

**SMEs DEVELOPMENT IN THE PROCESS OF ECONOMIC REFORM  
AND POLICY IMPLICATIONS**

**By**

**Tran, Trang Thi Cam**

**THESIS**

**Submitted to  
KDI School of Public Policy and Management  
In partial fulfillment of requirements  
for the degree of**

**MASTER OF PUBLIC POLICY**

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## **ABSTRACT**

### **SMEs DEVELOPMENT IN THE PROCESS OF ECONOMIC REFORM AND POLICY IMPLICATIONS**

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Small and medium enterprises (SMEs) have played an important role in economic development, which are considered as the back-bone of the economy in almost countries. In the recent years when scientific and technological progress has evolved fast, globalization trend emerged obviously and there have been many deep changes in practices of economic and business management, SMEs' role has been paid attention increasingly. SMEs development is seen to be an essential part of Vietnam's economic development strategy. This is confirmed in the resolution of the 8<sup>th</sup> Party Congress "Develop mainly small and medium enterprises with suitable technology that are labor-intensive, requiring less capital and quick return on investment". In the early 2001, the political report of the 9<sup>th</sup> Party Congress repeat again "pay attention to SMEs development ...". The socio-economic development strategy 2000-2010 also emphasis "develop widely small & medium production units with various industries and occupations. However, Vietnamese SMEs have not fully employed all of their potentials for their development. There are numerous reasons explaining the position, such as capital shortage, out-of-date technology, professional and management skill shortage, lack of market, land and premises, etc. Therefore, the thesis will try to assess SMEs development, clarify the hindering factors behind the problems, attempt to

identify the factors of government policy and institutional structure that affect the performance of SMEs, analyze policy implications for improvement of incentives to SMEs.

## **ACKNOWLEDGEMENTS**

This thesis have been completed with the valuable guidance of the supervisor, Professor Lee Joo Ho. First of all, I would like to express my thank for his great help.

I would also like to thank all my friends who encouraged, supported and facilitated me to conduct the thesis. They are: DAO Thi Huong Lan, Ha Quang Hai, NGUYEN Phuong Tra, NGUYEN Thi Thu Lien, Saw Naing, Mulyadi, XAYASOUK Anousone, SETIAWAN Gandy, Thi Thi Aye, KHANSIRI Chalee, SHIM Tong Wook, KIM Hyuk, KIM Bun-Soo, CHOI Jongwon, MUSTAJAB Moh, KARTIANINGSIH Dwi Wahyuni

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## **LIST OF ABBREVIATIONS**

CIEM	Central Institute of Economic Management
COMECON	Committee of Economic and Mutual Assistance
FIE	Foreign Invested Enterprises
GDP	Gross Domestic Production
GSO	General Statistic Office
MPI	Ministry of Planning and Investment
R&D	Research and Development
SMEs	Small and Medium – sized Enterprises
SOEs	State-Owned Enterprises
USSR	Former Soviet Union
VAT	Value Added Tax
VND	Vietnamese Dong (Currency Unit of Vietnam)

## INTRODUCTION

In general SMEs have been considered as a strongest/powerful and permanent engine over the periods of socio-economic development. They have contributed considerably to GDP growth, job creation, poverty elimination, meeting diversified demand of consumers, making the market flexible and lively, export expansion, promoting innovation in management technology and worker skill. They demonstrate a higher degree of efficiency as compared with large-sized enterprises in using capital and mobilizing savings, entrepreneurial talent and other resources that would otherwise remain idle; they can be efficient suppliers to large establishment, and can meet areas of demand neglected by larger enterprises, thus contributing to making manufacturing industries more efficient, more flexible, and less prone to external shocks.

It is important to understand what SMEs are from the outset. What enterprises, then, are regarded as small or medium? In answering this question, it is clear that the definition of SMEs must refer to the size of enterprises. In this regard, the classification criteria regarding SMEs vary from country to country and expert to expert.

Usually, various criteria that have been applied widely are the number of employment and amount of capital. The level of employment is often used to differentiate SMEs from large-sized ones. Classification criteria are also different between every sector. In many countries there have been three distinguished sectors: manufacturing, commercial, and service enterprises. Each sector has

existed its own criteria for SMEs. Moreover classification criteria have been not stationary, but changed over time. This is most obvious in the United States where the classification criteria for every sector are reviewed and even adjusted when necessary has been seen.

Since 1986, Vietnam initiated a process of economic reforms to move from a centrally planned economy to a socialist oriented multi-sector economy driven by market forces, under the State management. The economic reform program “doi moi” and the drive for industrialization and modernization have given a remarkable stimulus to the growth of the non-state sector, consisting mainly of SMEs. In Vietnam, primarily the matter has been settled by Document 681/CP-KTN issued by the Government on 20 June 1998 which stipulates that small or medium enterprises should have a maximum registered capital of VND5 billion (US\$387,600)<sup>1</sup> and employ less than 200 persons. Recently in the effort to give more priorities to small and medium-sized businesses on the 23 November, 2001 the government has issued a decision No 90/2001 on helping SMEs. This is the first legal framework for SMEs, which will facilitate SMEs to do their role well, and thereby contribute the economic development of the country. The new decision put forward a new definition of SMEs: they are the independent establishments of production and business with the maximum registered capital of VND 10 billion (double than before) and the maximum employees of 300 persons. Classification criteria has changed for being correspondent to the current reality

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<sup>1</sup> According to the exchange rate prevailing as of the date of issuance of Document 681.

when the size of private sector has been larger.

The thesis includes four chapters. The first chapter will discuss the objective necessity of the SMEs development in the process of Vietnam's industrialization. the advantages and disadvantages of SMEs as well as their socio-economic role and impact will be presented in this chapter. The second chapter will present the state of SMEs development in Vietnam by examining the economic features and the their standing. The third chapter will evaluate the implementation of policies that support SMEs development. Finally, present challenges that Vietnam's SMEs are facing and some suggestions to overcome them will discussed in the fourth chapter.

## **Chapter I**

### **OBJECTIVE NECESSITY OF SMEs DEVELOPMENT IN THE PROCESS OF VIETNAM's INDUSTRIALIZATION.**

#### **1.1. ADVANTAGES AND DISEADVANTAGES OF SMEs**

##### **1.1. 1. Advantages:**

- They are associated with intermediate technology and constitute a linkage bridge between traditional technology and modern technology.

In terms of business activities, they are dynamic, flexible and can have more freedom latitude for creativity.

- They can more easily and rapidly improve and change technology, and adapt themselves to the modern scientific and technological revolution.

- They only require a small start-up capital, are quite efficient and can recover rapidly the capital.

- Their capital investment ratio per labor is much lower than in the case of large enterprises and, as a result, can provide more employment.

- Their production and management organizational machinery is leaner, more flexible, with direct regulatory work by the managers.

- There are, in the enterprises, quite close relations between the worker and the management.

Even if they face sluggishness, losses and even bankruptcy, that would not entail a socio-economic crisis for the country but only some slight negative impact; they are also less affected by the chain reaction of economic crisis.

- They are the essential contribution for the existence and the development of the large-sized enterprises. In term of R&D, they may be a place for the tests of innovations and invention. In term of production, they undertake effectively the periods of manufacturing process that the large-sized enterprises need not and should not do. In term of service, SMEs can provide various services well. And in commercial field SMEs is highly mobile, easy to penetrate into the good markets and get out of the bad markets no matter they are large or small markets.

### **1.1.2. Disadvantages**

- They have a limited volume of capital; their material and technical basis, technical equipment are usually weak and backward.

- They have very limited access to information and marketing and also their management skills are limited.

- They have a much lower labor productivity and economic competitiveness.

- They do not have a superiority of economy of scale.

- They still have a weak voice in various relations (to government, markets, banks, scientific centers, press circles, partners, competitors, and customers...).

- They even usually depend on larger enterprises as the subsidiaries or peripheries.

In assessing SMEs, we should avoid to be partial to the good side or bad side. The good points should be developed, and the bad points should be subdued. This is a necessary work for conscious and effective policies and activities.

## **1.2. SOCIO-ECONOMIC ROLE AND IMPACT OF SMEs**

In view of their characteristics, nature and advantages, the SMEs, in spite of their disadvantages, have a very big role and socio-economic impact. In our economy with small-scale production, SMEs have accounted for a large density among the total enterprises and have an extremely important role in socio-economic development. Together with agriculture and rural economy, SMEs in industry have been a one of factors to ensure the stabilization and sustainment of the economy, economic growth, employment for laborers. They exploit and utilize effectively capital, skills and other domestic potentials, develop traditional occupations, complete large industry, and ensure big balances in economic - social – environmental aspect.

*One, their importance lies in the fact that they account for the majority of production and business units and are rapidly increasing in number.*

In most countries, SMEs account for more or less than 90% of enterprises. They have been increasing more rapidly in number than larger-sized enterprises. Vietnam does not have official figures about SMEs but most researchers agree that they account for 80-90% of total enterprises.

*Two, they play an important role in the growth of many economies and have been making a substantial contribution to the growth of national incomes, accounting for about 50% of the GDP.*

According to CIEM, SMEs have a share of about 25-26% in Vietnam's GDP in 1995. SMEs created about 31% of gross industrial production, 78% of total retail sales, 64% of total transportation volume of commodities, 100% of the production value in some sectors, such as reed mat, shoes, fine handicraft...

The effect of capital use of SMEs is very good: in order to create VND 1 in term of sales, SOEs under central management have to invest VND 0.562 in term of fixed capital, while SOEs under local management only invest VND 0.22; collective enterprises – VND 0.298; private enterprises – VND 0.197; limited ability companies – VND 0.188.

*Three, the biggest socio-economic impact of SMEs lies in their substantial contribution to employment creation, increased income for the working people, and eradication of hunger and alleviation of poverty.*

SMEs can create jobs for a large number of laborers and thus contribute to the solution of many pressing social problem. In other countries, SMEs are one of the largest, most dynamic sources of new employment, they have given employment to 50-80% of the labor force in industry and services. Obviously this is a very important factor for those who are unemployed in urban areas or those coming from rural areas in search of jobs. Increased employment opportunities benefit all - including the currently unemployed, the women and the handicapped.

In particular, when workers laid off by large-sized enterprises, the SMEs were recruiting additional labor or had a higher recruitments rate than larger-sized enterprises. According to the CIEM, non-agricultural labor being employed by SMEs amount to about for 79.2% of total non-agricultural labor and about 22.5% of the national labor force.

*Four, SMEs help to make the economy dynamic in the framework of market economy.*

In view of their size, they are usually more dynamic, flexible and creative in business, while their organizational form makes it possible to combine specialization and flexible diversification and to adapt themselves to the changing requirements of the market economy. The fact has showed that some economies, such as Taiwan, were hit very lightly by regional financial crisis because they had depended heavily on SMEs. In relations with large enterprises, SMEs also can act as agencies or peripheries, can consume goods, supply input with cheaper price, thereby decrease the costs and enhance productivity of large-sized enterprises. As a result, they can play a big role in enhancing the vibrancy of the economy governed by the market mechanism.

*Five, they can mobilize a considerable volume of capital from the population.*

Because of their size, they can penetrate deeply into various small streets and lanes, delta and highland villages and because of the small initial capital they require, they can efficiently attract small capital sources still lying idle among the

population for the purpose of production and business. As a result, they could gradually bring about the practice of investing in production and business and constitute the “core” for the successful mobilization of people’s funds in keeping with the Law on encouraging domestic investments.

*Six, They play a substantial role in economic restructuring, particularly with respect to rural areas.* The development of SMEs in rural areas has helped to accelerate the process of economic restructuring and the development of industry, as also the growth of trade and services there. In urban areas, their development has helped increase the ratio of industry and services in the national economy and to decrease the ratio and agriculture therein. They have also played an important role in changing and diversifying the industrial structure.

*Seven, They have made a substantial contribution to the implementation of the policy on “less concentrated urbanization” and “dissociating oneself from agriculture without leaving the villages”,* as their development in rural areas can absorb underemployed and unemployed peasants and labor hands in off-farming periods and can gradually shift a part of the agricultural labor force to industry and services without moving them to the urban areas (“dissociating oneself from agriculture without leaving the villages”). At the same time, they contribute to the emergence of fairly concentrated industrial and service zones right in the rural areas, which gradually become townlets and towns, and are intertwined with agricultural villages in short, a process of non-concentrated urbanization.

*Eight, they are the breeding and training ground of managers and businessmen* who are given opportunity to acquaint themselves directly with the

business environment. Businessmen who have the schooling and practice in small-size and then in medium-size enterprises are likely to become experienced and capable managers who can manage successfully their units.

## **Chapter II**

### **DEVELOPMENT OF SMEs IN VIETNAM**

This chapter will emphasize the state of SMEs development in Vietnam by examining the economic features and their standing. In the first section of the chapter, the economic policy context and legal framework for SMEs in Vietnam will be presented. Then the writing will give assessments on SMEs

#### **2.1. THE ECONOMIC POLICY CONTEXT AND LEGAL FRAMEWORK FOR SMEs IN VIETNAM**

##### **2.1.1. The centrally planned economy (1954 –1986)**

From 1954 in the North and 1975 in the South, Vietnam adopted a centrally planned, socialist model of economy, similar to that of formerly socialist countries in Eastern Europe and the USSR. To implement this model, the Vietnamese government nationalized lands, factories, plantations and mining industries that had been owned by foreign capitalists and transferred them to SOEs. The government also persuaded national capitalists to reorganize their businesses into mixed state and privately owned enterprises. However, these enterprises in fact were managed by the Government.

Based on the view that private ownership of the means of production is a source of exploitation, the Government adopted many policies and measures to restrict maximally the development of the private sector, especially of private

capitalists. These restrictions were applied in many business areas, including levels of investment and working capital, number of employees, import and export activities, etc. Generally, due to these policies and measures, by the end of 1970s, there were only two economic sectors of any significance - namely, SOEs and cooperatives. Private businesses were allowed to operate, but confined to a negligible size and scale. In agriculture, the majority of peasant households were forced to join cooperatives. In other areas, the State sector was dominant.

The economic system introduced in this period was the centrally planned economy: SOEs were responsible to produce outputs according to government plans. Thus, SOEs did not have any autonomy in their business activities. They were simply production units in a gigantic enterprise consisting of the entire economy. The State was the entity who owned and allocated all resources and factors of production. The decisions on what, how much, and how to produce were made by the Government. All commodities produced by SOEs were distributed by the Government through a state-owned trade network at prices determined centrally by the State. The cooperatives were classified as the collective sector, but they operated completely as satellites of SOEs. The production factors allocated to these cooperatives were subsidized by the State through the input distribution system; their products were delivered to the State through the procurement system and other necessities were supplied according to norms defined by the State.

During this period, Vietnam's international economic relations and trade activities were carried out mainly with country members of COMECON.

Commodities were exchanged according to bilateral or multilateral treaties and agreements entered into by the Vietnamese government. Although Vietnamese manufacturing enterprises participated in export programs assigned by COMECON according to the specialization level of each country, the enterprises had no right to transact directly with their trade partners. That is because the State maintained a monopoly in international trade through certain state-owned companies and general corporations which were specialized in international trade activities.

In summary, the essential characteristics of the centrally planned economic system were reflected in the predominant role played by the State in all areas and sectors. Generally, the economy was closed, autarchic and subsidized in nature. This mechanism to a certain extent demonstrated advantages in wartime conditions. However, this mechanism has not been relevant to economic development in the post-war period, because it could not create the incentives needed for economic development. By the end of 1980s, the Vietnamese economy had fallen into severe crisis, enterprises encountered many difficulties, and the living standard of the people had declined sharply.

### **2.1.2. Vietnam's economic and legal reforms and the current economic policy context and legal framework for the establishment and operation of enterprises**

To overcome the economic crisis, beginning in 1986, the Communist Party and the State of Vietnam adopted comprehensive reforms for the entire

country, in which the primary emphasis was given to economic reform. Shifting the economy from the centrally planned model based on bureaucratic directives and government subsidies to a market economy with socialist orientation is the most important feature of the economic reform policy. It established the legal, economic and political foundations for the development of the multisectoral economy in Vietnam comprising the state sector, the collective sector, the private capitalist sector as well as individuals and households.

Accompanying economic policy reforms was a commitment to building a State ruled by law and a massive effort to enact laws and other legal normative documents needed to implement the shift in economic policy. Most important of these has been the Constitution of 1992 which recognized the legality and rights of various economic sectors including the right to equal treatment among all economic sectors while preserving the leading role in the economy of the State sector. In addition there have been major pieces of legislation designed to realize this basic principle which have included the following: Land Law (1988), Law on Foreign Direct Investment (1988), the Company Law and the Law on Private Enterprises (1991), Law on Export and Import Taxes (1992), Ordinance on Land and Housing Taxes (1992), Amended and Supplemented Law on Export and Import Taxes (1993), Law on Revenue Tax (1993), Amended and Supplemented Law on Special Consumption Tax (1993), Law on Agricultural Land Use Tax (1993), Law on Land (1993), The Labor Code (1993), Law on Bankruptcy (1994), Law on Tax on Transfer of the Right for Land Use (1994), Law on Domestic Investment Promotion (1994), Amended Company Law (1994),

Amended Law on Private Enterprise (1994), The Civil Code (1995), Law on State Owned Enterprise (1995), Budget Law (1996), and the Commercial Law (1997), Law on Enterprise (1999 – replaced the Company Law and the Law on Private Enterprises).

In addition to economic policy and legal changes, the Vietnamese State has made numerous institutional changes necessary to implement the market mechanism, which have had a substantial impact on the development of the economical sectors. In sum, the economic reform, and especially the efforts made to establish the legal framework and institutions in the last several years, established a much more favorable environment where it is possible for private enterprises to operate alongside of SOEs and cooperatives and contribute to the nation's economic development. Thus, the scale and the quality of the legal and institutional framework are much better developed than before. As a result, enterprises have a legal basis on which to operate, not depending entirely on the discretion of officials in power. Under the current legal framework, in terms of ownership, enterprises in Vietnam are divided into the following types: SOEs, cooperatives, private Vietnamese limited companies, private Vietnamese shareholding (joint stock) companies, private Vietnamese individual enterprises(sole proprietorships), foreign invested joint ventures, and companies with 100% foreign capital. In the main, SMEs tend to be individual private enterprises and limited liability companies. In addition, other types of enterprises, such as individual and household businesses also exist, which can be called “micro enterprises” which are too small to be SMEs.

As a result of the economic and legal reforms and institutional restructuring programs that were initiated, the country's economic performance has achieved impressive results during the last 12 years: Thus, the serious economic imbalance which had arisen in 1980s has been reduced; the annual growth rate of the economy has achieved high levels of over 7% since 1990 and more than 9% in the past few years; the inflation rate was reduced from 67.5% in 1990 to less than 5% by 1997; and large inflows of foreign capital were attracted into the country until the end of 1996; and, at the same time, domestic savings increased considerably from 7.4% in 1990 to 17% by 1996. Consequently, the financial basis exists for domestic investment to expand rapidly.

With the severe domestic economic crisis of the 1980's behind them, the Party and State of Vietnam have adopted a policy of industrialization, modernization, and integration into the region and the world for Vietnam. To achieve industrialization and modernization, the VIII Party Congress determined that the country should "construct an open economy, integrate into the region and the world, direct more efforts to export orientation, and at the same time substitute the products efficiently produced at home for imported goods". Moreover, the VIII Party Congress set forth specific directions "to develop mainly the small- and medium-sized enterprises that are based on appropriate technology which require less investment, create more jobs, and require less time to recover the capital costs".

## **2.2.THE ECONOMIC FEATURES AND STANDING OF SMEs**

**2.2.1. SMEs constitute an overwhelming proportion of all enterprises in Vietnam in term of number.**

According to the criteria based on total capital value, in 1995 among the 23708 enterprises registered as economic units throughout the country 20856 enterprises--or 88%--belonged to the small or medium categories.

**Table 1: Distribution of SMEs by economic sectors based on the capital criterion**

ENTERPRISES	Total number of enterprises	Below VND 1 billion Capital		VND 1 to 5 billion Capital		Below VND 5 billion Capital		Over VND 5 billion Capital	
		Number	%	Number	%	Number	%	Number	%
Total	23708	16673	70.3	4183	17.6	<b>20856</b>	<b>88.0</b>	2852	12.0
<i>1.Domestic Enterprises</i>	23016	16547	71.9	4076	17.7	<b>20623</b>	<b>89.6</b>	2393	10.4
1.1 SOEs	5873	1585	28.0	2284	38.9	<b>3869</b>	<b>65.9</b>	2004	34.1
1.2 Cooperatives	1867	1634	87.5	184	9.9	<b>1818</b>	<b>97.4</b>	49	2.6
1.3.Private enterprises	10916	10383	95.1	485	4.4	<b>10868</b>	<b>99.6</b>	48	0.4
1.4.Shareholding Companies	118	17	14.4	33	28.0	<b>50</b>	<b>42.4</b>	68	57.6
1.5 Limited Liability Companies	4242	2928	69.0	1090	25.7	<b>4018</b>	<b>94.7</b>	224	5.28
<i>2. Enterprises with Foreign Investment</i>	692	123	17.8	107	15.5	<b>230</b>	<b>33.2</b>	462	66.8
2.1 Enter. of 100% Foreign Investment	150	19	12.7	26	17.3	<b>45</b>	<b>30.0</b>	105	70.0
2.2 Joint Ventures with State Sector	433	77	17.8	58	13.4	<b>135</b>	<b>31.2</b>	298	68.8
2.3 Joint Ventures with Coop. Sector	6	6	100.0	0	0.00	<b>6</b>	<b>100.0</b>	0	0.0
2.4 Joint Ventures with Private Sector	59	11	18.64	12	20.34	<b>23</b>	<b>39.0</b>	36	61.0
2.4 Joint Ventures with Mixed Sector	32	11	34.38	8	25.00	<b>19</b>	<b>59.4</b>	13	40.6
2.5 Contracts of Business Cooperation	12	2	16.67	3	25.00	<b>5</b>	<b>41.7</b>	7	58.3

**Source:** *Some major indicators on the capital size and efficiency of 1.9 million production and business units in Vietnam. GSO, Statistical Publishing House, Hanoi, 1997, Table 21, Pp. 158-159.*

As can be seen from Table 1, according to the capital criterion, as of 1995, SMEs accounted for 88% of all enterprises, 99.6% of all private enterprises, 97.4% of all cooperatives, 94.7% of limited companies, 42.4% of shareholding (joint stock) companies, and 65.9% of SOEs. Thus, one can say that almost all non-state registered enterprises are SMEs.

The above results do not include the individual and household business, because of the lack of data on the individual and household business. Therefore, in the private sector, the study is confined to registered private enterprises, limited liability companies, shareholding companies, and cooperatives.

### **2.2.2. The principal activities of SMEs are trade, repair and manufacturing**

As is shown in Table 2, SMEs constitute a substantial majority of the enterprises engaged in all fields ranging from a low of 61.5% of the enterprises engaged in production and distribution of electricity, gas, and water to: 94.1% in science and technology; 93% in trade and repair; 87.5% in education and training; 86% in manufacturing and construction; 84% in mining and hotel and restaurant; 78% in transportation, warehousing, and communication; and 72.3% in finance and credit.

As can be seen from Table 3, for the 20,856 SMEs, by far the most important activities are trade and repair and manufacturing with almost 78% of

SMEs engaged in these activities - 42.2 % in trade and repair and 35.4% in manufacturing. Then follows construction in which almost 10% of SMEs are engaged. Thereafter comes: hotel and restaurant, 4.43%; transportation, warehouse, and communication, 3.25%; property business and consulting services, 2.09%; mining, 1.2%; the other 7 activities less than 1% in each.

**Table 2: Distribution of SMEs by business activities  
based on the capital criterion**

Business Activities	Total Number	Below VND 1 Billion.	VND 1-5 Billion	Number of SMEs	% of SMEs	Over VND 5 Billion.
Total	23708	16673	4183	<b>20856</b>	<b>88.0</b>	2852
Mining	298	148	101	<b>249</b>	<b>83.6</b>	49
Manufacturing	8577	5839	1534	<b>7373</b>	<b>86.0</b>	1204
Production and Distribution of Electricity, Gas, and Water	117	34	38	<b>72</b>	<b>61.5</b>	45
Construction	2355	1276	743	<b>2019</b>	<b>85.7</b>	336
Trade, Repairing Services for Engines, Motors, Motorcycles, and Appliances	9468	7790	1013	<b>8803</b>	<b>93.0</b>	665
Hotel and Restaurant	1094	600	323	<b>923</b>	<b>84.4</b>	171
Transportation, Warehouse, and Communication	870	435	243	<b>678</b>	<b>77.9</b>	192
Finance and Credit	206	114	35	<b>149</b>	<b>72.3</b>	57
Science and Technology	17	10	6	<b>16</b>	<b>94.1</b>	1
Property Business and Consulting Services	521	336	99	<b>435</b>	<b>83.5</b>	86
Education and Training	8	7	0	<b>7</b>	<b>87.5</b>	1
Health and Social Security	8	4	3	<b>7</b>	<b>87.5</b>	1
Culture and Sport	98	37	29	<b>66</b>	<b>67.4</b>	32
Private and Public Services	71	43	16	<b>59</b>	<b>83.1</b>	12

**Source:** *Some major indicators on the capital size and efficiency of 1.9 million production and business units in Vietnam. GSO, Statistical Publishing House, Hanoi, 1997, Table 22, Pp. 160-163.*

**Table 3 . Proportion (%)of SMEs in business activities**

	Total Number	Below VND 1 Billion.	VND 1-5 Billion	Number of SMEs	Over VND 5 Billion.
Total	100.0	100.0	100.0	<b>100.0</b>	100.0
Mining	1.3	0.9	2.4	<b>1.2</b>	1.7
Manufacturing	36.2	35.0	36.7	<b>35.4</b>	42.2
Production and Distribution of Electricity, Gas, and Water	0.5	0.20	0.9	<b>0.4</b>	1.6
Construction	9.9	7.7	17.8	<b>9.7</b>	11.8
Trade, Repairing Services for Engines, Motors, Motorcycles, and Appliances	39.9	46.7	24.2	<b>42.2</b>	23.3
Hotel and Restaurant	4.6	3.6	7.7	<b>4.4</b>	6.0
Transportation, Warehouse, and Communication	3.7	2.6	5.8	<b>3.3</b>	6.7
Finance and Credit	0.9	0.7	0.8	<b>0.7</b>	2.0
Science and Technology	0.1	0.1	0.1	<b>0.1</b>	0.0
Property Business and Consulting Services	2.3	2.0	2.4	<b>2.1</b>	3.0
Education and Training	0.0	0.0	0.0	<b>0.0</b>	0.0
Health and Social Security	0.0	0.0	0.1	<b>0.0</b>	0.0
Culture and Sport	0.4	0.2	0.7	<b>0.3</b>	1.1
Private and Public Services	0.3	0.3	0.4	<b>0.3</b>	0.4

**Source:** Some major indicators on the capital size and efficiency of 1.9 million production and business units in Vietnam. GSO, Statistical Publishing House, Hanoi, 1997, Table 22, Pp. 160-163.

### **2.2.3. SMEs constitute a major source of job creation and employment in Vietnam**

Figures published by GSO clearly show that SMEs are a major source of job creation in all fields as follows: First, SMEs employ nearly 1 million employees, almost half of the work force (49%) employed by all enterprises. In

the key field of manufacturing, SMEs employ 355,000 employees, some 36% of the total. (In the manufacturing sector, simple averages show that a small enterprise has about 16 employees, a medium enterprise about 102 employees and a large enterprise, 543 employees.) In construction, SMEs provide jobs for 155,000 employees, 51% of the total; in trade and repair services, 195,000 employees, 88% of the total; transportation, storage and communication, 111,000 employees, 56% of the total; hotel and restaurant, 51,000 employees, 85% of the total; finance and credit, 36,000 employees, 89% of the total; property business and consulting services, 27,000 employees, 72% of the total production and distribution of electricity, gas, and water, 26,000 employees, 54% of the total; and mining, 24,000 employees, 25% of the total. Moreover, GSO statistics show that SMEs have become major employers throughout all regions of the country ranging from a high of 67% of all employees employed by all enterprises in the North Central Coast to a low of 44% in the Southeast Area and, as already noted above, 49% for the entire country.

Meanwhile, the proportion of overall employment by SOEs has decreased from 9.7% (in 1988) to 5.2% (in 1996). At the same time, the proportion of employment in government administration decreased from 5.2% (in 1988) to 3.6% (in 1996). As result, the role of the private sector has become crucial as an engine for job creation to meet the need for employment by leaving the SOE sector and the substantial number of new employees entering the labor force each year.

**Table 4: Number of labor working in the forms of production and trading**

	1992	1994	1995	1996
Total labors	4,706,503	5,453,404	6,368,509	6,903,242
SOEs	1,822,165	1,654,605	1,800,870	1,846,000
Cooperatives	140,632	135,284	102,597	98,400
Enterprises with foreign capital	53,149	97,832	144,380	208,100
Private enterprises	112,946	336,146	339,809	379,742
Householders	2,577,611	3,229,537	3,980,853	4,300,000

#### **2.2.4. SMEs play a significant role in manufacturing in Vietnam**

In manufacturing, the number and share of SMEs in manufacturing of various products varies substantially from category to category as shown in Table 5 below. No SMEs are engaged in the production of coal, petroleum, or atomic fuel. SMEs are mainly concentrated in 7 fields of manufacturing, ranging from 84% to 93% of the enterprises engaged in these 7 fields averaging about 77%. The shares of production of SMEs in these 7 sub-categories are ranked in ascending order, as follows:

- Food and Beverage: 40.24%
- Non-Metallic Mineral Products: 14.49%;
- Wood Processing and Production of Products from Wood, Bamboo: 8.03%;
- Production of Bed, Wardrobe, and other Furniture: 5.33%;
- Production of Metallic Products : 4.60%;
- Textiles: 4.10%;

- Clothing, tanning and dyeing: 4.06%

**Table 5. The number and proportion of SMEs engaged in Manufacturing based on the capital criterion**

Business Activities	Total	Below VND 1 Billion	VND 1 to 5 Billion	Number of SMEs	% of SMEs	SME share of production (%)
Total	8577	5839	1534	<b>7373</b>	<b>86.0</b>	<b>100.0</b>
Food and Beverage	3200	2621	346	<b>2967</b>	<b>92.7</b>	<b>40.2</b>
Textiles	417	225	77	<b>302</b>	<b>72.4</b>	<b>4.1</b>
Clothing, Tanning, and Dyeing the Skins	384	158	141	<b>299</b>	<b>77.9</b>	<b>4.1</b>
Production of Cases, Bags, Saddles, and Shoes	137	48	30	<b>78</b>	<b>56.9</b>	<b>1.1</b>
Wood Processing and Production of Products from Wood, Bamboo, Straws, and Stubble	656	467	125	<b>592</b>	<b>90.2</b>	<b>8.0</b>
Paper and Products from Paper	198	126	40	<b>166</b>	<b>83.8</b>	<b>2.3</b>
Publishing, Printing, and Photocopy	203	88	89	<b>177</b>	<b>87.2</b>	<b>2.4</b>
Chemicals and Chemical Products	290	106	86	<b>192</b>	<b>66.2</b>	<b>2.6</b>
Rubber and Products from Rubber and Plastic	226	127	53	<b>180</b>	<b>79.7</b>	<b>2.4</b>
Products from Non-metallic Minerals	1162	907	161	<b>1068</b>	<b>91.9</b>	<b>14.5</b>
Production of Metal	131	86	18	<b>104</b>	<b>79.4</b>	<b>1.4</b>
Production of Metallic Products (excluding machinery and equipment)	380	266	73	<b>339</b>	<b>89.2</b>	<b>4.6</b>
Production of Machinery and Equipment	247	95	83	<b>178</b>	<b>72.1</b>	<b>2.4</b>
Electrical Appliances	88	36	23	<b>59</b>	<b>67.1</b>	<b>0.8</b>
Radio, TV, and Telecommunication Equipment	76	19	20	<b>39</b>	<b>51.3</b>	<b>0.5</b>
Transportation Engines and Trailers	87	43	22	<b>65</b>	<b>74.7</b>	<b>0.9</b>
Other Transportation Means	185	83	58	<b>141</b>	<b>76.2</b>	<b>1.9</b>
Production of Bed, Wardrobe, and other Furniture	441	320	73	<b>393</b>	<b>89.1</b>	<b>5.3</b>
Others	69	18	16	<b>34</b>	<b>49.2</b>	<b>0.4</b>

**Source:** Some major indicators on the capital size and efficiency of 1.9 million production and business units in Vietnam. GSO, Statistical Publishing House, Hanoi, 1997, Table 22, Pp. 160-163.

(1)Data up to 31/12/1994.

## 2.2. DEVELOPMENT TREND OF VIETNAM'S SMEs

### 2.3.1. Recently established enterprises

Table 6 shows the development trends of newly established enterprises from 1991 to 1997 as follows:

**Table 6: The number and the capital of newly established enterprises**

Year	Total		Private Ent.		Limited Company.		Shareholding		SOEs	
	Num.	Capital	Num.	Capital	Num.	Capital	Num.	Capital	Num.	Capital
1991	109	119791	69	12059	36	27141	4	78600		
1992	5170	8239292	2858	608722	1064	1506826	56	925456	1192	5196296
1993	10670	33055123	5265	975901	2104	1930378	40	569015	3261	29577836
1994	7527	17817942	5306	846088	1840	1452289	25	1240739	356	14276832
1995	6592	31925856	4076	830892	2047	1658290	35	402226	434	29032453
1996	6172	20899686	3696	659893	1753	1433781	39	428123	684	18375893
1997	4277	8630623	2607	475176	1064	1098438	22	229066	584	6825946
Totals:	40,517	120,688,313	23,877	4,408,731	9,908	9,107,143	221	3,873,225	6,511	103,285,256

**Sources:** *MPI*

As seen from Table 6, private enterprises and limited liability companies (the main form of organization for SMEs) are rapidly increasing in number and overall capitalization. Thus, of almost 41,000 new enterprises established between 1991 and 1997, almost 34,000 or 83% were private enterprises (24,000) and limited liability companies (10,000).

### 2.3.2. Capital formation by newly established enterprises

During the period, SMEs accounted for about 11.2 % of the registered capital of new enterprises compared with 85.6% for newly established SOEs and

3.2% for shareholding companies. This capital proportion is not surprising, given that low capitalization is one of the defining criteria for SMEs. Concerning registered capital, therefore, the share of the registered capital in SOEs is still dominant. Due to the rapid increase in the number of private sector enterprises, the share of retail trade values in the private sector nearly doubled in the 10-year period 1986-1996 from 40% in 1986 to 75% in 1996<sup>2</sup>

### 2.3.4 Average capital per enterprise

Not surprisingly, given the great proportion of overall registered capital by SOEs, the average capital amount for SOEs and shareholding companies was greater than for other private enterprises and limited liability companies as is shown in Table 7:

**Table 7. The average capital size of enterprises (Million VND)**

Year/ Period	Total	Private Enterprises	Limited Companies	Shareholding Companies	SOEs
1991	1080.73	174.77	753.92	19650	
1992	1583.16	212.99	1416.19	16526	4359.31
1993	2947.81	185.36	917.48	14225.38	9070.17
1994	2323.57	159.46	789.29	49629.56	40103.46
1995	4796.52	203.85	810.11	11492.17	66895.05
1996	3301.78	178.54	817.90	10977.51	26865.34
1997	2017.00	182.27	1032.37	10412.09	11688.26
Overall:	2979.95	184.64	919.17	17,525.90	15863.256

**Sources:** *Calculated from the data given in Table 6.*

<sup>2</sup> Statistical Yearbook 1996, Statistical Publishing House, Hanoi.

The small capital amount per enterprises for SMEs is hardly surprising since a major definitional criteria for SMEs is a relatively small capital amount. Accordingly, for the period 1991-1997, the average capital for a newly registered private enterprise was VND 184 million; for a new limited liability company, about VND 920 million; for a shareholding company, a little over VND 17.5 billion; and for an SOE, VND 15.9 billion. Interestingly, overall for the period 1991-1997, shareholding companies had the highest average registered capital for all enterprises including SOEs, although they had the smallest total capital for the period due to their small number. This shows, however, the importance of encouraging the shareholding company form of enterprise organization from the standpoint of domestic capital mobilization.

### **2.3.5. The correlation between registered capital and jobs created**

In 1995, the average number of employees working in a state-owned enterprise, private enterprise, shareholding company, and limited company was respectively equal to 151, 12, 111, and 35 persons<sup>3</sup>. Thus, from the data given in Table 9, it is possible to calculate the required capital to create a working place in a state-owned enterprise, private enterprise, shareholding company, and limited company. The capital amount per working place in these types of enterprises in

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<sup>3</sup> Some major indicators on the capital size and efficiency of 1.9 million production and business units in Vietnam. GSO, Statistical Publishing House, Hanoi, 1997.

The number of establishments of SOEs, private enterprises, shareholding companies, and limited companies are respectively equal to 5873, 10916, 118, and 4242. The amount of employees working in these establishments are respectively equal to 886985, 127817, 13072, and 147792 persons.

1995 was respectively equal to 443, 17, 104, and 23 million VND. Thus, the capital cost needed to create a working place in a state-owned enterprise for the year 1995 was 26 times greater than that in a private enterprise, approximately 20 times greater than that in a limited company, and about 4.3 times greater than that in a shareholding company. It is important to note that these figures do not reflect the actual capital cost needed to create a working place in the concerned enterprises, because the registered capital cannot depict exactly the accounts or financial situation of an enterprise - only audited accounts can do this. However, registered capital does provide a rough guide, and it is the only indicator generally available at the current time because of the lack of published audited accounts by enterprises.

#### **2.3.6. Labor productivity**

From the figures in Table 8 on turnover per employee, one can see that the average labor productivity of shareholding companies is slightly greater than state-owned enterprises, but both are about 2.5 times more productive than individual private enterprises and 2 times more than limited liability companies - most of which are SMEs. To achieve higher productivity per worker, it appears that the larger enterprises - SOEs and shareholding companies - invest substantially more capital per worker than SMEs. Thus, according to data provided by the 1996 Statistical Yearbook the average capital amount per working place is VND 130.39 million in a shareholding company and VND 87.55 million in SOEs compared to only VND 35 million in an individual private enterprise and VND 45 million in limited liability companies. Thus, the greater

labor productivity of the larger enterprises - SOEs and shareholding companies - is achieved at a substantially higher capital cost compared to the SME individual private enterprises and limited liability companies.

**Table 8. The average turnover per employee by enterprises**

	Turnover	Number of Establishments (1)	Turnover per Establishment	Average Number of Employees per Establishment (2)	Average Turnover per Employee
SOEs	182419363	5873	31060.68	151	206
Private Enterprises	11419661	10916	1046.14	12	87
Shareholding Companies	2742742	118	23243.58	111	209
Limited Companies	19702605	4242	4644.65	35	133

**Source:** *Some major indicators on the capital size and efficiency of 1.9 million production and business units in Vietnam. GSO, Statistical Publishing House, Hanoi, 1997, Table 27, P174, and Table 2, P. 10. (1) Data up the end of 1994; (2) Data up to July 1995*

### **2.3.7. The Profitability of Vietnam's SMEs**

The survey on profitability of Vietnam's SMEs was conducted in 2000 showed the following results:

- 66% of the surveyed enterprises made profits, while remaining 34% did not make profits; 10% made profits amounting to over 500 million VND per annum per enterprise, 50% made annual profits amounting to 50 to 300 million

VND per enterprise, and 18% made profits amounting to less than 50 million VND per annum. The scale of profits of these enterprises is small as compared with other countries because they have a small number of workers and total assets.

- More production enterprises make profits than trading enterprises: production enterprises account for 34% of the surveyed enterprises and 36.4% of profit making enterprises; trading enterprises make up 66% of the surveyed enterprises but only 63.3% of the profit-making enterprises. Trading enterprises made up 70.6% of the non-profit making enterprises while such ratio for production enterprises is 29.4%. Also, private enterprises are more profitable than limited liability companies and shareholding companies. Privates enterprises, limited liability companies and shareholding companies made up respectively 26.7%, 70.0% and 3.3% of surveyed enterprises, but in terms of profits the respective ratios were 32.3%, 65.7% and 2.0%. Thus the limited liability companies made up 70% of surveyed enterprises, but only 65.7% of profit making ones, while the corresponding ratios for private enterprises are respectively 26.7% and 32.3%.

### **2.3.8. Other factors reflecting on the efficiency of SMEs.**

To evaluate the role of SMEs more fully, it is necessary to take some indicators into consideration in addition to the labor productivity as mentioned above. Table 9 reflects some indicators reflecting on the efficiency of SMEs.

**Table 9: Some indicators reflecting enterprise efficiency**

ENTERPRISES	Value of Fixed Capital vs. Turnover	Value of Building vs. Turnover	Value of Machinery and Equipment vs. Turnover	Investment per vs. Turnover	Total capital vs. Turnover	Credit vs. Turnover	Budget Contribution vs. Turnover
Total	0.502	0.118	0.325	0.052	0.755	0.276	0.109
Domestic Enterprises:	0.381	0.098	0.234	0.039	0.611	0.275	0.095
1. SOEs	0.417	0.101	0.261	0.043	0.652	0.302	0.110
2. Cooperative Enterprises	0.298	0.089	0.188	0.010	0.358	0.065	0.033
3. Private Enterprises	0.197	0.099	0.088	0.018	0.287	0.045	0.018
4. Shareholding Comp.	0.224	0.102	0.097	0.010	1.359	0.603	0.047
5. Limited Liability Companies	0.188	0.074	0.103	0.018	0.363	0.147	0.020
<b>Comparison with Central SOEs (%)</b>							
Central SOEs	100	100	100	100	100	100	100
Local SOEs	39	82	30	69	40	29	70
Cooperative Enterprises	53	81	51	21	41	15	26
Private Enterprises	35	91	24	36	33	10	15
Shareholding Comp.	40	94	26	20	155	140	37
Limited Comp.	33	68	28	37	41	34	16

**Source:** *Some major indicators on the capital size and efficiency of 1.9 million production and business units in Vietnam. GSO, Statistical Publishing House, Hanoi, 1997, Table 28, pp.176-177*

As previously mentioned, most non-state enterprises can be regarded as SMEs. Because adequate and specific data on SMEs in particular is not available, the comparison must be made between SOEs and non-state enterprises generally, even though a few of these may not qualify as SMEs. This comparison, therefore, will at least indicate to some extent the efficiency of SMEs. As far as the

correlation between fixed capital and turnover is concerned, the Table 9 shows that: Central SOEs have invested 0.562 VNDs of fixed capital per 1 VND of turnover, while local SOEs have invested only 0.220 VNDs; cooperative enterprises have invested 0.298 VNDs; in private enterprises have invested 0.197 VNDs, and limited liability companies have invested 0.188 VNDs. If compared to the central SOEs, the fixed capital per 1 VND of turnover in local SOEs is only 39% as much as that for the central SOEs; in cooperatives, 53%; in individual private enterprises, 35%; and in limited liability companies, 33%. *ble 28, Pp. 176-177.*

Similarly, the other indicators in Table 9 show that private individual enterprises and limited liability companies tend to be relatively efficient as compared to SOEs. Only with respect to the indicator expressing the budget contribution per 1 VND of turnover, do the private individual enterprises and limited liability companies appear to be less efficient.

*In short*, overall contribution of SMEs business sector to total national economic investment and GDP remains small: According to available figures, SMEs have mobilized VND 47,793 billion for investment in their businesses and have created 3 million jobs. SME turnover is about VND 137,000 billion, and SMEs pay VND 5,000 billion of taxes. In part, these figures may be understated, but, in any case clearly show that the economic potential of the sector has not yet been fully realized.

This chapter shows that - although currently accounting for a relatively small proportion of GDP and, by definition, invested capital - the role and importance of SMEs are growing and their potential as an engine of economic development, employment and domestic capital mobilization is very great. Thus, as mentioned above, about 96% of all enterprises in the country are SMEs, and they form a majority of the enterprises engaged in most fields of economic activity. Moreover, SMEs are a major source of job creation: Together, SMEs already employ almost half-- 49%--of the non-agricultural labor force in the country and are the fastest growing new enterprises in terms of number. In some parts of the country, SMEs employ a majority of the non-agricultural work force. Moreover, figures indicate that, although, their labor productivity is lower in terms of turnover per employee, in many respects they are more efficient in that the capital per job created is much lower and the invested and fixed capital per VND 1 of turnover is significantly lower.

## **Chapter III**

### **VIETNAMESE GOVERNMENT INCENTIVES TOWARD SMEs**

SMEs of Vietnam still have weaknesses and providing them with supports is very necessary.

Since the period of renovation, Government promulgated legal documentations to constitute gradually institutional framework as well as policies that give intensives for developing SMEs. The most important documentations are follows:

- The 1992 Constitution recognizes that every resident has the business freedom under the legal regulations; that economic sectors have a right to be treated equally while the state economic sector is dominant.

- The 1993 Law on Land that was modified 2 times in 1998 and 2001 determines that enterprises obtain the legal right to use the land, transfer or mortgage or use it as collateral for loans and credit.

- The Law and Company and the Law on Private Enterprises in 1990 defined the legal framework for private enterprises operating and enter domestic and foreign markets.

- The Ordinance on Income Tax of high income earners in 1994 was modified by the 1997 Ordinance, the 2001 Ordinance.

- The 1995 Law on Civil stipulated a lot of civil rights, such as the business right through contracts and the right carrying out contracts through collateral and mortgage.

- The Law on Cooperate Income Tax in 1999 simplified and applied a unified level of income tax for all enterprises.

- The Law on Value-Added Tax came into effect from 1 January 1999 to replace the Turnover Tax is considered simpler and more equal.

- The Commercial Law that came into effect since 1 January 1998 created a legal base for enterprises' trading.

- The 1994 Law on Promotion of Domestic Investment defined clearly prior policies for business projects in special occupations and poor areas.

- The 1998 Law on Promotion of Domestic Investment (adjusted) and the 51 Decision (July 1999) concretized the implementation of the above law and promulgated quite a lot of policies that apply to all kinds of production and business.

- The Decree 57/CP (July 1998) allow the registered enterprises to export the registered goods items, except for some export products subject to quotas or conditional export – import.

- The 1999 Law on Enterprises (came into effect since 1 January 2000), which replaced the Law on company and the Law on Private Enterprises, determines organization and operation of four kinds of enterprises: limited liability company, shareholding company, private enterprises, hop danh.

company.

- The 46 Decision, which was promulgated on 4 April 2000 in regards to export and import in the period 2001-2005, gave a 5 year mechanism instead of the annual one before, reduced non-tariff measures, and increased economic measures.

- The 90 Decision (issued on 23 November 2001) on helping SMEs announces that SMEs will be entitled to enjoy priority policies in leasing land, transferring, mortgaging and other rights in using land. Under the decision a fund for small and medium-sized enterprises will be established to guarantee credits for these businesses when they do not have enough collateral and mortgage so that they can get loans from credit institutions.

This chapter will try to evaluate the implementation of those policies promoted SMEs development. They are Decrees, Circulations, Decisions ... related to trade policy, tax policy, land policy, technology and training policy. Procedures for establishment and registration of SMEs as a factor promoting or restricting SMEs development also will be presented in this chapter.

### **3.1. TRADE POLICY**

As a result of economic reforms, many enterprises since 1991 have been allowed to export and import the products produced by themselves and to import the necessary intermediate inputs for their production. As mentioned above, new Decree No. 57/ND-CP dated July 31, 1998 permits all enterprises to engage in import-export activities within the scope of their registered business without being

required to have an import or export license. The new decree is a dramatic step forward in Vietnam's trade liberalization for all enterprises including SMEs.

### ***3.1.1. Non-tariff trade controls - recent liberalization measures***

As already noted above, new Decree 57/CP dated 31 July, 1998 to implement the Commercial Code, represents a significant step forward in trade liberalization. In Decree 57, the Government sets out lists of banned or controlled products. Those goods and products which are outside of these lists can be freely imported or exported by any registered enterprise without the need for import-export permits, provided that the goods are relevant to their registered business activities. Again, Decree 57 represents a substantial and praiseworthy advance by the Government in providing access to international markets for all enterprises including SMEs. At the same time practice indicates that some of the banned import classifications are vague--namely "depraved and reactionary cultural products", and "toys which may impact badly on children's psychology" giving rise to inevitable disagreements over meaning between importers and customs officers. Even a classification such as "second hand consumption goods" gives rise to disagreement because some customs officers have apparently treated some reconditioned goods as new, even though they are used. Clarifying regulations are needed to clear up the ambiguities.

### ***3.1.2. Foreign exchange controls--Recent restrictive measures***

Foreign exchange is the life blood of foreign trade and investment to the extent that production equipment, production components, technology, spare parts

and other inputs must be obtained from abroad. Without access to foreign exchange, as a practical matter, an enterprise has no access to international markets for needed imports. While enlightened trade liberalization measures as described above have provided access to international markets for all enterprises from all sectors, recent tightening of foreign exchange controls have had the opposite effect of reducing access to international markets for Vietnamese enterprises--especially SMEs who have relatively little influence.

Foreign exchange controls imposed in Vietnam are composed of the following elements: (i) individuals and business organizations who transfer foreign currencies into Vietnam are required to promptly convert them into Vietnamese Dong or keep them in a foreign exchange account at an authorized bank. More recently, Decision No. 173 requires enterprises to sell 80 per cent of their foreign exchange to the banks; (ii) enterprises are permitted to freely obtain foreign exchange. Instead, to convert Vietnamese Dong into foreign exchange, enterprises are required to show that they have a "legitimate purpose" for doing so. It means that an enterprise is participating in producing specific items included on the Government's import substitution list or in particular infrastructure and important projects.

Access to foreign exchange for import and factor payments is thus limited and uncertain for all enterprises, including and especially SMEs. To the extent that access to foreign currency to pay for needed inputs is limited by the controls, exports will be reduced.

### ***3.1.3. Controlling imports and exports by tariff measures***

For SMEs the most important features of Vietnamese import duties is that they tend to be very high and very complex: In this regard, it is important to note that the number of tariff lines and the maximum tariff of Vietnam are much higher than that of countries in the region. In theory, high import duties are a mechanism to protect domestic industries from foreign competition. In fact, protection of industry by high tariffs is illusory because: protected industries produce goods of lower quality and higher prices than foreign goods, thereby making the protected industries less competitive in the international market place; high tariffs, import restrictions and low quality and/or higher priced domestically produced goods mean that high profits can be made from smuggling into Vietnam foreign-made goods which are lower priced and/or higher quality.

Thus, the industries supposedly “protected” by high tariffs in fact are not protected because the higher tariffs render them less competitive internationally, and they often end up having to compete against foreign goods anyway which are smuggled in because the high tariffs have made smuggling a highly profitable activity.

High tariff “protection” do not benefit to domestic enterprises including SMEs. Accordingly, the only way to significantly reduce competition from smuggling is to take away or reduce the high profits from smuggling by reducing tariffs to at or below the levels prevailing in the region and to improve the competitiveness of domestic industries by exposing them to greater competition

and by serious efforts to lower the high costs of doing business in Viet Nam - such as high costs for land, high costs of income taxes on skilled employees at rates more than double those of other countries in the region, high costs of international communications, high costs of internal transportation, high transaction costs resulting from complex bureaucratic procedures and, in some cases, corruption. Moreover, reducing the high tariff “protection” for Vietnamese enterprises will soon make them globally competitive much sooner.

The other problem posed by import-export duties are the customs procedures themselves arising from the complexity of the classification system, multiple tariff rates, gaps, exemptions, the means of determining value and customs clearing delays.

Recently, Decision 46 which was issued by Prime Minister on 4 April 2001 has given favorable regulations for export. This Decision reduced non-tariff measures, banned import items, rejected “asking-giving” mechanism, increased economic measures, ... Especially, a clear schedule has been determined: when and what will be abolished, and how long, how and what will be protected. But the important thing is to realize that decision and help SMEs access to foreign markets.

### **3.2. TAX POLICY**

Taxation policies also play a very important role in the process of transition to a market economy and of integration into the regional economies. Before economic reform, the state budget revenue relied heavily on contributions

from revenues of SOEs. Perhaps, for this reason SOEs have been regarded as the leading sector in the economy.

With enterprise and economic reforms, taxation policies have changed and a series of tax laws have been introduced over the past several years. The current tax system in Vietnam consists of 10 types of taxes, namely: license tax, turnover tax, special sales tax, export taxes, import taxes, profits tax, agricultural land use tax, tax on land transfers, natural resource tax, and tax on high personal income.

Thus, Vietnam has constructed a fairly comprehensive legal framework for taxation in a relatively short time. From time to time, the State has made regular revisions, amendments and additions to correct distortions and irrationalities. Indeed, the State is now in the process of significant tax reforms. The Law on Value-Added Tax came into effect from 1 January 1999 to replace the turnover tax. At the same time, the Law on Corporate Income Tax replaced the profits tax.

Unfortunately, the VAT as adopted has four rates (0%, 5%, 10%, 20%) and over 20 exemptions. This really is difficult to administer for the taxpayers as well as the tax collection agencies, is perceived as unfair, and created opportunities and incentives for tax evasion.

The corporate income tax eliminated differential rates among domestic enterprises by imposing a single, uniform rate of 32% on the profits of enterprises regardless of the type or nature of business activity. But the unreasonable thing is that the additional income tax still exists, which applies to business units with the favorable business location, do not face with competition, and high profit.

According to the Decree 26/2001, from 19 July 2001 after contributing the corporate income tax with the rate of 32%, an enterprise will be imposed to contribute a additional tax if the after-tax income is 20% bigger than the current ownership capital.

Another tax that is concerned greatly by businessmen in SMEs is the personal income tax on high income earners. After amending some times, a tax rate schedules was applied from 1 July 2001. The initial point of tax base increases from VND 2 million to VND 3 million, and the highest tax rate reduces to 50% (from 60%).

Overall, for almost all taxes in Vietnam, the tax base is still narrow and the array of concessions, exemptions and multiple rates are too many and too great, and rates tend to be high. These features make the system complicated and result in differential treatment among taxpayers. When rates are too high, taxpayers will strive to avoid taxes legally by taking advantage of legal loopholes or even to evade taxes illegally by hiding income, falsifying accounts or bribing tax officials.

The best overall solution for taxes in a developing economy is tax reform aimed at achieving simplicity by eliminating exemptions and loopholes to broaden the tax base and lowering tax rates overall. This will lower the incentive to evade taxes and increase the incentive to engage and invest in productive economic activity, especially develop more SMEs.

### **3.3. LAND POLICY**

The land reform has an important impact on industrial development and the private sector. The 1993 Law on Land lays out the basis for the allocation of long term land use rights. Article 1 of the Law reconfirms that "land is the property of the people, and is subject to administration by the State". Thus, formal ownership on land is not changed. Individual parties and entities may obtain the legal right to use the land but never to own it. Land use rights and obligations vary according to the type of land - i.e., agricultural, forest land, urban, residential, special purpose land, and unused land; they may also vary according to user categories - namely, individuals, households, domestic and foreign organizations. The right to use land is instituted and proved by means of a land use right certificate. The certificate of land use right is supposed to reduce uncertainty and to enable land to be used as collateral for loans and credit.

### **3.4. TECHNOLOGY AND TRAINING POLICY**

Being well aware of the importance of human resources and technology factors as determinants to the economic development, the Communist Party and State of Vietnam have paid special attention to technology and training policies. The Second Plenum of the Central Committee (VIII Congress) was convened to discuss these two topics. In light of the Resolution passed by the Plenum, 17 science and technology programs have been implemented.

Despite this attention by the Government and the Party to technology transfer and training, a number of factors limit access to modern technology for Vietnamese workers and enterprises, including SMEs. Some of these are as

follows:

1. Lack of financial resources for the basic education and training needed to enable Vietnamese students and workers to absorb new technology.
2. Lack of the needed access to both foreign and domestic capital and to medium and long term credit.
3. The investment and company licensing system reduces competition, the chief spur to technology innovation and which fosters uncertain business. This is the chief enemy of technology innovation.
4. Policies which inhibit the freest possible interchange of people and information which are the indispensable means of technology transfer, namely: high rates of personal income tax on foreign experts; high costs of international communications which is another main channel from transmission of technology; high costs for Internet access.
5. To import used equipment or machinery, the rules promulgated under Circular 2019 of 1997 of the Ministry of Science, Technology and Environment require an enterprise to obtain approval of the concerned state management agencies and to secure certification by a licensed inspection company that the value of the equipment is equal to 80% of its original value, that the equipment not consume materials or fuel in an amount more than 10 percent of a new machine and that the equipment meets safety and environmental standards. The cost and difficulty of

obtaining these approvals and certifications render the importation of second hand equipment impossible in most cases. This in turn means that enterprises which cannot afford new machinery and equipment are unable to upgrade their technology and improve production by acquiring good second hand machinery and equipment.

### **3.5. CONSULTATIVE ORGANIZATIONS**

Consultative organizations as well as group of consultants in Vietnam are drawing customers' attention because of comparative advantages. That is: services costs is relatively cheaper, the quality of consultation is enhancing gradually due to many advantages in combining received principles and methods of foreign management with the concrete condition of Vietnam.

Recently, a lot of non-government organizations that provide services on consultation, promotion, and support have been established and are operating, creates a diverse network serving enterprises. They include 3 files: (i) consultation on development of enterprise (such as consultation in finding market and financial resources, investing, applying new technology, making production and business plan/project, v.v...); (ii) consultation on business administration (skill of production management, personal management, wages, legal documentations, v.v...) and (iii) Organizing short training courses, going sightseeing at home and abroad, supporting high quality goods exhibitions... Operation of these organizations have contributed surely to helping SMEs from the time starting business to over the business period.

Thus, markets for consultation are formed and development in many different forms. But their formation is still spontaneous without long-term development strategy and appropriate operating mechanism. Consultative organizations are taking great pains to operate by their self. Meanwhile a number of SMEs still are not get familiar with using consultative services as the necessary services for their own production and business. Many new established organizations are lack of operating experiences, usually operate in differently separate industries, and it is difficult to assess correctly the quality of services that are provided by these organizations.

### **3.6. SUPPORT POLICY**

The Decree 90/2001/ND-CP that was issued by Vietnamese Government on 23 November 2001 shows a further attention to stimulating and facilitating SMEs' development. Government considers development of SMEs as an important task in the strategy on socio-economic development, industrialization and modernization strengthening. SMEs are encouraged and facilitated to develop activeness and creativeness, enhance management skills, evolve techno-science and human resources, expand links with other types of enterprises, increase business effectiveness and competitiveness, motivate production and business, create employments, and improve living standard.

Support policies are as follows:

*Investment stimulation:* Government makes policies in regards to finance and credit, and applies in certain time for SMEs that invest in some industries

including traditional industries, and in stimulated locations.

*Establishment of the credit guarantee fund:* This Fund is used to assist SMEs having difficulty with meeting the requirements for collateral to obtain credit from official sources..

*Production place:* SMEs enjoy priorities in land rent, transfer, mortgage and other rights in regards to land using under legal regulation.

*Market and competitiveness:* Support SMEs to expand their market; to exhibit, introduce, advertise, do marketing products; encourage to develop the form of sub-contract, strengthen the links between SMEs and other enterprises in production; through support programs, facilitate SMEs' technology innovation, equipments, machineries, new product development, management modernization.

*Export promotion:* Support a part of cost for SMEs to examine, learn, exchange, cooperate and participate a fair, exhibit products, study foreign markets.

*Information, consultation and human resource development:* Government provide the necessary information in publications and on the Internet; support finance to consult and develop human resource; encourage domestic and foreign organizations to provide information, consultation and development of human resources.

Besides, Government also decide to establish SMEs promotion organizations such as: SMEs Development Department, SMEs Development Stimulation Council, the Center for SMEs Technical Support.

### **3.7. PROCEDURES FOR ESTABLISHMENT AND REGISTRATION OF SMEs**

In Vietnam, establishment and registration procedures, as well as registration agencies, are different for each type of business organization. Those procedures and types differ not only according to size or form of organization but also according to its ownership characteristics: Thus, a state-owned enterprise (SOE) formed under the SOE law is a type of enterprise which is different from a shareholding company formed by private Vietnamese persons under the Companies Law and is registered in a different agency; and both of these in turn are different from a FIE under the Foreign Investment Law even though FIEs have the form of a limited liability company under the companies law. All of these business entities are registered under different procedures.

Individual private enterprises and incorporated companies - i.e. shareholding and limited liability companies - are very important and dominant forms of business organization for private sector SMEs in Vietnam's economy. Moreover, these forms of businesses have great development potential in Vietnam from the standpoint of mobilizing capital and creating jobs.

Because of the problems created by the obstacles and delays in registration of enterprises and companies, the Government has acted to alleviate the situation. On 1 August 1998, new regulations on enterprise and company establishment and registration contained in Joint Circular 05/1998/TTLT-KH-DT-TP issued by the MPI and the Ministry of Justice became effective. Next, On 3 February 2000, Prime Minister signed to promulgate the Decree 02/2000 on

business registration, the Degree 03/2000 on guideline of implementing some articles of the Law on Enterprises, and the Decision on abolishing those licenses against the Law on Enterprises. The new regulations are a dramatic and significant effort at streamlining enterprise establishment and registration procedures, make establishment and registration simpler by eliminating the duplicative procedures and submission of documents which plagued investors, ensure the right doing business freely for citizen.

The Degree 03/2000 also stipulates: the prohibited sectors; business license-required industries; legal capital – required industries; and professional certificate-required industries. Apart from those industries just mentioned above, economic sectors have right to register and do their business without asking permission from any administrative organ. Enterprises base on announced regulations in order to actively register business industries.

Great changes on procedures for establishment and registration of SMEs are as follows:

- Appointment of the Department Planning and Investment as the agency responsible for coordinating and telescoping the entire establishment and registration into one.

- Reduction of required documents and associated procedures: initial business plan now to be required only for applicants seeking preferential treatment; certificates of personal characteristics of founders – mental health and no criminal record or prosecution – replaced by simple declaration in the application; certification of capital value by banks and public notaries eliminated

for companies and replaced by declaration in the application. These changes considerably streamlined the process and brought Vietnam in line with practices in other countries in the region.

- Streamlined procedures and time requirements: the new regulations also prescribe clear streamlined procedures and time requirements.

- Prohibition of People's Committees from issuing further guidelines of procedures for the establishment of enterprises. This is a welcome effort to maintain a simple, uniform and streamlined procedure for Vietnam.

Unquestionably, the new regulations represent a highly significant improvement in company and enterprise establishment and registration procedures which go as far as it is possible to go under the current laws on companies and enterprises. They should considerably lighten the burden for both investors and government officials and significantly speed up the enterprise and company establishment and registration process.

Obviously following the transition from the planning centralized economy to the market economy a system of legal documentations in accordance with the institution of market economy has been shaped step by step, even though not perfect. Owing to it private economy has started to bloom, production forces has been liberalized have created new development energy for Vietnam's economy and many employments for labors. An remarkable example is that since the Law on Enterprise came into effect, only in 2000 there were over registered 14,000 establishments with the capital of 13,000 billion VND – 3 times more than

in 1999 in term of both the number and capital. Those new establishments created 300,000 employments.

## **Chapter IV**

### **PRESENT CHALLENGE TO VIETNAM'S SMEs**

#### **AND SOME SUGGESTIONS**

Although SMEs are paid attention and are given priorities for development, they still are facing with some constraints come from legal framework, from the implementation of laws, and from external environment. Based on finding out challenges that SMEs are facing, this chapter will give some suggestions for improving the business environment and thus promoting SMEs development in the future.

#### **4.1. PRESENT CHALLENGES**

##### **4.1.1. Capital**

Lack of capital is popular difficulty of SMEs. Recently 75% of total SMEs have less VND 50 million of capital. Only few SMEs have got loans from banks. According to the MPI's report on granting credit from the Fund of investment assistance under the Law on Domestic Investment Stimulation, from 1 December 1999 to 30 June 2000 there were 164 projects with over VND 424 billion of preferential loans. Among these projects, 61 projects belonged to the state sector (39% of total projects) with the loans of VND 294 billion (69% of the total preferential credit); 103 projects belonged to the private sector with the preferential credit of VND 130 billion. Further a big amount of credit fell into the hand of large private enterprises, not SMEs.

Thus, SMEs borrow mainly from non-financial institutions, usually from relatives and friends, to meet their demand for credit. Sometimes they must pay informal lenders 3 to 6 times the official interest rates. In part, this is because it is very difficult for SMEs to access short, medium or long-term credits from banks and other formal credit institutions. Guaranteed loans are rarely provided to SMEs. Some enterprises revealed that procedures for getting credit provided by banks and formal institutions are very complicated. If the negative fees is counted the transition cost is too high. The regulations on collateral and feasibility of investment projects are too tiff for many SMEs to meet, while SOEs have been excused from providing collateral. At this moment banks have been assigned to assess actively SMEs' projects, provide loans without collateral, but only little has been done. Therefore, to SMEs access to credits from banks, the procedures for getting credit should be eased.

Abundance of credit and lack of feasible projects are the case. So the important thing is to help SMEs build the feasible projects. Banks should enhance their ability of project valuation, be more responsible and more active in lending. Banks should not be merely financial institution, but also should joint SMEs to do business.

#### **4.1.2. Workshop, production and business space and technical infrastructure.**

Vietnam's SMEs have many difficulties in production and business space and the expansion thereof, due to inappropriate policies and their limited financial

means. Means of acquiring and exercising land use rights are not clear and often no recognized for SMEs. Especially in the case of industrial land, the right to sell, buy, transfer, and mortgage land use right for collateral are still not recognized for industrial land. As a result a majority of enterprises had to hire some space of state enterprises or use their own residential buildings as production and business floor, as space for the display and sale of goods. In many areas, they do not enjoy secure supply in power and water. They virtually have no installations for the disposal of liquid waste, with attendant impact on the living environment.

In the 9<sup>th</sup> Meeting (May 2001) National Assembly approved modifications of the Law on Land to facilitate SMEs in renting land and freeing the space. But they are still not fundamental .

Other difficulties and limitations involve storage facilities, communication lines within and without enterprises concerned, and in particular the roads and highways that serve the needs of production, business, circulation of goods all over the country and in the rural areas are still very limited in terms of density and width, quality of road, surface and bridges, and this is bound to negatively affect the operation of all enterprises, including SMEs.

#### **4.1.3. Management and business skills of heads of enterprises.**

Vietnamese businessmen also face a dearth of experiences from which to learn. There is a little experience nationally in the light manufacturing sector that is most attractive to capital-poor entrepreneurs. Vietnam's small industrial sector is largely capital-intensive, heavy industry of the type found in most Communist

countries. As a result, the pool of Vietnamese with experience in light industry is very small.

This line-up in SMEs is quite poorly equipped to cope with the requirements of modern business and trade. The majority of the heads of these enterprises have a lower secondary education (45-50%), 30 to 35% of them have a upper secondary education, college and university education while 10 to 15% only have a primary education. Very few of them (2-3%) have been educated or trained official management, 20 to 30% have gone through short-term courses, while the majority manages the enterprise with their hard-earned experiences. This is a major difficulty which should be overcome thanks to the active assistance of the Government and non-government organizations.

#### **4.1.4. Skills and knowledge of the labor force**

The majority of the labor contingent in these enterprises have a lower secondary education (40-45%), 20-30% have a upper secondary education, while 25 to 30% have a primary education. But their technical level and skills are quite low, particularly in the countryside. Unskilled labor accounts for 60 to 70% of the total labor force. In rural areas, duly trained workers only account for 10% of the labor force.

#### **4.1.5. Educational institutions**

Vietnam's educational infrastructure is not geared to the needs of commercial business. Managers with university degree were actually less successful in business than those without such credentials.

There is a plethora of new training courses in business management on the market in Vietnam's main cities. Quality varies but many such courses have simply been transplanted from Western business schools. As a result, students study the operations of large, mostly Western, corporations. Materials are rarely adapted for use in Vietnam, and are even rarely tailored for use in small business.

Technical training in Vietnam has largely been the responsibility of state vocational school and colleges that were designed to serve the training needs of SOEs. Government is in the process of withdrawing much of its support for the large number of industry-specific training centers in existence around the country. Though the quality of the technical training offered by these institutions may be of limited relevance to modern industry, these centers represent the only industrial training facilities available and their future is highly uncertain.

#### **4.1.6. Information system and access to information.**

Vietnam has made some progress in improving its information system thanks to better collection of information and diffusion thereof, but in general its flow of information lacks rapidity, timeliness, accuracy and comprehensiveness and, as a result, is still far from meeting the demands of production and business units that are struggling in the context of the modern market, and the revolution in modern science and technology.

There is a lack of information about products, market, technologies, trends, ect ... Reliable economic information about domestic economic trends is not available, and neither are the resources needed to filter and identify the most relevant information. Lack of high quality information about export markets leads to capture information to producers. Furthermore, language barriers restrict access to information not available in Vietnamese, and limit communication with foreign suppliers and buyers.

SMEs have no components specialized in the collection and processing of information. Because of their limited financial means, they cannot afford to buy equipments for rapid communications and cannot spend money on access to, collection and processing of information. Further, the capacity of the heads of SMEs to process and analyze information is still very limited.

#### **4.1.7. Technology**

Most SMEs in Vietnam are using very obsolete technology that lags behind the world average technology level up to 3-4 generations. Even many enterprises are using outdated machines and equipments that were rejects by SOEs. The low level of technology causes the low quality and poor competitiveness of products. This is really extremely big difficulty in the context of the severe competition.

Recently, the model of breeding ground of technology in some Hoa Lac high tech zones, and the Quang Trung breeding ground of enterprises producing

software in Ho Chi Minh city have been created. These organization types should be stimulated in order to help SMEs develop based on technology.

#### **4.1.8. State policies and laws**

Laws and government policies exert a comprehensive impact on all aspects of social life, including the emergence and development SMEs. They may facilitate or hinder the emergence, activities and development of these enterprises. In the process of renovation, a whole set of policies and laws relating to SMEs has been gradually worked out and improved with positive results in creating the conditions which encourage and promote the emergence and fairly vigorous growth of the SMEs.

Yet, the existing policies and laws lack coherence and consistency and are still inadequate, and have not been able to create a liberal and equal environment among all types of enterprises, to encourage them to efficiently engage in production and business and to strictly abide by the laws, particularly with respect to the policies in land, taxes, credits and export and imports ... Thus, policies and laws must be further improved in order to create the conditions for vigorously promoting the emergence and development of SMEs.

## **4.2. SUGGESTIONS FOR SME PROMOTION**

**4.2.1. Continue tax reforms: simplify taxes and make them fairer by eliminating differential treatment.**

- *The Corporate Income Tax should be further simplified and the base broadened by eliminating exemptions and unifying the rate for all enterprises.*

Although the Corporate Income Tax introduces the principle of a single unified tax rate, other laws such as the Foreign Investment Law and the Law on Domestic Investment Promotion provide for a bewildering array of exemptions, multiple rates, and concessions as incentives to promote investment and other desirable economic activities. Research has shown, however, that tax incentives are complicated and expensive to administer for both Governments and taxpayers. In addition, tax incentives usually create differential treatment among taxpayers which given rise to resentment and a perception that the tax system is not “fair”.

Thus, the world wide trend for enterprise taxation in recent times has been to eliminate special tax incentives for specific economic activities and lower tax rates across the board for all enterprises

- *Simplifying the Value-Added Tax and broaden the tax base by reducing exemptions and reducing the 4 rates to a single rate for all non-exempt goods and services*

The number of tax rates should be reduced to one - say 5% or 7% - and the exemptions should be reduced to only a few

- *The tax on high income earners should be amended by reducing the margin rates and increasing brackets to approximate those of other ASEAN countries and unifying the rates for Vietnamese and foreigners*

The tax rate on high income earners which imposes on Vietnamese citizens is excessively high compared with the world standards while the per capital income of Vietnamese is 80% lower than that in other countries. These rates are more than double those of other ASEAN countries. High tax rates harm the competitive position of SMEs; encourage “brain drain” emigration; provide strong incentive for tax evasion and corruption.

#### **4.2.3. Improve SMEs access to finance – credit and capital.**

- *Creating a “level playing field” so that all borrowers are subject to the same rules.*

The Asian financial crises has demonstrated that it is essential to ensure that all lending is made on the basis of financial rather than political considerations – including loans to SMEs. This is the only way to ensure the soundness and solvency of the financial system for the benefit of the entire economy for long term. Thus, the key question for bankers must be the creditworthiness of the borrower not the ownership.

- *Encourage and allow greater participation by SMEs in foreign invested joint ventures.*

SMEs have participated only in a very small percentage of foreign invested joint ventures under the Foreign Investment Law to date. Ways and means should be found to eliminate obstacles such as difficulties with contributing land, and to encourage and permit greater participation by SMEs in foreign invested joint ventures.

#### **4.2.4. Improve SME access to land**

As was mentioned above, land issues remain one of the biggest challenges for enterprises, especially SMEs. The amendments and/or implementing sub-laws should at a minimum:

- Clarify and speed up procedures for issuing titles to land use rights and housing titles
- Eliminate the heavy fiscal disincentives for registration of land and buildings--namely fees and taxes amounting to over 25% of the value of the property
- Provide clear, simple and fair procedures for resolving disputes and “quiet title” proceedings to settle ownership and use rights even where all required documentation is not available.

#### **4.2.5. Improve SMEs access to technology**

- Provide for accelerate depreciation of machinery and equipment as a deduction for profit tax determination

- Encourage leasing or hire purchase or installment sale agreements to better enable SMEs to have access to new or up-grade machinery and equipment
- Continue to eliminate law and policy barriers to technology transfers from abroad to Vietnam
- Continue supporting funds to provide information and training to SMEs managers, technicians and employees.

#### **4.2.6. Establish enterprise associates and encourage SMEs to participate in**

This absorb the foreign resources to effectively support SMEs in services on information, market expansion, training, technology ..., improve the effectiveness in production and business of SMEs.

## CONCLUSION

Obviously, SMEs play an extremely important role in the socio-economic development of Vietnam. Following one decade of emergence and growth, SMEs of Vietnam has recorded certain achievements in contributing to economic growth, in creating employment, in generating more income, improving living conditions and promoting social equity ect... As a result they could assert its position in the national economy.

However, its actual process of development also reveals the main trend of development, and the defects of SMEs as well as the limitations and hindrances on the part of the Government institutions, policies and macro environment,... Therefore, if SMEs is to develop vigorously in the next decade, we must further improve the macro policies and measures of the Government in order to create a liberal and favorable environment for SMEs growth. This is also the best way for the Government to bring into play the endogenous role of SMEs in serving economic growth, industrialization and modernization.

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