfinance Development Strategy and road map approved, increased number of licensed microfinance institutions and cooperative banks, reporting microfinance client data disaggregated by sex in place Strengthened supervisory and regulatory capacity in the microfinance regulators Strengthened credit institutions involved in microfinance to provide affordable and sustainable services to the poor Infrastructure that supports microfinance through a microfinance center at the Banking Academy; developing a microfinance-specific credit information exchange system at CIC</p> <p>(iii) Ongoing projects Inputs to the formulation of the programmatic approach and subprogram 1 of the Microfinance Development Program Formalized microfinance institutions Enabled environment, strengthened supervision, and improved standards Money market established, a more liquid bond market, and capacity developed</p>

ADB = Asian Development Bank, ADF = Asian Development Fund, CIC = Credit Information Center, CDTA = capacity development technical assistance, FSDP = Financial Sector Deepening Program, GDP = gross domestic product, JFPR = Japan Fund For Poverty Reduction, PATA = policy and advisory technical assistance, PPTA = project preparatory technical assistance, TFSP = Trade Facilitation Support Project, VPSP = Vietnam Bank for Social Policies.

Source: Asian Development Bank.