

**CIEM- DFID**

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**EFFICIENCY AND COMPETITIVENESS OF THE PRIVATE SECTOR IN VIETNAM**

**(Draft)**

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## **ABBREVIATIONS**

ASMED	Agency for SMEs development
BOD	Board of directors
CIEM	Central Institute for Economic Management
EL	Enterprise Law
EPZs	Export-processing zones
FDI	Foreign direct investment
FIES	Foreign invested enterprises
GDP	Gross domestic production
GSO	General Statistic Office
ICT	Information and communications technology
IZ	Industrial zones
M&A	Mergers & acquisitions
MOF	Ministry of Finance
MPI	Ministry of Planning and Investment
PCI	Provincial competitive index
PFFCM	Porter's five forces competitive model
PESTLE	Political economic social technological legal environmental analysis
R&D	Research and development
ROA	Return on asset
ROE	Return on equity
ROS	Return on sales
SB	Supervisory board
SMEs	Small and medium enterprises
SOEs	State-owned enterprises
TNCs	Transnational corporations
WTO	World Trade Organisation

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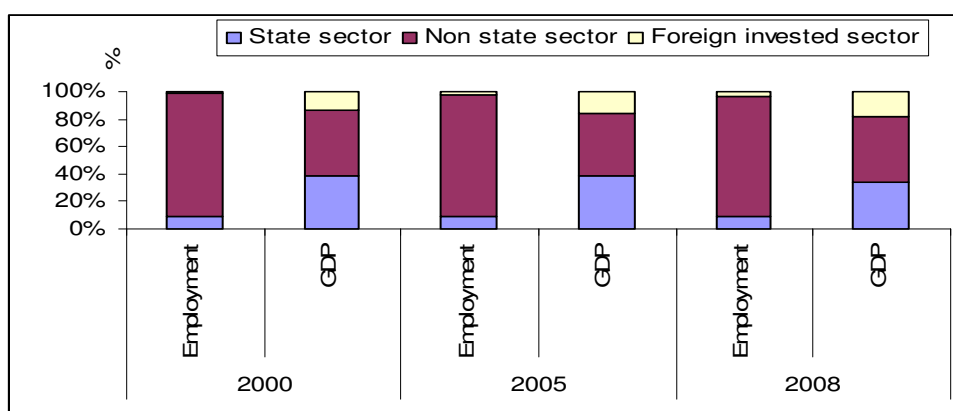
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## INTRODUCTION

The private sector has increasingly played an important role in the economic development of Vietnam. In the period from 2005 to 2009, the GDP average annual growth rate of the formal private sector was 13.87%, much higher than the rate of 7.83% for the whole economy; also the whole private sector has produced nearly half of GDP in Vietnam and created most of jobs. In general, this trend does not change much overtime as illustrated in figure 1

**Figure A: Employment and GDP structure by ownership**



*Source: GSO.*

Though the important contribution of private sector to the economy was recognized, there are still debate and even critics on the very low level of productivity of the sector. In fact, the productivity of this sector grew at the highest rate of roughly 14% compared with 12.6% of the state sector and 1.2% of FIS during 2001-2008. With this growth rate, however, the private sector can hardly narrow the productivity gap with two other sectors. Because of its biggest share in GDP, a low level of productivity of this sector should be seen as a serious matter for restructuring the economy to attain a higher level of productivity in the next stage of development in Vietnam.

Taking this into account, the paper is an effort to understanding factors that are behind the productivity growth of the private sector in Vietnam. Its final objective is, however, to assess efficiency and competitiveness of this sector instead of directly analysing productivity. Following this approach, we assume that the private sector can only raise its sustainable productivity if it can enhance the efficiency and its competitiveness in the long-term.

In Vietnam, there are many studies related to the private sector, especially since early 90s when the Company Law and Law on private enterprises went into effect in 1991. Yet, most of the papers mainly concentrated on evaluation of the private sector development from legal aspects and business environment.

Recently, there have been some notable studies on similar themes relating to the competitiveness of the business sector in general and private sector in particular.

- Nguyen Dinh Cung, David Dapice (2004), *"History or policy: Why is the Northern provinces not growing fast"* was one of the first study raising issue of the productivity and tried to explain what is behind the phenomenal that the economies of Northern provinces are mostly less developed than those in the South. These authors come to the findings in regulatory regimes, which are less pro-reform in the North than in the South.

- Finn Tarp and John Rand (2006), *"Characteristics of the Vietnamese Business Environment: Evidence from a SME survey in 2005"*. In this report, the authors have carried out a small interviewed survey of 2,821 firms to come out with several interesting findings on all aspect of the firm operation, including the growth, effects of bureaucracy, bribes, informal fees, tax evasion, employment, education, social insurance, production, technology, exports and sales structure, access to finance and investment.

- CIEM (2009), Report on Implementation of the Resolution No 14-NQ/TW of the Party Central IX of *"Continuation to renovate the mechanism, policies, and create promoting conditions for the growth of private sector"*, focuses on policy analysis on the political perspective, yet it is rather weak in making an intensive assessment of the business efficiency of the private sector.

- Le Duy Binh (2010), *"Quick Review on the Quality of Vietnam private sector during 10 years of Enterprise Law enactment"*, has good analyse of the financial indicators and employment data, yet it is mainly based on financial and economic indicators rather than the current policy framework.

Though recent studies make sense for policy makers, none of them analyse deeply the efficiency and competitiveness of the private sector toward boosting productivity growth as the final objective. It makes this paper different from other works which had been done before.

To conduct this study, we apply an analytical framework that is developed selectively based on the theory of the firm to assess the efficiency and Porter's five forces of



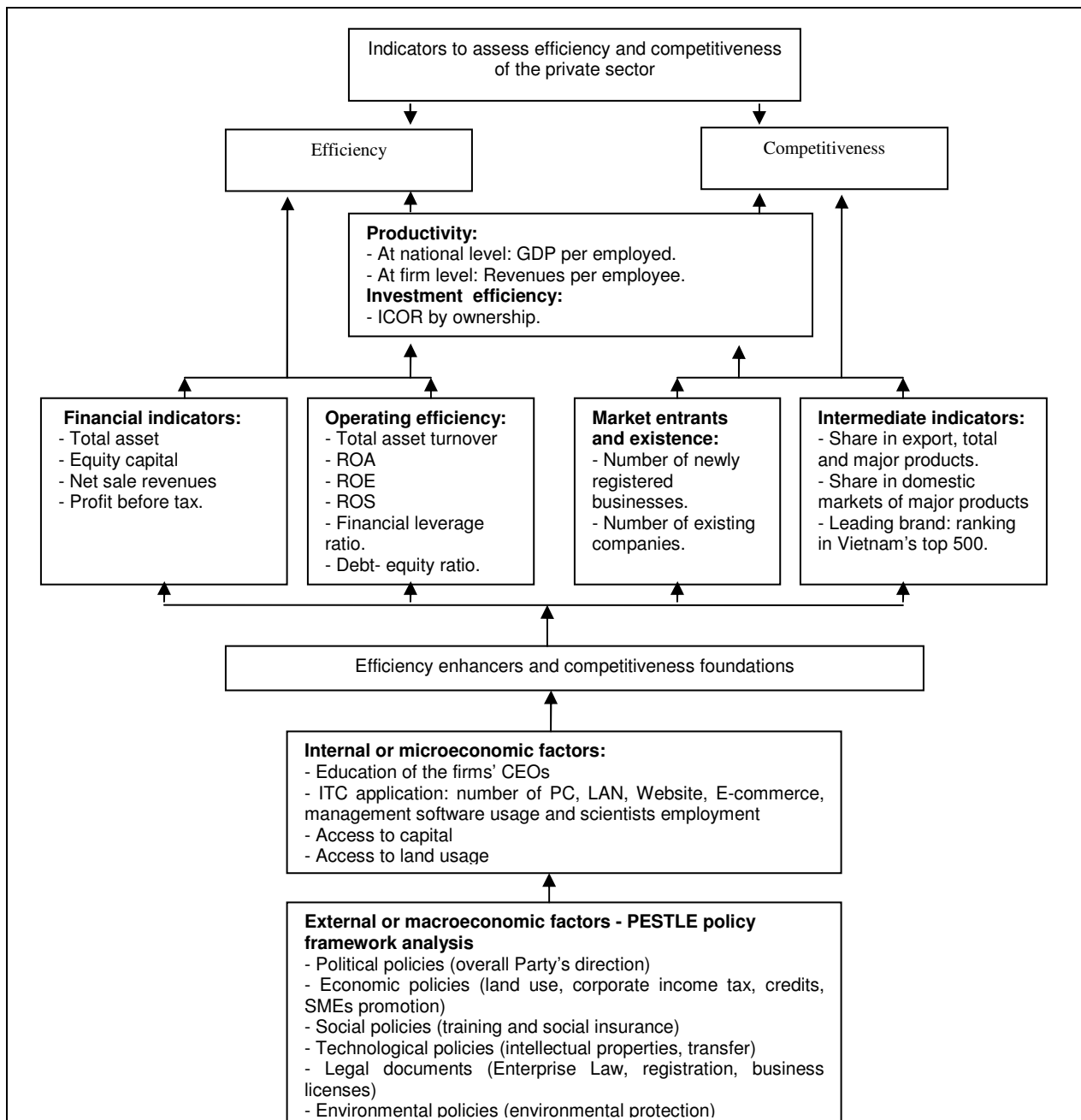
competitive position model (PFFCM) to analyse the competitiveness of a firm. The theory of the firm tells us that a firm should be trying to enhance its efficiency to be able to survive and compete with its main competitors in the long-term. Therefore, increasing efficiency will boost the capacity of the firm without any change in the number of inputs employed. A firm has efficient production when it is operating at maximum output at minimum cost per unit of output. Based on this, efficiency is defined as a measure of how well the production process is performing. To assess efficiency is however not easily. The most commonly used measure is labour productivity. Other indicators can be used to measure efficiency are ROA, ROE and ROS. Whereas ROA tells us how efficiently a firm turns its asset into net income even considering the effect of borrowed capital, ROE measures how much profit a company generates with the money shareholders have invested. ROS is also used as a measure of a firm's operational efficiency.

PFFCM consists of five sub-areas to be analysed, including competitive rivalry, new market entrants, supplier power, buyer power and product and technology development, whereby the core of the model is competitive rivalry. Assessing a firm's competitiveness by using PFFCM, however, is much more complicated because this model needs lots of information and data at firm level which are often not available in developing countries. These theories are often applied for assessing and analysing of a firm's efficiency and competitiveness; therefore, the framework being applied here is a mixed, comprising other indicators to assess the efficiency and competitiveness of the private sector for the whole country as indicated in the figure 2.

We use two channels of data sources for the study which include statistics and raw data captured from Enterprises Surveys. Both were produced by the General Statistical Office of Vietnam. A comparative analysis will be also conducted for the purpose of comparing some of these defined indicators with those of state and foreign invested sector at national level or of SOEs and FIES at firm level. At the moment, Vietnam's private sector comprises of about 350,000 registered enterprises considering as the formal sub-sector, and roughly 4 million household businesses and 10,000 business farms as belonging to the informal economy. Thus, it is worth to note that besides of analysing the whole sector on aggregate indicators, we mainly focus the rest sections for critical assessment of the formal sector based on firm-level information which is collected more credibly in the GSO's newest Enterprise Surveys. It is strongly believed that this focal selection is quite necessary since only the formal sector is the organisational management entity that we can draw meaningful analysis and policy recommendations for improvements of the efficiency and competitiveness.

The paper consists of three sections. Section 1 and 2 assesses the private sector's efficiency and competitiveness respectively. Section 3 analyses major factors which assumed to have influence on the efficiency and competitiveness of the private sector in Vietnam. The paper will conclude with some major findings and recommendations which are expected to contribute to the project on “*economic restructuring*” prepared by Central Institute for Economic Management (CIEM).

**Figure B: Analytical Framework for assessing efficiency and competitiveness of the private sector in Vietnam**



This study report is prepared by Dr. Nguyen Thi Tue Anh, Director of the Department for Business Environment and Competitiveness (DBEC) and Mr. Luu Minh Duc, MBA., researcher of the DBEC at the CIEM. We greatly appreciate the guidance and advices of Dr. Nguyen Dinh Cung, Vice President of the CIEM. Additionally, we would also like to thank Mr. Le Phan, BA., researcher at the DBEC for his assistance in data processing. The findings and ideals presented in the report belong to the study group and do not necessarily reflect the viewpoints of the CIEM or DFID.

# SECTION I

## OVERVIEW OF THE PRIVATE SECTOR DEVELOPMENT IN VIETNAM

### 1.1. The private sector development policies

Only since the early 1990s, the private business sector has officially been recognised as one of the multi-sectors having positive contributions to the national economic development in Vietnam.<sup>1</sup> And from the end of the 90 decade, the sector has been increasingly considered as one of the most important engines for the country's economic recovery, growth and internal resources capitalisation, initiatives mobilisation, and grow-rich determination of the population, and poverty reduction and hunger alleviation. The governmental policies have increasingly targeted in liberalising business freedoms, promoting market entries, simplifying administrative procedures, reducing operational costs for the companies in this sector. The Private enterprise law and Company law were issued in 1990 (amended in 1994) created the first legal framework for the corporate type of private ownership. However, the scope and scale of the sector's contribution to the national economy was still quite limited in comparison with SOEs and FIES sectors. During the 90 decade, Vietnam economic growth mainly relied upon the two engines of exports and foreign investment. Although about 40,000 private enterprises were established, the sector was still a weak and small force, with tied business rights, under discrimination and bias, and minimal contribution to the economic development (Pham Chi Lan, 2007).

The private sector has only been rising strongly after 2000, when the Enterprise Law enacted. The East Asia financial crisis in 1997 caused the FIES to reduce sharply; meanwhile the SOEs equitisation has just been started, thus leaving them in inefficient operation. In that context, the internal strength capitalisation and attraction of population's capital became an urgent demand of the economy. Furthermore, international experiences show that the successful economic development of all "*Asian dragons*" had been based on the private sector. Therefore, the Enterprise Law made breakthroughs to give all citizens the right to form enterprises without legal capital, and they can do businesses in all areas that are not forbidden by laws. Business organisation is opened to four basic types as the private enterprises, limited liability companies with upto two members, joint stock companies and partnership

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<sup>1</sup> The overall direction of multi-sectoral economic development was confirmed through Party's Convention VI, VII, VIII, IX in the beginning period of the *Doi Moi* process (from 1986- 2001).

firms. Exporting rights are no longer confined to the SOEs monopoly, but encouraged for all private firms.

Enterprise Law 2005 (EL) continues to make progressive improvements by creating a consistent and relative equal legal framework for businesses of all sectors. The private firms, SOEs and FIES are all organised in the same corporate organisational types and operate under the same legal environment. The EL also improved regulations of the corporate governance mechanism, the transitions between corporate types, and transactions among companies, such as joint ventures, or mergers and acquisitions. In addition, the Law removed inappropriate administrative barriers and business licenses to reduce the start-up and operation risks and costs for the businesses.

As Vietnam fully integrates into the world economy by joining the WTO, unfair treatments and barriers are more and more pulled down not only for the domestic markets but also the international ones, opening a lot of business opportunities for our private companies while the domestic markets are still limited due to low level of incomes and consumption. As a result, private firms can now not only have exporting freedoms but also attract both foreign direct and indirect investment, and invest into overseas markets. Cooperative forms and business opportunities have become diversified, such as the commercial franchising, exports leasing, trade representatives, strategic partnership, M&A to bring the competitive advantages and international specialisation into full play, participating in the global distribution network and value chain.

However, taking the private businesses as objectives is to target small and medium enterprises (SMEs), because most of the private firms (97%) are in this size. As raising the awareness of the increasing important role of the private sector and SMEs in the national economic growth, besides of the above mentioned grand direction, the Central Party spent a separate Session and Resolution to fully create the political foundation to promote the sector's development.<sup>2</sup> Before that, the regulations on SMEs and supporting policies for SMEs development had been issued by the Government.<sup>3</sup> The Prime Minister and related ministries have made a range of Decisions and Circulars to create the Fund for SMEs credit insurance, establish the Council for SMEs promotion, develop the Human resources training programme, the National focused trade promotion schemes, and form the technical assistance centres for SMEs in three central major cities. Additionally, the Agency for SMEs Development

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<sup>2</sup> Resolution No 14-NQ/TW of the 5<sup>th</sup> Session, 9<sup>th</sup> Plenary, 18/03/2002 on renovating the mechanism and policies, encouraging the private sector development.

<sup>3</sup> Decree No 90/2001/ND-CP of the Government , 23/11/2001 on supporting the SMEs.

(ASMED) is established within the MPI organisation to manage the business registration activities, simplify relating administrative procedures relating to business start-ups, and develop promotional policies for the SMEs growth. The SMEs Development Plan from 2005- 2010 was approved in October, 2006.<sup>4</sup>

## **1.2. Opportunities and challenges of the private firms**

Eventhough political determination, legal framework and policies are created and issued, from the Governmental policies to real changes in practical is not a small gap, especially in the context of low effective public sector and authorities and the great social inertia of such an economy in transition as Vietnam. That the above policy changes have taken place not as “*shocking*” doses but “step-by-step” ones during a period of 20 years can be said to be slow. Yet, the changes in practice have even more slowly occurred. Until now, the private sector landscape is characterised with such features as quantity without quality, small size, lack of linkages, crumbling, and running for short-term profit. In another study (Le Duy Binh, 2010), more than 80% of the private firms having equity capital size of under VND 5.0 billion, and 87% using less than 50 employees. In the ranking of the 500 biggest companies in Vietnam (VNR500), the private sector accounts only less than 30%, and most of them derived from the SOEs equitisation.

In other indicators relating to competitiveness, such as the scientific technological application, managerial skills, labour quality, access to land, credit and overseas markets, the private sector is all less advantageous than SOEs and FIES. Especially, during the time of crises, the above weaknesses often make the private sector more vulnerable to changes in market demands, input- outputs prices, foreign exchange rate, bank interest, and inflation. Evenmore, it is worth to note that there is a large number of inactive companies that can not carry out the bankruptcy or liquidation procedures as regulated by laws. It reflects the inadequacies in related legal regulations which hinder the dynamics and flexibility that should be seen as the private sector’s strengths. In short, the Vietnamese private sector has observed a remarkable growth in recent years, mostly in the quantity of market entries and its presence in most of the business areas of the society.

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<sup>4</sup> The PM’s Decision No 193/2001/QĐ-TTg, 20/12/2001 on the Fund for credit insurance, and No 12/2003/QĐ-TTg, 17/1/2003 on the Council for SMEs promotion, No 143/2004/QĐ-TTg on the Programme for human resources training assistance; Decision No 236/2006/QĐ-TTg on approval of the SMEs development Plan 2005-2010; MPI’s Decision No 290/2003/QĐ-BKH, 12/5/2003 on establishment of technical assistance centres for SMEs in Hanoi, Ho Chi Minh City, and Danang; MOFT’s Decision, 24/1/2003, on the Trade promotion programme; MOF’s Circular No 93/2004/TT-BTC, 29/9/2004, on the establishment and operation rule for the SMEs credit insurance fund, and other subordinating and amended normative documents.

Nevertheless, the private sector also have a lot of external opportunities such as the more and more profound integration of the world economy and positive policies of the State reflected by the political determination and a series of specific policies which creates more favourable business environment to foster the growth of the sector. Beside of that, there are also subjective opportunities since the growing per- capita income makes the capital source of the population wealthier; the managerial knowledge, skills of the businesspeople and workers are improved; and the social credibility and respect to entrepreneurship and employees working for the private firms are higher.

However, the private sector also meets great challenges. Firstly, the room for policy maneuver has been increasingly shrunken due to restrictions of the international commitments. On the one hand, the Government has to withdraw preferential treatments for SOEs; on the other hand, industrial policies that promote investment in certain areas can neither be applied. The level playing field is created for all local enterprises. Yet, those domestic firms (in which many have not grown enough) also have to compete fairly with foreign companies that are penetrating the local market which is not protected as before. That means the new game requires greater level of capital, technologies, managerial skills, and greater competition. These are the very weaknesses of the private sector.

To subordinate these vulnerability, the local enterprises need to have better connection among all sectors, and more effective interaction between the business community and the governmental agencies. However, this is the second weakness of the domestic companies in general and private ones in particular. Thirdly, in order to grow in scale and improve in quality, the private firms should have greater access to credit, land, technology, natural resources and labour. Therefore, the financial and credit, technological, real estates, and labour markets should develop quickly. But, as being observed, only those businesses having nepotist relationship with officials in related authorities and financial- credit institutions (even in private sector) can gain the advantages. In fact, these businesses are mostly the SOEs. Hence, the legal framework for this area should be improved to enhance the transparency, information disclosure, to protect the minority investors and shareholders, and to prevent the negative transactions between related parties or corruption and rent-seeking activities both in the public and private sectors.

Additionally, the legal regulations of the capital, securities and M&A markets and relating to the foreign investment needs to be improved to make the documents more

specific and consistent with each other in order to create favourable conditions for more participation of the private companies in these fields. When listing in the securities market or entering the M&A market, the private sector can attract more capital from both domestic and foreign sources to shorten their capital accumulation period, enhance the technologies and brands, employ the economies of scales to improve their competitiveness. Moreover, the M&A should be seen as an effective channel helping companies to withdraw from the markets or change the investment forms and areas while still securing their capital efficiently. Therefore, the more developed these markets are, the more dynamic and flexible the private firms will be.

Fourthly, the quality of the infrastructure, and other governmental policies in tax, customs, labour, and environment areas all poses direct impacts over the development and competitiveness of the private sector. It can be seen that many studies have figured out the gap of the asset and capital sizes between the private companies and SOEs and FIES. It reveals that once the infrastructure in Vietnam is still inadequate, posing high costs for Vietnamese enterprises on using the roads, seaports, energy, administrative regulatory compliance, customs and tax, the small-scale private companies are the most vulnerable.

Therefore, the issue of growth and competitiveness improvement for the private sector can be seen as difficult and complicated, requiring a comprehensive package of many solutions. The Government should take responsibility in policy making process and issuance of legal regulations to address these bottle-necks, improve the business environment, reduce the business costs, and minimise risks, create conditions for the private firms to have capital accumulation, expand the production capacity, diversify the markets, and enhance their competitiveness in a sustainable way.

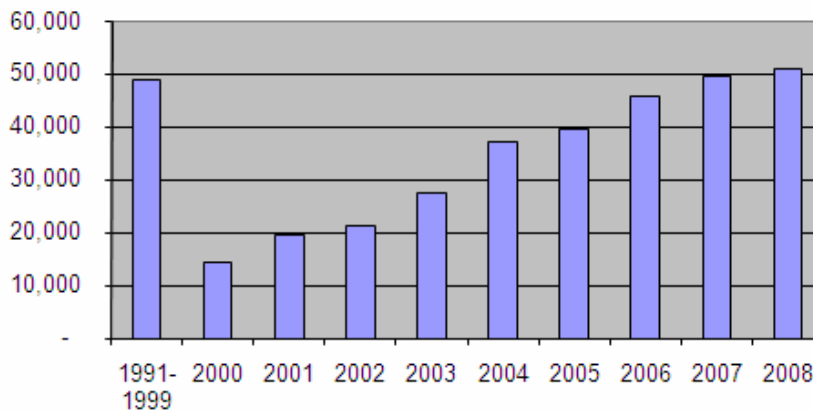
### **1.3. Market entry and the business survival rate**

Under the impacts of the above mentioned policy changes and legal regulations, the private sector has observed a boom in both of the number of newly-established companies and the amount of registered investment capital. It can be said that the sector has changed its face during the last ten years, and increasingly become one of the major engines for Vietnam's economic growth.

The annual number of newly-registered enterprises company has observed a sharp increase by 3.5 times in the period from 2000- 2008. Since 2007, this figure has started to be higher than the total quantity of company registration for the previous ten years, 1991- 1999. On average, the inflow of incorporation has continuously risen at a rate of 17.8% annually.



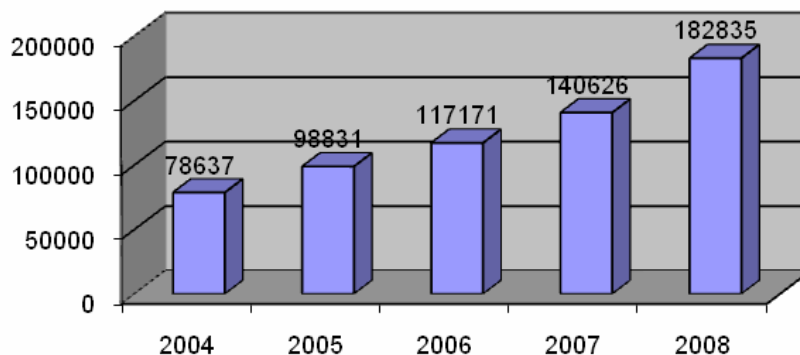
**Figure 1.1: The annual number of newly- registered companies (private sector)**



*Source: Agency for SMEs development (ASMED) statistics*

By 2009, the total number of established companies reached 355,545 which was 7.2 times compared with the quantity we had at the end of the year 1999. In the Fig. 4 below, the continual rise in GSO enterprise survey respondents shows that the private business community has been increasingly more self-confident and active in their business and interaction with governmental policies.

**Figure 1.2: Continual increase in GSO enterprise survey respondents**

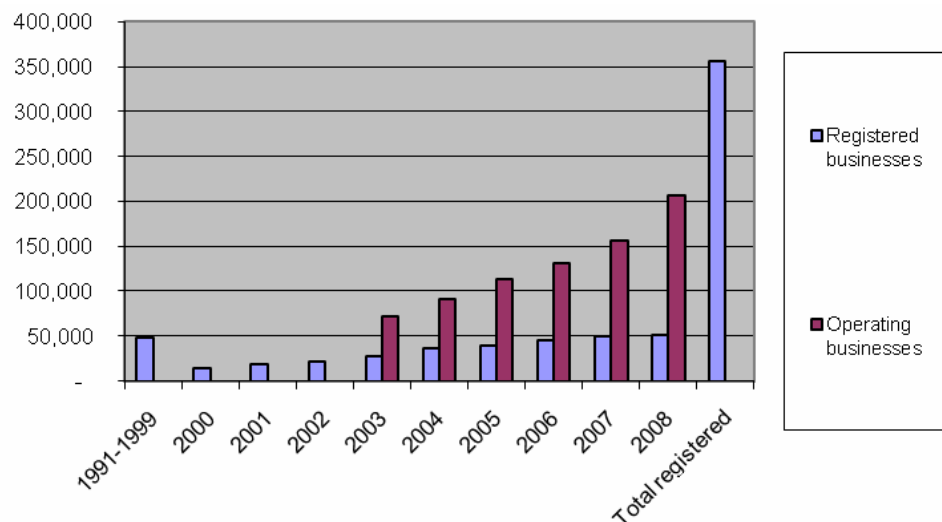


*Source: GSO enterprise survey 2009*

It can be explained that the expansion in market entrants of private firms has been resulted by governmental efforts of market liberalisation and administrative simplification. Vietnam joined the WTO in 2007, and within regulatory reform to keep up with international standards and best practice, the Enterprise Law was issued in 1999 and 2005, which was widely recognised as significant milestones to boost the growth of private sector by lifting and reducing restrictions, such as legal capital, business forms, and licensing conditions.

But, more importantly, the private sector has also achieved positive results in survival rate. According to the General Tax Office (by March, 2009), among 355,545 registered enterprises of by 2009 as mentioned above, there are 272,680 operating tax-payers of the private sector (in the total of 289,672 companies of all ownership types). If taking this result into account, the private formal sector accounts for 94.1% of the total corporate quantity in Vietnam, and its survival rate is 76.7%. By another source, according to General Statistics Office, there are a total of 177,281 private companies, about 3,370 SOEs and 5,342 FIES which are currently in operation (respondents) in Vietnam.<sup>5</sup> The figure of GSO shows that private sector accounts for up to 95.3% of the total number of corporations at the national extent. Yet, although the GSO statistics seems to be less accurate since they based the results on the number of respondents to their survey, the operating figure is still at 51.4% of the total registration, which is considered as positively normal with international practice.

**Figure 1.3 : Operating companies (compared with registration number)**



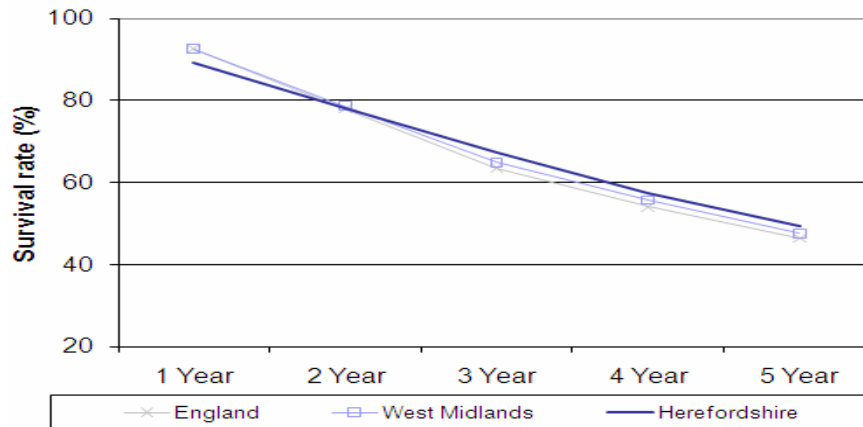
*Source: ASMED statistics and GSO Statistics Yearbook 2008*

In his study, Le Duy Binh (2010) also produced consistent results with us and quoted an ILO source that only 50% of the established firms can exist after 5 years. More strictly, it needs a separate study to figure out how is the actual survival rate of Vietnam's private sector because the data we had above provides only the total quantity of existing companies in comparison with the total incorporation number, while the bulk of samples should be separated into intervals of operation time and

<sup>5</sup> In 2009, according to the Agency for SMEs Development, it is estimated to have nearly 69,000 newly registered enterprises, adding up to the total number of nationwide registration to nearly 425,000 companies, in which 340,000 are operating.

followed-up after each incorporation. However, it is still believed to be a positive result for our country since a lot of other studies provide much lower figures.

**Figure 1.4: Comparative business survival rates in the UK**



*Source: State of Herefordshire report 2003*

According to Nytrom and Starbuck (1984)<sup>6</sup>, the survival rate of newly-registered businesses after five years is 38%, ten years (21%), fifteen years (14%), twenty years (10%). According to the UK Bureau of the Cencus (2003), the small business survival rate is 75% after one year, 50% after four years, and just 29% after ten years. Below is the figure provided by another independent study over the comparative business survival rate of the Herefordshire county in the UK. It is rather consistent that the rate dramatically drops during the first years, from about 90% in the first years to 60% after 3 years and just nearly 50% after 5 years.

In terms of governance type, there have recently been obvious developments. The number of limited liability companies and joint stock companies have risen quickly; meanwhile the sole proprietors has remarkably shrunken. This shows the investors have learnt to choose for them the best business type to balance risks and build capacity for their business.

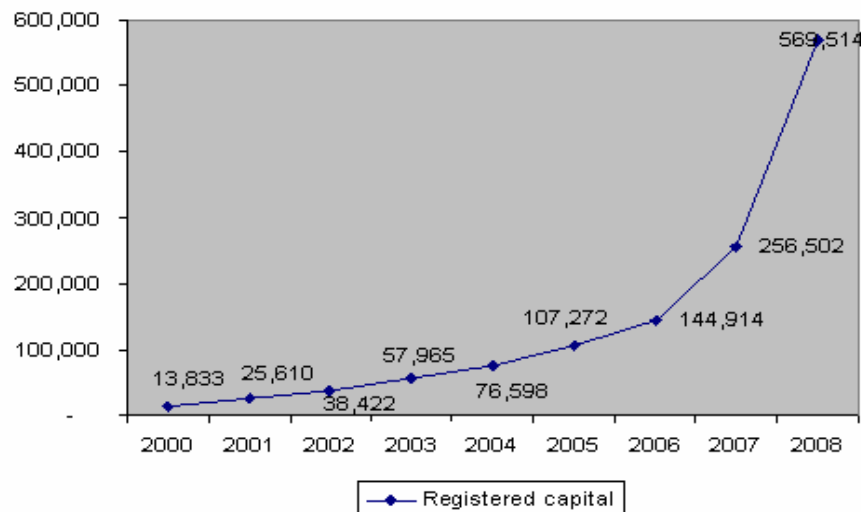
Besides of the corporate businesses, the household enterprises have increased to large number. By the end of 2008, the country is estimated to have nearly 4 million households enterprises and non-agricultureal households, increasing by 60% from 2002; and 118,778 farms (increasing by 40% of the 2003).

<sup>6</sup> Nytrom and Starbuck (1984), To avoid organizational crisis: Organisational Dynamics, American Management Association, New York.

#### 1.4. Growth rate of the investment capital

Along with the increasing high number of newly-established companies, the share of the private sector's investment in the society's total investment has increased at high rate of 30.4%/ year from 2000- 2008. Under the impacts of the EL 1999, a range of policies for internal capitalisation, the private investment has increased from 13,833 billion (2000) to 144,914 billion VND (2006), ie. multiplied by ten times in six years. In the next period, the investment has been boosted up to 569,514 billion VND in 2008. The second rise was under the influences of the EL 2005, and the country's entry in WTO. This was the time when the financial – credit markets were eased and observed critical development. It shows the private sector is always sensitive to changes in the legal framework, international commitments, and financial – credit markets.

**Figure 1.5: Total registered capital of the private firms (2000-2008, bil. VND)**



*Source: ASMED, MPI*

The investment structure of each sector has also seen big changes in this period. As the equitisation was pushed ahead, especially after the IPO period during 2006- 2007, the proportion of the governmental investment has gradually declined. Meanwhile the FID increased like the private one as above mentioned, making the share of the State's investment reduced from 48.1% (2004) to 28.5% (2008). The private sector has accounted from 40%, ie. much over the SOEs's share, including the State budget.

However, it should be added that the figures relating to the companies' capital has just certain meanings, but only for referential purpose. Because, there is no investment

certifications for chartered capitals when companies registered<sup>7</sup>, hence, the actual capital of the businesses may be different from how much the registered capital they invest.

**Table 1.1: The society's investment structure by ownership (2004-2008, %)**

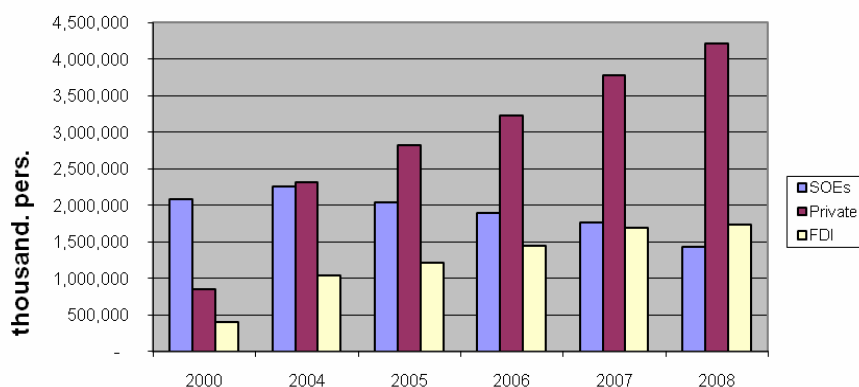
Ownership	2004	2005	2006	2007	2008
Total	100,0	100,0	100,0	100,0	100,0
State sector	48,1	47,1	45,7	37,2	28,5
<i>Budget</i>	23,8	25,6	24,8	20,2	16,2
<i>State-owned credit</i>	12,2	10,5	9,1	5,7	4,1
<i>SOEs and other sources</i>	12,0	11,0	11,8	11,3	8,2
<b>Non-state sector</b>	<b>37,7</b>	<b>38,0</b>	<b>38,1</b>	<b>38,5</b>	<b>40,0</b>
FIES sector	14,2	14,9	16,2	24,3	31,5

*Nguồn: GSO 2008*

### 1.5. Employment:

The employment picture shows similar characteristics. The SOEs used to be the biggest employer in ten years ago, but has been declining. Meanwhile, the private formal sector has grown so quickly, passing the SOEs since 2004. In 2008, it employs 4,208,713 people, equal to 2.9 and 2.4 times more than the SOEs and FIES, and 32.9% higher than the two sectors combined.

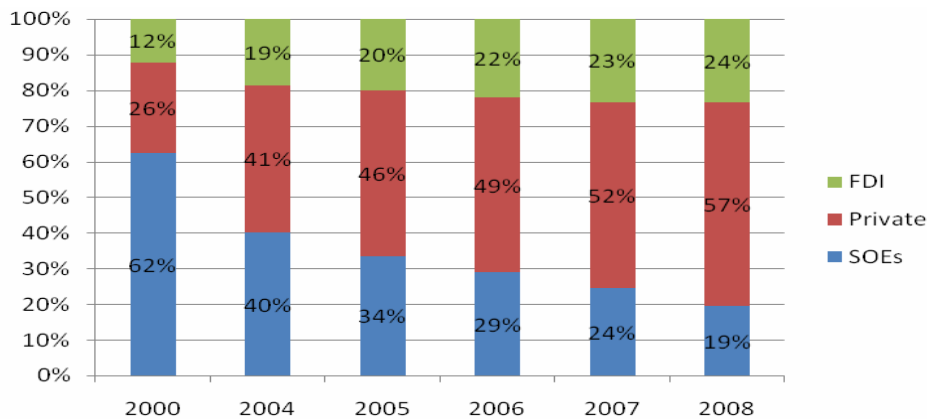
**Figure 1.6: Total employment by ownership**



*Source: GSO statistic Yearbook 20009*

<sup>7</sup> Chẳng hạn theo Luật Doanh nghiệp, đối với công ty CP các cổ đông phải có nghĩa vụ đóng góp đủ số vốn điều lệ trong 90 ngày kể từ ngày ĐKKD. DN tự chịu trách nhiệm pháp lý về tính trung thực của mình.

**Figure 1.7: Share of employment among three business sectors**

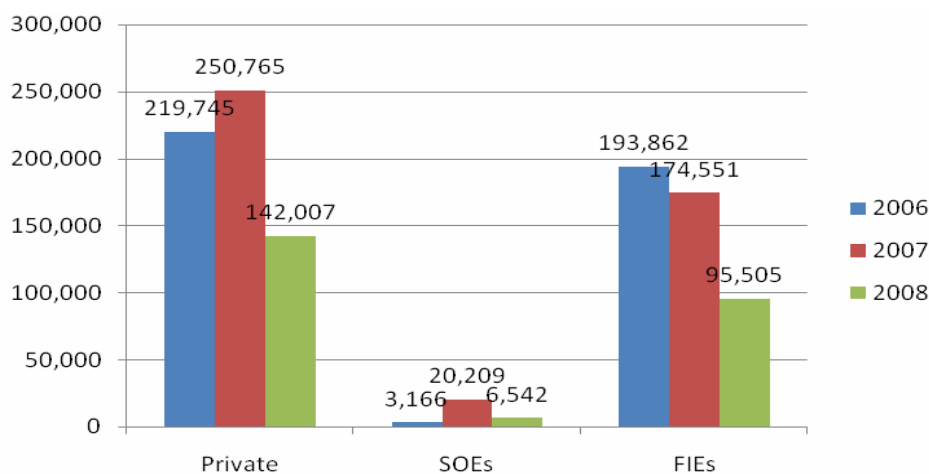


*Source: GSO Statistics Yearbook 2008*

In terms of structure, the private sector employment accounts for 57% of the total in business sector. The trend is also shown in the following figure that while the FIES employment is steadily increasing, the private sector will bite into the SOEs much more rapidly.

In total, the private sector has been the biggest job creator during the last three years. In the peak time of 2007, the business sector as a whole created nearly 500,000 jobs, in which the private sector accounts for 50%. From 2002-2007, the total private sector had created more than 4 million jobs, in which the formal corporate sector created 2,33 million.

**Figure 1.8: Number of job creation by ownership**



*Source: GSO Statics Yearbook 2008*

However, the apparent growth of the private sector is just the first positive sign of the economic reform in Vietnam from a demand economy where the state sector is the

single and biggest part. Yet, it should be noted that the growth is almost quantity-drive. The scope of each private firm on average both on financial or employment indicators is much smaller than their competitor in the SOEs or FIES sectors. These will later be analysed in below sections of this paper.

In terms of labour income, according to Le Duy Binh (2010) study which is also based on the GSO data, the gap between the income of the private sector's employees and the national GDP per capita has been enlarged from 1.4 times to nearly 2.0 from 2000 – 2008 period. Moreover, the increasing rate Since there is the price devaluation impacts, we take this figure as the evidence that private sector has become a more attractive employer for the society.

## SECTION II

### ASSESSMENT OF THE PRIVATE SECTOR'S OPERATING EFFICIENCY AND COMPETITIVENESS

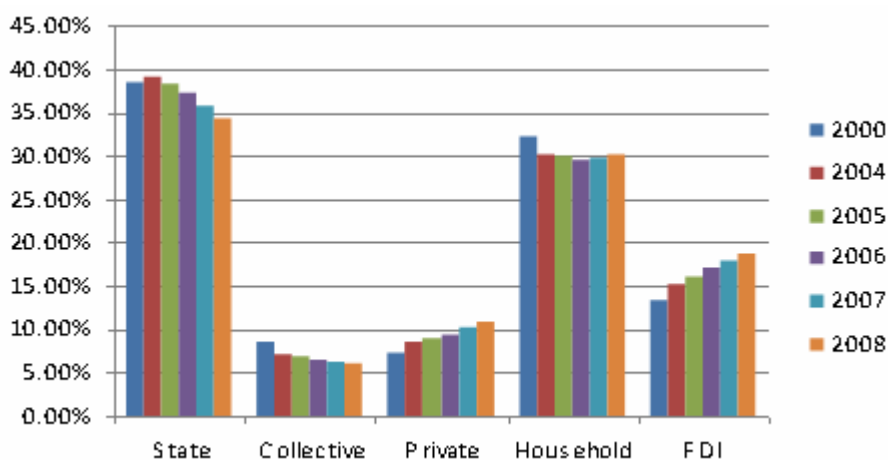
In this section, both of the aggregate indicators of the whole private sector at national level and firm-level indicators of the formal indicators will be assessed. In the first part we will analyse the private sector's contribution in GDP, industrial output, the state budge income. The labour productivity and ICOR efficiency are two important indexes to be drawn to analyse the sector at aggregate level. In the next part, major aspects of efficiency and competitiveness of the private sector will be evaluated and compared with those of the rest two sectors upon several business operation indexes. From these results, the picture of the operation efficiency and competitiveness of the private sector is to be described more clearly.

#### 2.1. ASSESSMENT THROUGH AGGREGATE INDICATORS

##### 2.1.1. GDP contribution

The below figure of GDP contribution of all formal and informal sectors shows that the total private sector accounts for the greatest part, upto 46.9%, next is the SOEs which still holds a major role with 34.4% and FIES – 18.7%. However, it can be seen that the performance of the private sector as a whole still depends on nearly 4 million households (30.1%). The role of the private sector in here is still quite limited (10.8%).

**Figure 2.1: GDP contribution structure by ownership (current prices , 2000-08)**

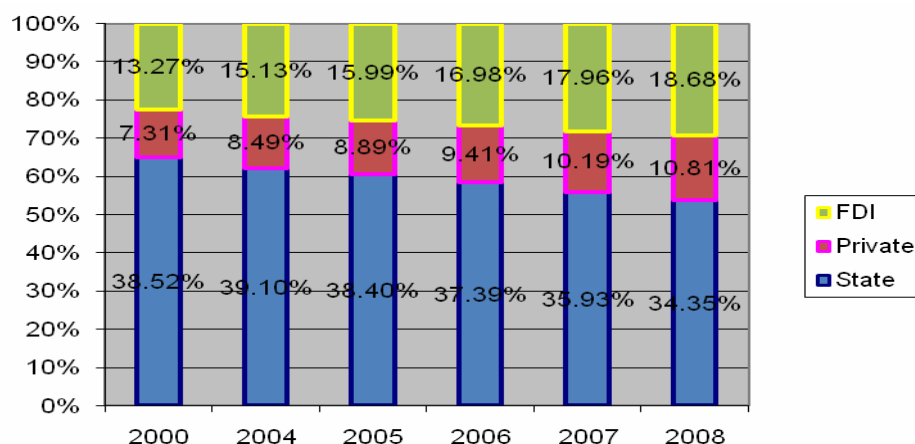


*Source: GSO Statistics Year Book 2008*



Nevertheless, it is also exposed that among all sectors, only the private and FIES have a continual growth through the years, while the SOEs's share increasingly declines. This trend is likely to remain in the coming time.

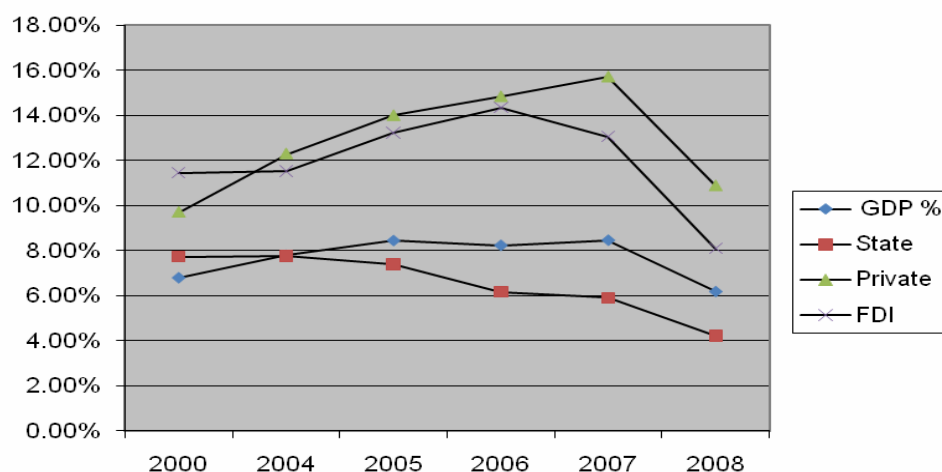
**Figure 2.2: Share of GDP contribution by business sector (%)**



*Source: GSO Statistics Yearbook 2008*

The private sector's GDP has increased at over 10% during the last five years. Since 2004, the growth rate surpassed the FIES to be the highest-growing among sectors, which compensates the declining SOEs. This has made the private sector become major factor helping to keep GDP annual growth at 7.83%/year.

**Figure 2.3: GDP growth rate by ownership (%)**



The highly growth rate of the private sector has also improved its share in the GDP contribution, from 7.31% in 2000 to 8.49% (2004) and 10.81% (2008). It is worth to note that during the time of financial crisis in 2008, the private sector GDP still grew at highest level among all business sector, showing its strength and resilience against

reverse impacts from the crisis. Nevertheless, though it is likely to be improved, in general we have to wait for a long time to make the presently limited role and scale of the private sector's GDP contribution be a leading engine of the economy.

### 2.1.2. Industrial output

At present, the industrial output accounts for more than 40% of the national GDP. Thus, industrial development plays an important role in the industrialisation and modernisation of the Vietnam economy. According to the below table, the private sector's contribution to the national industrial output has the most impressive increase, from 15.2% (2003) to 24.3% (2007), whilst the FIES's growth is minimal and the SOEs greatly shrunken.

**Table 2.1: Industrial output structure (2002- 2007)**

Year	2002	2003	2004	2005	2006	2007
Total	100	100	100	100	100	100
SOEs	40.3	38.5	37.0	33.9	31.6	29.7
<b>Private firms</b>		<b>15.2</b>	<b>17.1</b>	<b>19.2</b>	<b>21.6</b>	<b>24.3</b>
Collective		1.4	0.5	0.5	0.4	0.4
Household		9.9	9.3	9.3	9.0	8.7
FIES	35.4	35.8	36.1	37.3	37.8	38.6

*Source: GSO.*

It is also shown in this table that most of the household and collective (co-op) businesses (private informal sector) operate in non-industrial areas. Their contributions here are so limited and reduced. It can be foreseen that the private sector will soon become the leader in industrial production.

### 2.1.3. Contribution to budget income

The contribution of the private business sector in the state budget income structure has gradually increased in recent years. Its proportion increased from 6.5% (2001) to 10.6% (2007), equal to the FIES sector. In the coming time, the income from SOEs is likely to shrink, while those from the crude oil and trade activities are fluctuating. In that context, the contribution from private corporate and individual income taxes will be pillar for the state budget income.

**Table 2.2: Budget income structure (2001- 2007)**

Year	2001	2002	2003	2004	2005	2006	2007
Total	100	100	100	100	100	100	100
Domestic income (excl. crude oil)	50.7	51.3	51.7	54.8	52.5	52	55.4

<i>SOEs</i>	22.3	20.2	18.9	16.9	17.1	16.5	18.7
<i>FIES</i>	5.5	5.9	6.5	7.9	8.4	8.6	10.6
<b><i>Private enterprises</i></b>	<b>6.5</b>	<b>6.3</b>	<b>6.8</b>	<b>7.0</b>	<b>7.4</b>	<b>7.8</b>	<b>10.6</b>
<i>Households and individuals</i>	16.4	18.9	19.5	23.0	19.6	19.1	15.5
Crude oil	25.3	21.4	24.2	25.4	29.2	29.8	23.8
Export-imports	22.1	25.5	22.2	18.3	16.7	15.3	19.6
Non-refund foreign assistance	1.9	1.8	2.0	1.5	1.7	2.8	1.6
<i>Source: GSO</i>							

#### 2.1.4. Geographical allocation

Private business registration mainly focuses in two regions- the Red river Delta and South East. They account for 70% of the company allocation.

**Table 2.3: Geographic allocation of private companies (2003-2007)**

Year	2003	2004	2005	2006	2007
National	100	100	100	100	100
<b>Red river Delta</b>	<b>32.1</b>	<b>32.4</b>	<b>33.6</b>	<b>31.2</b>	<b>31.5</b>
North East	5.4	5.0	4.4	4.5	4.4
North West	1.2	0.9	0.9	1.0	0.9
Central North	4.5	5.8	4.3	5.6	5.1
Central coast	6.8	6.8	7.4	7.6	7.2
Highland	2.1	3.1	2.8	2.7	3.2
<b>South East</b>	<b>38.3</b>	<b>35.0</b>	<b>37.7</b>	<b>39.5</b>	<b>39.4</b>
Cuu Long river Delta	9.7	10.6	8.6	7.6	8.1

*Source: ASMED, MPI*

However, it is worth to note that the business presence in other regions, for example in the North West, North West and Cuu Long river Delta have observed a serious reduction. This result shows the big difference in infrastructural conditions between urban and rural areas. The newly-registered firms tend to concentrate only in and around two big cities of the nation: Hanoi capital and Ho Chi Minh city. Also, it is exposed that poor infrastructure conditions may hinder businesses to bring into full play the natural advantages of each provinces, such as the resources, tourism, or agriculture. The over-concentration in urban zones, of course, is perceived as normal rationale. Yet, it may lead to over-competition there, which hinder the growth of the private firms which are already in small scale and scope.

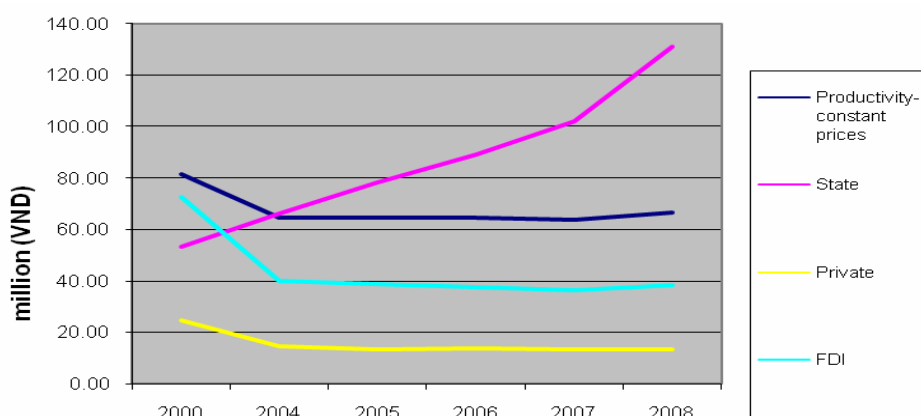
## 2.1.5. Labour productivity and ICOR efficiency

### Labour productivity

Labour productivity is the centre of efficiency and competitiveness assessment. However, it is quite hard to produce accurate and reliable results hereby. Yet, the issue is more complicated than simple math of the divide between the added value and an employee. The technical factor has its role here. For example, the crude oil industry surely claims the most productive field. Yet, could Vietnam economy only focus in crude oil exploration? or are the textile and garment still encouraged to create job and solve poverty reduction and hunger alleviation task? Thus, we still calculate the comparative labour productivity of each sector but also know that only many related factors and indicators are analysed the full picture of the sectoral efficiency can be attained.

As the below figure shows, the labour productivity of the private sector is the lowest among all business sectors. One employee in the private sector contributes only VND 13.36 million of GDP at the 1994 constant price in 2008, next is the FIES (3.0 time higher); while the SOEs seems to be the most productive (nearly 10 time higher). In fact, it can be explained that huge amount of labour employed by the private sector has diluted its result. There may be more explanations, as being mentioned earlier, many highly value-added industries are under the SOEs and FIES operation; crude oil and other mineral exploration are examples. Still, it can be drawn that the private firms and FIES engage in labour-intensive areas more than the other sectors.

**Figure 2.4: Productivity by ownership (constant prices)**



Source: GSO Statistics Yearbook 2008

Additionally, it is important to note that the productivity levels of the private and FIES sector have stood nearly the same at low during the last five years. Only the SOEs show improvement, which certainly comes from labour-reduction effect of the equitisation process, especially during the period of high- growth in the financial and stock markets.

### **ICOR efficiency**

By calculating the ICOR efficiency we find that the private sector is still the most efficient one. In 2007, to generate 1.0% GDP, the private sector needs only 3.74%, SOEs (8.28%) and FIES (4.99%) increase in investment capital. Although the general average ICOR tends to increase during the last ten years, and so does the figures of each sector; the private sector's ICOR is still rising the most slowly in compared with the SOEs.

**Table 2.4: ICOR by ownership (%)**

	1996	2001	2007
Total	3.44	5.14	5.38
SOEs	3.5	7.42	8.28
Private	2.31	2.63	3.74
FIES	5.82	6.29	4.99

*Source: GSO*

In fact, it is not contradictory between the productivity and ICOR calculation results as it seems. They shows that private sector are found mainly in labour-intensive fields, whilst the SOEs in capital-intensive ones. More importantly, the former has low productivity, while the latter has low capital efficiency. It is also worth to draw that the SOEs has a clear advantage of access to capital and credit over the private sector, though taking into account the historical factor that almost the SOEs have been established longer than the private ones. In the next sections, we will look more into indicators at micro-level of the private formal sector to have more detailed assessment of the efficiency and competitiveness issue.

## **2.2. ASSESSMENT AT FIRM- LEVEL**

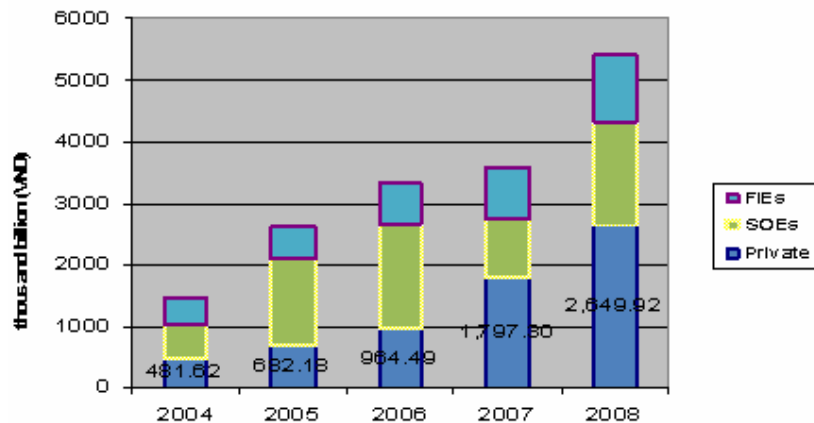
### **2.2.1. Corporate financial indicators**

In this part, we are comparing the financial size of the private firms and those of the SOEs and FIES sectors, both in the total and on- average figures. The indicators mainly include total asset, equity capital, sales revenue and profit before tax. These are calculated based on the newest Enterprise Survey of the GSO.

### Total asset:

The rapid inflow of private firms has help this sector to accumulate the greatest total asset since 2007 in compared with the state-owned and foreign invested enterprises.

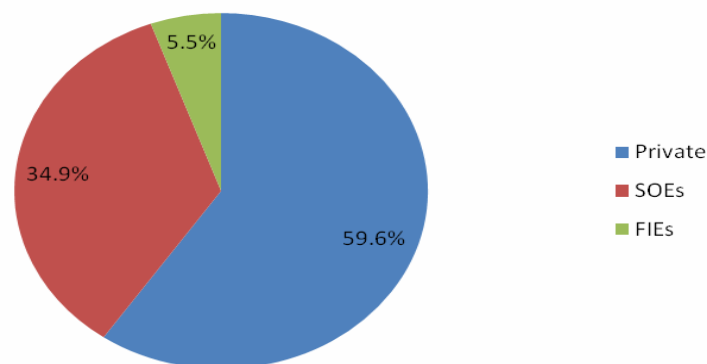
**Figure 2.5: Total asset by ownership**



*Source: GSO Statistics Yearbook 2008*

In terms of the total business sector's asset structure, the private sector has increased its share from 26% (2005) to 49% (2008), the SOEs shrank from 54% to 31%, while the FIES nearly maintained at 20% during the same period. That means the private sector is replacing the SOEs to be the biggest asset holder. If its growth rate is kept at 54.2% as during the last five- years, its total asset will be VND 54,940 thousand billion, accounted for 60% of the whole corporate sector's total asset by 2015.

**Figure 2.6: Share in total asset, forecasted by 2015 (thousand billion VND)**

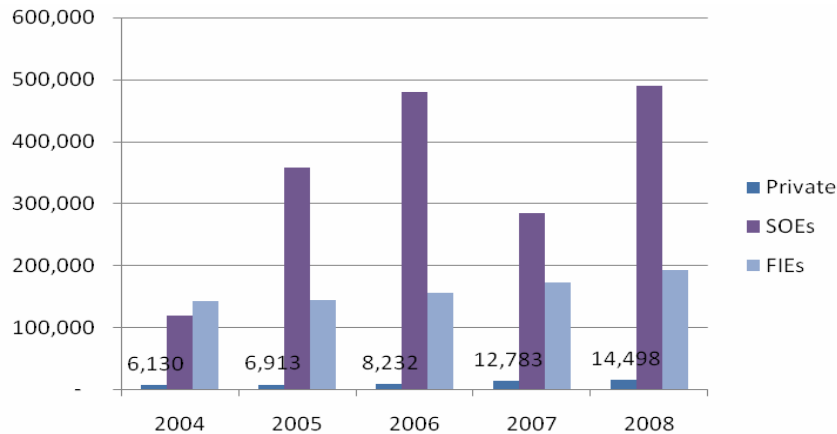


*Source: author's calculation*

The total asset on average has also recorded a remarkable expansion, yet at a lower speed than the total figure due to dilution by the quantity of newly established firms.

For five years, a private company has more than doubled its total asset from VND 6,130 million in 2004 to VND 14,498 million. The increase rate on average was 25.1% annually.

**Figure 2.7: Total asset value on average (mil. VND)**



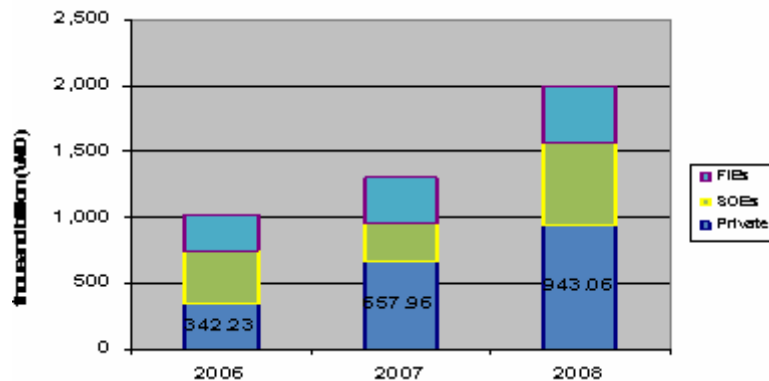
*Source: GSO enterprise survey 2009*

However, the average scope of each company in private sector is much smaller than competitors in SOEs and FIES. And this situation seems to be unchanged. It is not to mention that if compared with international competitors, the asset value of the whole private business sector in 2008 is just equal to a medium TNC in the US.

### Equity capital:

The equity capital of the private sector has continually increased, making its share in the total business sector rapidly improved from 34% in 2006 to 47% in 2008, and the SOEs and the FIES shrunken from 39% to 31% and 27% to 22% in the same period.

**Figure 2.8: Equity capital structure of all business sectors**



*Source: GSO Enterprise Survey 2009*

However, the equity capital on average is found to be with similar features with total asset that the private sector record higher amount in total figure thanks to its dominating quantity, making them typically in much smaller scale.

**Figure 2.9: Equity capital on average of private sector (mil. VND)**



*Source: GSO enterprise survey 2009*

The figures also show that, in 2008, an average private firm is just equal to 2.8% and 6.7% to a SOE and FIE respectively in terms of equity capital. Additionally, the growth rate in equity capital on average of the private sector was 35.2%/ year, much higher than increase in total asset on average (25.1%) shows that private companies took the financial leverage opportunity thanks to the credit boom, especially during 2006-2007, less than the SOEs (21.4%-66.5%). It can be seen that most of the corporate establishment (SMEs start-up) are funded by the capital from entrepreneur's owned savings, and borrows from family and friends.

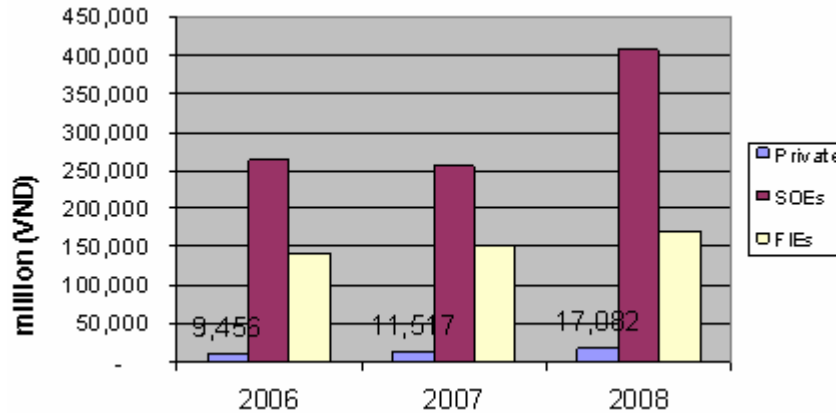
Once again, in comparison with international competitors, Vietnamese private firms are so less capitalised. In Taiwan, the capital of registered companies is USD 2.4 million (VND 45.6 billion), nearly 9 times greater than our company's.

#### **Sales revenue and profit before tax on average:**

The figures of net sales revenue and profit before tax also show that private companies on average are just tiny competitors before giants from SOEs and FIES. The much smaller size of the private firms in general will surely affect the corporate capitalization and re-investment capacity. The advantages of capital strength and accumulation, economies of scale belong to SOEs and FIES. Thus, it explains why private companies are much longer (or can not) to grow to big scale, and are so vulnerable in the competition.



**Figure 2.10: Net sales revenue on average by ownership**



*Source: GSO Enterprise Survey 2009*

In terms of international comparison, the sales revenue of companies in the UK is about USD 3.0 million. Typically, the firm of 1-4 workers sells 500,000 USD/ year; and the one of 5-9 workers sells USD 1.2 million (VND 22.8 billion). That means our companies are just equal to a micro-level company in the UK.

**Table 2.5: Profit before tax on average by ownership (mil. VND)**

Year	Private	SOEs	FIES
2006	178	15,233	20,708
2007	332	15,796	20,326
2008	192	24,565	18,508

*Source: GSO enterprise survey and statistics Yearbook 2008-2009*

### 2.2.2. Corporate operating efficiency

Corporate operating efficiency can be measured by several indicators such as the sales on asset, ROA, ROE, ROS, debt on asset, debt on equity ratio. These will help us to know if the private firms use their asset, equity capital efficiently, and how they employ the external financial opportunities to lever their capital strength.

#### Total asset turnover

The statistics shows that the private sector employs asset much efficiently than SOEs and FIES. If an average SOE and FIE can only generate 0.8 and 0.89 VND of sales revenue respectively from 1.0 VND asset, the private firm can produce up to 1.18 VND of sales revenue.

**Table 2.6: Total asset turnover by ownership**

Year	Private	SOEs	FIES
2006	115%	55%	91%
2007	90%	90%	87%
2008	118%	80%	89%

*Source: GSO enterprise survey 2009*

### **Return on asset (ROA), return on equity (ROE), return on sales (ROS):**

However, all figures evaluating the profit with total asset, equity capital and sales revenue reveal contradictory results. The FIES operate the most efficiently, and the SOEs and private firms stand the least. Yet, according to some experts, these figures should be sceptical since they are even smaller than the bank's interest rates that means the investment decisions is not verified. Because, it is a common wisdom that private companies often adjusted their books (reducing profit) to avoid corporate income tax.

**Table 2.7: Return on asset, equity capital and sales revenue by ownership**

Year	ROA			ROE			ROS		
	Private	SOEs	FIES	Private	SOEs	FIES	Private	SOEs	FIES
2006	<b>2.5%</b>	3.4%	14.5%	<b>6.1%</b>	13.2%	31.0%	<b>1.9%</b>	5.6%	14.5%
2007	<b>3.3%</b>	6.2%	13.3%	<b>7.1%</b>	17.4%	29.0%	<b>2.9%</b>	6.1%	13.6%
2008	<b>1.5%</b>	5.4%	10.6%	<b>3.7%</b>	13.3%	24.3%	<b>1.1%</b>	6.3%	10.9%

*Source: GSO enterprise survey 2009*

Among these above mentioned figure, only the asset turnover ratio with calculation of sales revenue on the total asset is credible for evaluate the efficiency of the private sector, since they tends to truthfully declare their sales revenue which is hardly to hide and still relates to VAT repayment. Thus, we can believe that the private sector has a higher asset efficiency in compared with the two other sectors.

### **Financial leverage ratio, Debt- equity ratio**

The financial leverage ratio (debt on total asset) is found approximately equal among the sectors, although the private sector is slightly higher than SOEs because of the huge amount of total asset of the latter ones.

**Table 2.8: Financial leverage ratio:**

Year	Private	SOEs	FIES
2006	0.65	0.77	0.57
2007	0.64	0.69	0.60
2008	0.65	0.63	0.61

However, companies in all sectors have a rather sound financial situation. On average, the private firms have the highest debt-equity ratio that is 1.9 in compared with 1.7 and 1.5 of the SOEs and FIES, which are all ranked within safe levels. Nevertheless, these figures illustrate an equal opportunity of all businesses in accessing credits.

**Table 2.9: Debt- equity ratio (repayment capacity)**

Year	Private	SOEs	FIES
2006	1.9	3.3	1.3
2007	1.8	2.2	1.5
2008	1.9	1.7	1.5

*Source: GSO enterprise survey 2009*

As the financial markets grow as observed during the recent years, financial investment is increasingly important part of the business operation. The below table shows that only SOEs record positive results over the period of hot and cold in the financial market (2007-2008), while the FIES and private companies are mostly losers in their financial investment.

**Table 2.10: Financial investment gain on average (mil. VND)**

Year	Private	SOEs	FIES
2006	19	854	621
2007	(24)	1,072	272
2008	(285)	2,952	(1,454)

*Source: GSO enterprise survey 2009*

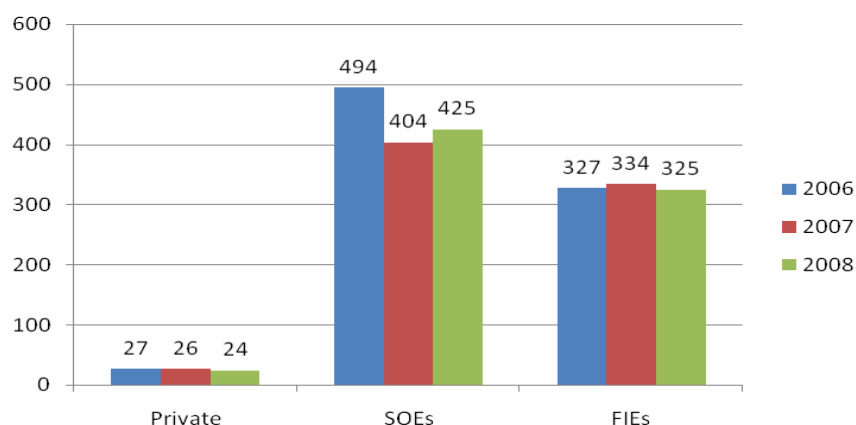
### 2.2.3. Employment and Labour mobilisation

#### Employment average size

However, similarly to asset and capital, the private sector is the most limited in scale. On average, each private firm employs only 24-27 people, but this figure is declining due to dilution by the incorporation inflow. On employment size, a company in private sector is only equal to 5.6% and 7.3% to the one in SOEs and FIES sectors. Also, we

can see that upon the criteria of the Decree No 90/2001/ND-CP and Decree 56/2009/ND-CP on SMEs definition, the average size of private firms places them into small enterprise category while only SOEs and FIEs just over the medium level.<sup>8</sup>

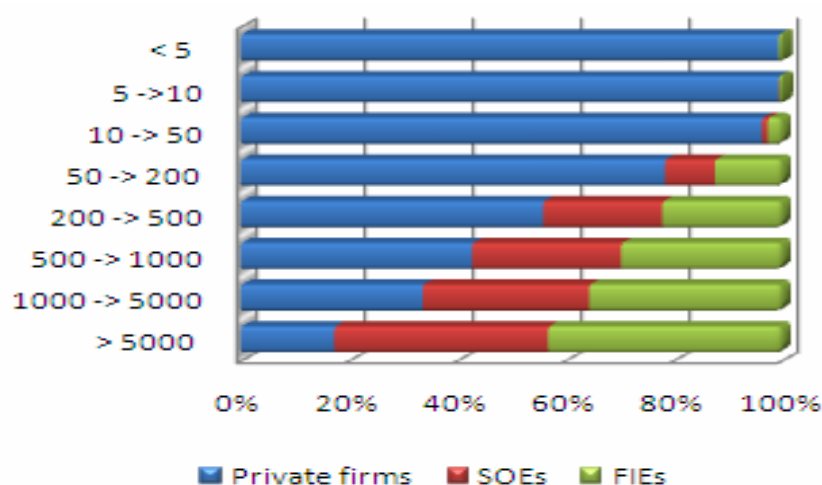
**Figure 2.11: Employment on average by ownership**



*Source: GSO Statistics Yearbook 2008*

The above result is also consistent with the ownership structure within each labour size category, and the distribution of labour size category in each sector of ownership.

**Figure 2.12: Total sector's structure by labour size**



<sup>8</sup> According to the Decree No 90/2001/ND-CP, the micro firms are those employing less than 10 labour; small firms < 50; and medium firms < 300. However, it has been replaced by Decree No 56/2009/ND-CP in which company size categories in terms of labour are classified with differentiation of economic sector: for agriculture and manufacturing firms, the micro are those employing < 10, small < 200, medium < 300; for those operating in trade and services, the micro: less than 10, small: <50, medium: <100. We agree with the industrial difference in classification of the Decree 56, and the increase of size grouping the latter decree has over the former to reflect the business expansion during the time. Yet, we believe the grouping of medium firms for agricultural and manufacturing firms are narrow, thus in this section we still categorise companies into different suitable grouping for comparison.

As we can see in the above figure, the private sector accounts for nearly an absolute majority of those companies employing less than 10 labour (99.4%) and less than 50 labour (96.31%). From the larger size categories, its share gradually decreases, while the SOEs and FIES increase their proportions pretty evenly. However, the private sector continues to outnumber in categories of 50-200 (78.38%) and 200- 500 (55.83%), even in 500- 1000 (42.74%). In the size between 1000- 500, three sectors take nearly equal shares of over 30%, and for the biggest categories of over 500 labour, the private sector accounts for 17.28%, SOEs 39.51%, and FIES 43.21%.

There are 177,281 private companies, 3,370 SOEs and 5,342 FIES responding to the Survey on labour issue. This number is slightly lower than the total sector, but it can represent the ownership structure of the country's business sector, ie. 95.3%, 1.8%, and 2.9% respectively for private, SOEs, and FIES sectors. Interestingly the above figure also shows that a majority of the SMEs are private; but the higher level of employment the more SOEs and FIES are found in each sector.

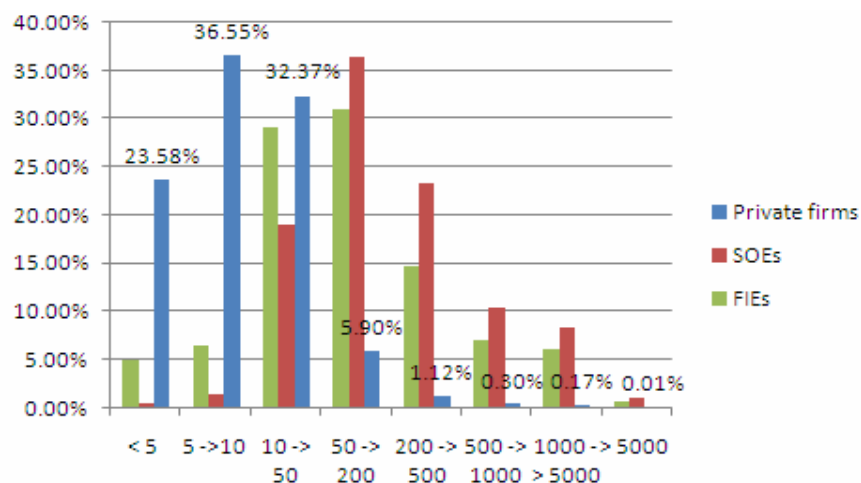
**Table 2.11: Distribution of labour size categories in each sector**

Labour size	Private firms	SOEs	FIES	All sectors
> 5000	0.01%	0.95%	0.66%	0.04%
1000 -> 5000	0.17%	8.34%	6.08%	0.49%
500 -> 1000	0.30%	<b>10.30%</b>	7.02%	0.68%
200 -> 500	1.12%	<b>23.23%</b>	<b>14.71%</b>	1.91%
50 -> 200	5.90%	<b>36.47%</b>	<b>31.04%</b>	7.18%
10 -> 50	<b>32.37%</b>	18.96%	<b>29.15%</b>	32.03%
5 ->10	<b>36.55%</b>	1.34%	6.48%	35.05%
< 5	<b>23.58%</b>	0.42%	4.87%	22.62%

Considering the labour size distribution within each sector, 60.13% of the private firms are micro (employing less than 10), 92.49% less than 50, and 98.4% less than 200. Thus, it can be said that almost of the private firms are SMEs. On the contrary, the distribution of SOEs and FIES are highest in the medium and large size categories. 70% of the SOEs are those having from 50- 1000 workers. This sector has only 57.18% of the SMEs, and the rest of 42.82% are all large and macro companies. The FIES has smaller sizes in comparison with the SOEs. Upto 74.9% of FIES having from 10-500 workers. Also, more than 2/3 are SMEs, and less than 1/3 are large and macro-size enterprises. Thus, it can be seen that if considering the total business in a single picture, the SOEs and FIES have filled the “*missing middle*” of the private sector. Yet, with regards of the private sector competitiveness in terms of scope and

scale , it is much more disadvantageous than the other two sectors. Nevertheless, if the private firms know how to build linkages with and to provide supporting industries for the SOEs and FIES, they can form an efficient value- chain network.

**Figure 2.13: Labour size structure of sectors by ownership**



*Source: GSO Enterprise Survey 2009*

### Labour mobilisation

Nevertheless, the private sector shows a clear improvement of efficiency in asset formation. In 2006, one employee in the private enterprises could create VND 320.37 million of asset, in compared with 498.3 million, and 980.8 million VND by those in FIES and SOEs. Yet, by 2008, the private sector surpassed the FIES and only achieved less productivity than SOEs.

**Table 2.12: Total asset/ employee (mil. VND)**

	2006	2007	2008
SOEs	980.82	717.88	1162.38
Private	320.37	509.53	629.63
FIES	498.30	546.53	625.04

Figures also show that it is more expensive to creat a job in the SOEs and FIES sectors than the private. And this trend seems to be unchanged for the time being.

**Table 2.13: Equity capital/ employee (mil. VND)**

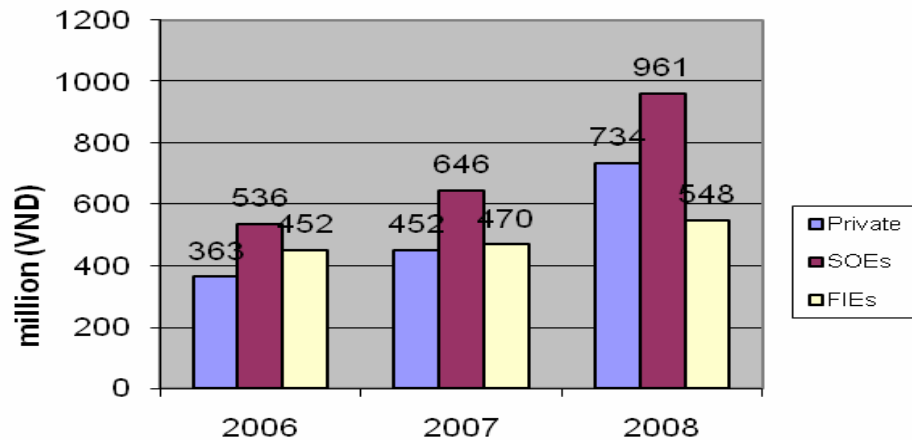
	2006	2007	2008
SOEs	229.60	225.44	436.46
Private	113.68	186.53	224.07
FIES	212.36	220.19	249.37

*Source: GSO enterprise survey 2009 and statistics Yearbook 2008*

### Net sales revenue per one employee

Yet, the sales/ employee figure of the private sector has been greatly improved from the lowest level, surpassing the FIES to be the second among the three sectors.

**Figure 2.14: Sales revenue/ employee (mil. VND)**



*Source: GSO enterprise survey 2009*

Within 2 years, the average sales value an employee of the private sector has doubled, while the SOEs increased just 79.3% and FIES 21.3%. Therefore, it is likely that the situation will be improved for the private sector in the near future.

**In sum**, as we can see the financial indicators show that private firms on average are much in smaller size and scope in terms of resources and markets.

**Table 2.14: Size of a private firm on average equals to? (2008, %)**

Indicators	SOEs (100%)	FIES (100%)
Total asset	3.0%	7.5%
Equity capital	2.8%	6.7%
Employment	5.6%	7.3%
Sales revenue	4.2%	9.9%
Profit before tax	0.78%	1.04%

*Source: GSO Statistics Yearbook 2008 and authors' calculation*

Yet, there are still unclear whether the private business sector operates more efficiently than SOEs and FIES. Since the quality of data sources is not quite reliable, the data processing result is still a question that we must look for other factors to answer. For example, it is so hard for the private sector (and even the FIES) to overperform the SOEs in indicators relating to labour, because the number of SOEs and employment in SOEs are drastically reduced during the equitisation process in

recent years. The comparison of two sectors in which the one operates in labour – intensive areas and the other in capital- intensive areas might not be relevant. Nevertheless, there is question that whether SOEs outperforms the private sector with their clear advantages of historical established brands, capital accumulation with state- supporting credit, and huge access to land. So, in next parts, we continue to assess the other efficiency and competitiveness enhancers of the private sector.



## **SECTION III**

### **EFFICIENCY AND COMPETITIVENESS ENHANCERS**

The performance of every business is influenced by their external and internal impacts. Therefore, after assessing the comparative outputs and outcomes of the private sector in the previous sections, we are looking for the underlying reasons for these results. Why can the private firms not grow big? Why do they mainly operate in labour-intensive fields? How can they escape from that vicious circle? By examining the macro-environment and micro-capability of the private business sector, we hope that the findings will help to address the above issues and initiate useful solutions for improvement of the situation.

#### **3.1. EXTERNAL FACTORS**

##### **3.1.1. Overall political direction**

For a long time, the question how to treat private sector has been a serious political matter in Vietnam. There was a clear move to unchain the growth of this sector as the Enterprise Law 1999 was enacted, abolishing major market-entry obstacles for the private entrepreneurs. However, until 2002, under the pressure to promote the domestic investment after the Asian crisis, the Central Party issued the Resolution 14-NQ/TW to affirm *'the private sector is an important part of the national economy' and 'the development of this sector is strategically significant'*.

This was a milestone in changing the mindset and attitudes of the State towards the private sector. It shows a political determination overcoming the concerns that the growth of the private sector may de-route the course to Socialism, or just be a short-term means, which discourage the long-term investment commitment of the entrepreneurs. By the overall political direction, the population's belief in asset and investment protection and economic reform of the Government has been enhanced. Recently, a lot of businessmen and women has been officially praised and rewarded by many contesting prizes and trophies by the governments and associations, recognizing their contribution to the country's development, patriotism, and pride.

##### **3.1.2. Improvement in the legal framework**

###### **Enterprise Law 1999 and 2005**

After the Enterprise Law 1999 (EL) was implemented, there had been several amendment and guiding legal normative documents. It can be named a few as the

Prime Minister's Direction No 17/2002/CT-TTg on measures to promote the implementation of the EL; the Direction No 08/2003/CT-TTg on enhancing the efficiency and competitiveness of enterprises; Decree No 37/2003/ND-CP on administrative fines in business registration; Decree No 109/ND-CP on business registration and the Decree No 125/ND-CP guiding the implementation of the EL. These documents had institutionalised the breakthrough made by the Enterprise Law 1999 that transformed the business incorporation procedures from ex-ante to ex-post mechanism and kicked-off to simplify the licensing conditions.

In 2005, the new Enterprise Law has created a common legal background and unified forms of corporate governance for enterprises of all sectors, regardless of their sizes and ownership. As a result, by official regulations, for the first time in nearly 20 years, the private sector has been treated fairly, equal and non-discriminately. Beside that the EL 2005 covers its regulation scope on all companies; it has consolidated the ex-post principle in incorporation, re-classified licensing conditions into appropriate level of authority. Additionally, it adds several new business forms, such as the one-member limited liability company, and improvements for corporate governance. Moreover, the EL 2005 highlights the business freedom and self-reliance rights that entrepreneurs can do businesses in any fields that are not prohibited by laws. These changes in market liberalisation has helped to encourage a new wave of investment and business establishment (as shown in figure ...).

### **Business registration procedures**

In terms of administrative procedures relating to business start-ups, the legal documents following the EL 2005 have been issued to materialise the efforts to create more favourable conditions for businesses. In 2007, three ministries of the Planning and Investment (MPI), the Public Security (MPS) and Finance (MOF) have jointly issued the 'Circular No 02/2007/TTLT on coordination mechanism to create the One-stop shop in processing the business registration by combining the the incorporation, tax and seal-making procedures. These moves have helped to shorten the time for businesses in registration, from 10 days to 05 days. In some provinces, the time to complete a profile may even be reduced to 3 days (PCI report 2009- VCCI). Then, the Joint Circular No 05/2008/TTLT of the MPI and MOF has regulated to use the incorporation code as the tax one. As the result of this administrative simplification, it is much easier to establish a single system of the business registration at national scale with a common identification for each firm, meanwhile state agencies can coordinate more effectively and less costly in business certification and supervision.

## **Business licenses**

Business licenses produced by poor-quality regulations have long spoilt the business environment in Vietnam, giving opportunities for corruption and increasing the business costs for enterprises, especially the private ones as most of them are small and medium firms. In 2000, the Prime Minister issued the Decision No 19/2000/ QD-TTg to abolish 84 unnecessary and illegitimate licenses upon the recommendations of the PM's Taskforce for EL implementation. In 2002, the Decree No 59/2002/ND-CP removed 04 types of business licensing requirements, and replaced 10 licenses by business conditions. However, there have rarely been additional efforts to cut more licenses of poor quality. According to the Review report of the Taskforce in 2008, there are more than 300 licenses regulated in about 450 normative legal documents. Until now, those licensing requirements that are not in line with Article 7 Enterprise Law have not been abolished or corrected. Business licenses are still one of the greatest problems in improvement of the business environment in Vietnam.

### **3.1.3. Economic management policies**

#### **Land-use and geographical planning policies**

The amended Land Law in 2003 had made a breakthrough in land-usage legal framework. According to that, land-use rights are officially recognised to be special goods that can be traded or exchanged in markets. Then, there are several important legal documents issued to form a rather complex system of regulation on land-use, for example the Decree No 181/2004/ND-CP on implementation of the Land Law, Decree No 188/2004/ND-CP on land-use price system, Decree No 17/2007/ND-CP and No 84/2007/ND-CP on amendment of the Decree No 181/2004/ND-CP. Later, the Law on real estate business was approved and issued in June, 2006 and specified by the Decree No 153/2007/ND-CP. They create the legal framework for the development of real estate markets.

In terms of geographical planning, the Decree No 92/2006/ND-CP on socio-economic development planning, and then adjusted by Decree No 04/2008/ND-CP, and the Law on urban planning 2009 have institutionalised the legal framework on geographical planning. Yet, this is still another big problem as unofficial licenses relating the enterprises' access to land-use.

#### **Taxation**

Corporate income tax: the Law on corporate income tax has been issued in 1997 and amended twice in 2003 and 2008. In general, there have been important changes

such as tax reduction and creating equal and favourable conditions for enterprises of all sectors. Moreover, the regulations of preferential schemes for tax relief that are found in many documents have been unified and regulated in the new law.

Value added tax: the Law on value added tax was issued in 2004, and also amended twice in 2005 and 2008. Since 2004, the businesses declare and pay taxes by themselves. These regulations have reduced costs for companies. Additionally, it helps supervise the business operation through bill keeping and repayment procedures. However, there are still reflections of discrimination in granting tax preferential schemes, especially for small companies of the private sector.

### **Credit policy**

Improvements in banking regulations have helped to develop the credit markets for the private sector. Commercial banks have freedom and self-reliance in decide their credit policies based on the market supply-demand, customers' financial status. And most recently, last month the State Bank has removed the ceiling requirement of the medium and long-term loan interests. Besides of that, different borrowing channels have been opened such as guarantee, depreciation and re-depreciation and payment guarantee. Moreover, a lot of preferential policies (without collateral) for small businesses in remote areas (Decree No 02/2002/ND-CP) or operating in aquaculture (Decision 103/2000/QD-TTg and Governmental resolution No 03/2000/ND-CP and Circular 03/2003/TT-NNNN). Since 2001, the Government early established credit guarantee funds for SMEs by the Decree No 90/2001/ND-CP on assistance for the SMEs development. Then, the fund's management has been adjusted several times with important reforms. However, the fund has been slowly extended to provinces. Administrative procedures are claimed to be costly, thus making it less attractive.

### **SMEs development promotion schemes**

Recognizing that SMEs account for over 95% of the businesses and most of the private firms in Vietnam have small and medium sizes, the Government has paid attention in promoting the growth of these objectives, started by the issuance of the Decree No 90/2001/ND-CP. As mentioned above, a credit guarantee funds for SMEs was established under Decision 193/2001/QD-TTg (amended twice in 2004 and 2006), and a Council for SMEs development promotion formed under the Decision No 12/2003/QD-TTg. In line with these moves, three centres for SMEs technical assistance have been created in Hanoi, HoChiMinh City and Danang by the Minister of Planning and Investment in 2003. During this time, several Directions have been made by the Prime Minister that puts forth and prepares policy direction for the

governmental agencies at lower and local level to develop SMEs development promotion schemes.

#### **3.1.4. Labour, employment and training policies**

##### **Social insurance**

The Law on social insurance was approved in 2006. There are several important contents such as the social insurance beneficiary entities are extended to all participants, the social insurance fund is increased, and better schemes for the employees. As a result, all working people are socially insured. Most recently, since 1 January, 2009, they are subjected to unemployment insurance. In general, the Law on social insurance has specific regulations on the conditions and beneficiary package of the employees based on the time of payment, age, labour capacity, job features and working conditions. Insurance schemes have been upgraded and specifically regulated than before.

##### **Training policies and enhancement of the labour force quality**

A Program for human resources training assistance has been funded by the Government under the Decision No 143/2004/QĐ-TTg. The Joint Circular No 65/TTLT of the Ministry of Finance and the Ministry for Labour, Invalid people and social issues has guided the funding for short-term training of the workforce in rural areas. Most of the assistance is in financial form, ranging from VND 300,000- 1,000,000/ a local employee who works in professional village or SMEs.

#### **3.1.5. Scientific and technological policies**

The Ministry for Science and Technology (MoST) is constructing the 'Program to assist the SMEs in improvement of the productivity and goods quality'. Its 'Program to develop the intellectual property of the enterprise's has been implemented under the Decision No 68/2005/QĐ-TTg with the objectives to enhance the awareness among businesses in intellectual properties protection; and assisting the Vietnamese firms in develop their intellectual properties rights in exporting markets.

In order to improve the enterprises' competitiveness, state agencies have provided the information services through business portals, prints and media. For example, the website of the Agency for SMEs development of the MPI has been created at [www.business.gov.vn](http://www.business.gov.vn) has given enterprises useful information such as updating legal regulations, start-ups advice, administrative procedures. Similarly, the database online website <http://sme.tcvn.gov.vn> of the MoST has also provided SMEs with

necessary information of the overseas markets, and related legal information about tax, intellectual properties, and technological transfer.

### 3.1.6. Good governance at local level

One of the most direct impacts posed upon business operation costs is the local governance; because any governmental policy has to arrive at and only been implemented at the lowest level, thus the effects of those policies are determined by the quality of the local authorities. Every year, the Vietnam Chamber of Commerce and Industry (VCCI) conducts a survey named Provincial Competitive Index (PCI) to ranking the quality of Good governance at provincial level. In 2009, they asked nearly 10,000 companies throughout the country.

**Table 3.1: PCI performance by national median scores (2006- 2009)**

Year	2006	2007	2008	2009
<b>PCI</b>	<b>52.41</b>	<b>55.56</b>	<b>53.17</b>	<b>58.31</b>
Market entry costs	7.4	7.9	8.3	8.4
Land access and security of tenure	6.0	6.3	6.7	6.5
Transparency	5.4	5.8	6.3	5.3
Time costs of regulatory compliance	4.4	6.2	5.4	6.5
Informal charges	6.3	6.6	6.7	6.0
Proactivity	4.8	5.0	5.6	4.9
Business support services	4.9	4.7	3.4	5.2
Labour policy	5.1	5.0	4.3	4.8
Legal institutions	3.6	4.3	4.7	5.5

*Source: PCI Vietnam 2009, VCCI*

According to the survey result, the national median score continues to increase, reflecting a trendy improvement of the provincial governance quality in recent years. As it can be seen, among 9 indicators, the *Market entry costs*, *Land access and security of tenure*, *Time costs of regulatory compliance*, *Business support services*, *Labour policy*, and *Credibility in legislative institutions* are those having clear upgradation; while the indicators of *Transparency and access to policy information*, *Informal costs*, and the *Proactivity of the local authority* are those showing a setback.

It is also exposed through the survey that the market entry has been significant eased after the One-stop shop model widely applied. The time for a registered business to wait on average reduced from 12.25 to 10.0 days. Similarly, the time costs of regulatory compliance are also shortened from 22% to 15% of the total time for management. 47% of the respondents said the regulatory compliance weight has

reduced in the last two years. Additionally, the credibility in legislative institutions are enhanced as the suits by private businesses at provincial courts raised from 65% to 72%.

On the other hand, the transparency indicator is worsening, with 62.26% of the respondents said that nepotism relationship is needed to have access to policy information. Only 8.4% are confident that they can forecast the implementation of the local authority. The local budget spending, land-usage, and infrastructure development plans are considered as the most difficult documents to access. More concerned, even though the proportion of respondents that they have usually pay informal charges reduces from 65% to 59%, there is upto 52% businessmen think that local officials take their own regulations for individual rent-seeking, and 53% said commissions is needed if they want to win any public biddings.

More than the bright and grey picture as mentioned, it can be sure that the room for local authorities to improve their governance quality is still large. The 58.31 median score for the whole country is closer to the lowest point of 45.43 than the highest of 75.95, which can still be performed better.

#### **3.1.7. Project 30 on administrative simplification**

As we can see through the PCI report, there is a positive change in the time cost of regulatory compliance in 2009. 44% of the respondents said that the local officials address their procedures more quickly. This improvement has certainly derived from the Project 30 on administrative simplification which started from 2008 and planed to cut at least 30% of the procedures and improve the quality of the rest by the Guillotine method. According to the results of the first phase - Inventory, there are 5,700 procedures, regulated in 9,500 legal documents. The Project 30 has involved all ministries and provincial authorities. By the end of 2009, they have completed the inventory and announcement of all procedures within their realms. As a result, businesses now can easily have online access the governmental regulations.

At the moment, the second phase of is on-going with a quick review of the 256 procedures chosen as priorities. Initial progresses have been recorded, such as the Ministry of Finance has reviewed 86 over its 145 prioritised procedures. It is estimated that by cutting 32 procedures among these mainly tax and customs procedures relating to 300,000 enterprises, the Ministry has saved 2,100 billion VND for businesses in time cost of regulatory compliance. Similarly, the Ministry for Resources and Environment has reviewed 26 with 28 prioritised procedures in which 4 were cut.

It can be said that the Project 30 is carried out in massive scope and scale with best-practices method. It is currently one of the hottest news in administrative reform and expected to bring about a critical change in the system.

#### **3.1.8. Infrastructure conditions and costs**

Besides of soft elements, i.e. governmental policies, in forming the business environment, the infrastructure conditions are also an important hard factor which directly poses costs and risks for businesses. Every year, a Japanese organization – Jetro conducts a survey upon Japanese affiliated firms in Vietnam on aspects of the business environment. Although this is an overseas survey of and for foreigners, its results can help us to draw the full picture of Vietnam investment climate, especially in comparison with regional countries.

In the most recent survey (2009-10), 67.2% of respondents complain about the complicated administrative procedures, 66.4% are worried of the weak infrastructure and 49.6% of the unclear policies. These are issues Vietnam ranked within the worst three nations in the region. However, the survey also recognised the improvements in the comparatively low costs of communications (telephone and internet connection), electricity and water supply fees. The rents for industrial land are also advantageous, except the rents for offices. Most importantly, the cost of seaport transportation to Yokohama has reduced significantly to regional level (i.e. about 13% cut from the 2005). However, the congestion at seaports is still a concerning problem.

In general, foreign investors still highly evaluate Vietnam's business environment for political stable, growth prospects, and cheap labour costs. On average the workers' salary in Vietnam is still lower at 30%- 60% in compare with Japan, China, Thailand, Indonesia. However, if Vietnam relies on this advantage for too long, we can only attract investment in labour- intensive areas. On the other hand, Vietnam meet great problems in the quality of labour at higher level. The Jetro survey also shows that Vietnam is worst in indicators of hiring local engineers, middle-level managers, appointing local workers in supervisory jobs, and retention.

### **3.2. INTERNAL FACTORS**

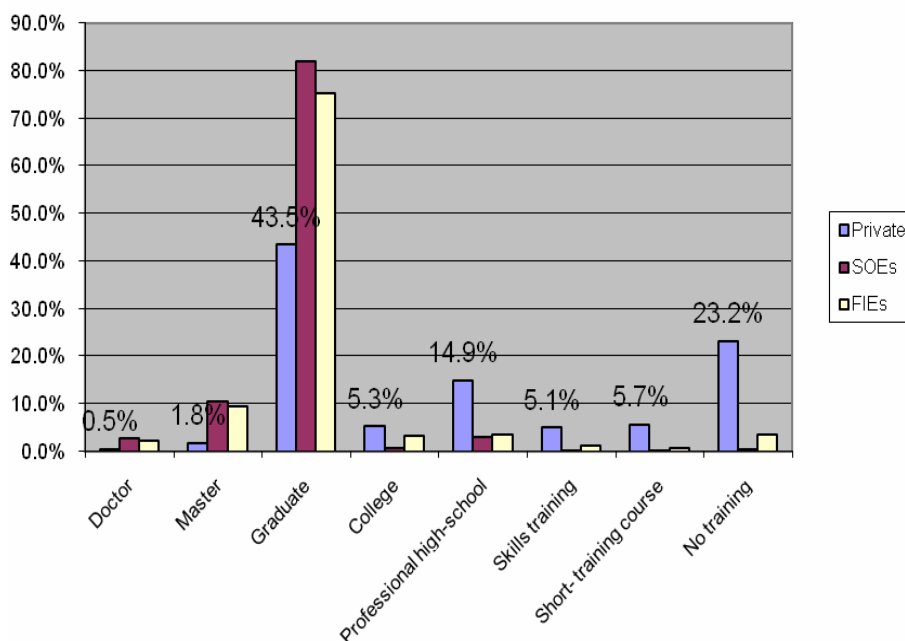
To employ the positive impacts and opportunities from the external factors, the private firms have to possess certain level of internal capacity. In other words, the more capable each firm is, the more they can survive and grow in the same business environment. However, it is admitted that these internal factors are not just of the entrepreneurs, but there is a large room for the governmental policies to maneuver.



### 3.2.1. Education of CEOs

The survey shows that private firms, on average, are led by leaders who are less educated than those working for SOEs or FIES. Moreover, the difference gap is not small. Just 45.8% of the private directors have graduate degrees. Most of the rest are trained at professional high-school (14.9%) or untrained at all (23.2%). Contrarily, most of the leaders in SOEs and FIES are all graduates, 95.1% and 87.3% respectively. Again, it shows that the private sectors mainly operate in fields of lower levels of knowledge-base than the SOEs and FIES.

**Figure 3.1: Educational and training levels of the firm's CEOs**



*Source: GSO Enterprise survey 2009*

### 3.2.2. Scientific technologies and ICT application

The survey's results on scientific and ICT (information and communications technologies) application criteria are consistent with the previous findings. It is clearly shown that private companies are lagged far behind than SOEs and FIES in modern technologies. While almost all of the SOEs and FIES (94.2%- 98.8%) are equipped with PCs and Internet connection, the comparative figures of the private firms are just 47% and 76.6% respectively. The number of companies having LAN in the private sector is just half of the two others (38.6% in compared to 75.8% and 77.1%).

**Table 3.2: Percentage of companies with ICT application**

Year	Having PCs			Having LAN			Having Internet		
	Private	SOEs	FIES	Private	SOEs	FIES	Private	SOEs	FIES
2007	<b>37.9%</b>	98.8%	99.4%	<b>36.6%</b>	70.7%	76.3%	<b>69.4%</b>	88.1%	95.4%
2008	<b>47.2%</b>	97.7%	98.8%	<b>38.6%</b>	77.1%	75.8%	<b>76.6%</b>	94.2%	96.5%
Year	Having website			Using E-commerce			Using management soft- wares		
	Private	SOEs	FIES	Private	SOEs	FIES	Private	SOEs	FIES
2007	<b>8.9%</b>	27.4%	22.5%	<b>1.5%</b>	4.8%	3.4%			
2008	<b>10.9%</b>	35.4%	28.1%	<b>1.7%</b>	5.5%	3.8%	<b>1.3%</b>	5.2%	7.4%

*Source: GSO Enterprise Survey 2009*

Similar trends are also found in website, e-commerce and management softwares application indicators. The percentages of equipped companies in the private sector is all equal to less than half of those in SOEs and FIES.

**Table 3.3: Having scientists, environmental standards and development funds**

Year	Employing scientists			Applying environmental protection standards			Having development funds		
	Private	SOEs	FIES	Private	Private	FIES	Private	SOEs	FIES
2007	<b>0.7%</b>	8.7%	2.3%	<b>5.1%</b>	19.4%	36.6%	<b>30.8%</b>	63.7%	61.5%
2008	<b>0.4%</b>	9.4%	3.1%	<b>5.6%</b>	24.2%	42.6%	<b>23.5%</b>	65.4%	65.1%

*Source: GSO Enterprise survey 2009*

The number of scientists working in private firms is much fewer than in other sectors as well. In 1000 private companies, there are on average only 4.0 scientists employed, while the respective numbers in SOEs is 94, and FIES 31. They are also much less concerned with environmental protection and R&D than the SOEs and FIES. It can be concluded that the private firms often invest less in knowledge-base areas and also less capable than the SOEs and FIES in terms of modern technology application.

In the broader picture, the investment for technological renovation of Vietnamese private firms has been very inadequate with the demands for competitiveness enhancement. Until now, only some large SOEs have R&D centres. Most of the private sector has used imported technologies without any strategical and long-term plan for R&D.

In one SMEs study in 30 provinces in the North, just 8% of 11,000 manufacturing enterprises here possess modern technologies (by self-assessment), those have medium-level technologies are 50%, and outdated are 42%. Moreover, the workers in private firms mostly are low skilled. Consequently, the products and services quality can not be high, making them less competitive in the domestic and international markets. Worriedly, the investment in technologies is not like to be improved. In that study, only 6% of the enterprises say they are in need of technological trainings. It shows the private enterprises in Vietnam do not evaluate the technological issue, while this is a determinant of competitiveness in the markets.

### **3.2.3. Strategic business vision**

With the economy's bottle-necks of infrastructure, human resources, technologies, Vietnam's private firms find it difficult to participate into regional and global value chains. They have just confined their operation in trading and services of low-valued level. The quantity of enterprises in manufacturing and high-valued products has been so limited.

In general, private firms mostly lack long-term investment plans and strategies. They are still in favour of short-term business opportunities and profits. Long-term interests are often compromised easily.

Yet, even the private companies of larger size have met difficulties in developing their long-term visions and strategies. Firstly, the core businesses of these large scale companies are mostly in labour- intensive areas which have gradually lost their profitability and competitive advantages for future markets. Secondly, most of the private enterprises do not have enough knowledge and technologies and brands for international competition. In most cases, they are often satisfied with exporting bi-products and processed assembling parts. Thirdly, business diversification is so expensive and highly risky that not many companies would want to enter.

In some cases, even when the private enterprises has achieved a certain level of capital accumulation, it is often re-invested in opportunist speculation such as securities or real estates, rather than specialisation in core business production to improve the efficiency and competitiveness.

### **3.2.4. Corporate governance and human resources quality**

In most cases, the corporate governance of the private firms is still in "family rule" model. It can be explained by the fact that many of the currently private companies have grown from the households. As long as they stay in small scope and scale, that

governance model is hardly to change. Indeed, transition costs are not small. Besides of that, they are not equipped with enough knowledge and skills for such as transition. Worriedly, this situation is kept even with some large companies, in which the presence of independent investors seems to be unnecessary. As a consequence, the number of private firms applying good standards of governance is very small. Those principles of transparency, information disclosure, and minority shareholders protection are even more unfamiliar.

The private sector's access to human resources training services funded by the State has been limited due to the budget for this program has been kept at very low level. Most of the private enterprises have not highly concentrated in building the human resources development strategy. This is partly due to the limitations not only in the businesspeople's awareness of the need for human resources training but also of their financial capability. As small companies are constrained by resources and have to struggle for existence, they perceive trainings as unnecessary or unrealistic task.

#### **3.2.5. Access to land**

The insufficiency of land for production and infrastructure conditions are frequently found in the private sector. Most of the enterprises have to use their owned houses to place their head offices. A small number of those having land has used it for their enterprises' production.

More than 53% of our private firms mainly operate in trading and services areas, and most of them have to use their own houses or rent small spaces for placing head offices or plants. The situation is shared by large firms as well. Many companies have to rent spaces of the state agencies and enterprises under high prices, but they can not invest in long-term since the legitimacy is weak.

The SMEs survey on 30 Northern provinces shows that 42% companies having difficulties in access to land and production sites. Although the Land Law 2003 introduced better mechanism and policies, and the access to land has been improved, there needs to be more efforts in studying to make adjustments and amendments to these regulations to create favourable conditions for the enterprises' production.

#### **3.2.6. Access to international markets**

The domestic market is limited in size and growth rate due to slowly rising incomes of the population. Moreover, the industrialization strategy creates fewer jobs, hence making the population incomes slowly improved. In addition, though the public sector

is a big household; yet the goods it has procured seems not be of the private sector. As a consequence, domestic market is not enough for the private sector to grow.

However, as turning into exports, the private companies also meet challenges of lacking information on the overseas markets, local traditions and customs, laws, and marketing network. They also find it difficult to have access to the exporting credit and credit insurance, despite that they have been implemented by the Government. Beside of that, in terms of trade promotion, the private firms are rarely invited to join the visiting delegations to foreign markets. Thus, they have few chances to introduce their exporting products in the international markets. Furthermore, lacking capable employees with knowledge of foreign trade experiences and foreign language skills are also among the greatest disadvantages of the private firms.

## SECTION IV

### CONCLUSION AND RECOMMENDATIONS

#### 4.1. MAJOR FINDINGS

The above data and analysis allow us to draw several major findings as follows:

**Firstly**, during the last ten years, the private sector has grown rapidly in terms of quantity both in terms of market entries and investment capital, making it increasingly become an engine for the national economic growth. In the context of the SOEs and FIES sectors have been declining due to equitisation or stagnant and fluctuating by global crisis, the strong growth of the private sector has been a major pillar supporting for a range of national indexes such as GDP growth rate, investment capital, state budget, industrial output, and employment to perform well.

**Secondly**, the private sector is also the biggest employer and job creator. If taking into account the formal sector alone, the private firms still employ upto 57% of the total employment of the business sector. Although they often invest in labour-intensive areas, combining with the cheap start-up costs of this sector, the growth of this sector is very important in such a young country (with 50% of the population are 25 years old) as Vietnam, and plays a strategic role in the poverty reduction and hunger alleviation task.

**Thirdly**, it should be noted that the formal sector is still a small part in the total private sector. The number of more than 350,000 operating companies is just equal to 8.7% of the nearly 4.0 million household businesses. In fact, many household businesses even have bigger sizes than micro-level companies. That is why the households still contribute upto 30.1% of the GDP, nearly triple of the private sector (10.8%). Therefore, corporatising the informal sector may be an important strategy to enhance the strength of the whole private sector.

**Fourthly**, the private sector has just been liberalised and grown strongly in the last ten years, thus most of them are young enterprises, even younger than FIES which had already been present in Vietnam since the 1990s, not to mention the SOEs with dozens of years of establishment. For quite a long time, the SOEs received the state generous credits and subsidies and other preferential conditions such as tax, land, technologies, licenses, monopolies, and trade promotion. Meanwhile, the FIES are actually arm-length branches of the global TNCs. In the context, the size of the private firms on average is quite small (from 3-10%) in compared with SOEs and FIES in

many aspects including assets, capital, sales revenue and employment. Moreover, they are also limited in capacity, reflected by the directors' educational levels, scientific and technological equipment and ICT application.

A majority of the private companies are SMEs. Only a few have grown big, but many of them are equitised from the SOEs. It is not to mention when Vietnamese firms are compared with international competitors, our average capital size is 9 times smaller than a company in the regional tiger- Taiwan. In terms of sales revenues, our companies are just ranked at micro-level in the UK, and in terms of asset, the whole business sector is just equal to a TNC in the US.

**Fifth**, in terms of labour productivity, the private sector is found to be the least among three business sectors, and it is likely unchanged in the short-term. This might be explained that the huge amount of workers employed has diluted the sector's figure. In fact, since most of the private firms do business in labour-intensive areas, the low productivity is more understandable.

However, in terms of asset and capital usage efficiency, the private sector performs better than SOEs and FIES. Yet, the statistics provide quite contradictory results in operating efficiency indexes. The private firms achieve poorer profitability than the SOEs and FIES. However, we are apparently skeptical over the profit-related figures as the tax evasion is widespread. The ROA, ROE, ROS results obtained by the statistics also seem to be unreliable because those of the private and SOEs sectors are all below bank saving interest rates, making investment decision unrealistic. We suppose that only the FIES declare their profit figures truthfully. Thus, the indexes of the SOEs and private sectors might be inaccurate.

**Sixthly**, the private firms mostly operate in labour- intensive areas, leaving the capital-intensive and knowledge-based areas for SOEs (the FIES are found in both). As the result, in terms of job creation and poverty reduction, the private sector might play a central role. But in terms of economic competitiveness, the private sector is surely less competitive than those in the SOEs and FIES. As mentioned earlier, it is because the private sector is not only much smaller in scope and scale, but also less advantageous in access to business efficiency and competitiveness foundations.

**Seventhly**, private enterprises are lagged behind from the SOEs and FIES in obtaining high-quality labour, the scientists, and application of modern technologies. It is more vulnerable in corporate governance, access to land, credit, technologies, and more costly and risky against administrative barriers, informal charges and poor

infrastructure conditions. Furthermore, these two weaknesses are linked with each other.

**Eighthly**, the role of the private sector has been highly evaluated by the Government, especially when it was looking for new engine for economic growth in recent years. Comprehensive package of policies, strategic plans have been designed and institutionalised particularly for the private sector development. However, these policy moves have been poorly implemented. As we observe, the private sector has so far only been benefited by improvements of business environment targeted for all business sectors in general. The unified Enterprise Law and Investment Law issued in 2005 are examples. In fact, Vietnam investment climate has been clearly improved in recent years. The legal system is developed, markets are liberalised, entry costs are reduced, local authorities' governance is better, and infrastructure costs are pulled down. Especially, the Project 30 on administrative simplification is, at the moment, a spotlight.

Nevertheless, there are still chronic issues. For external factors, the policy transparency is weak, legal documents are inconsistent, business licenses are poorly regulated, informal charges and corruption are widely reflected, and the quality of the labour force is at low level. For internal factors, corporate governance and investor protection are weak, connections and linkages among businesses are rarely found, and technologies and capital accumulation are not attained.

Above all, we are so concerned of the nepotism or cronyism issue. It is hard to have evidence to vindicate our findings due to its complication. However, there are always a lot of claims, though informally, over nepotism. Easy contracts, expensive lands, and rent-seeking opportunities are reserved for whom have relationship with officials or related people. In this matter, we understand that it is not only confined in between the authority officials and businesses, but also within the corporate practices itself. Insider trading, transactions of related parties, and corporate corruptions are all reported.

Surely, nepotism is harmful for the business environment as making the competitive playing field not level, unjust and unequal. It distorts the governmental policies and provides quick-money opportunities for some and denies the efforts of others. As long as the nepotism exists, the playing rules are rewritten that only through building special relationships with officials can the firms grow big, otherwise they stay at certain level forever. We think this is the very answer that helps explain the '*missing middle*' situation of the private sector in Vietnam.



## **4.2. POLICY RECOMMENDATION**

Based on the above analysis and findings, we would like to propose three groups of policy recommendations, including:

- (i) the business environment improvement policies to reduce the operation, transaction and opportunity costs for the private businesses;
- (ii) the efficiency and productivity enhancing policies to improve the private sector's competitive quality;
- (iii) the expansion supporting policies to help the private firms expand their market shares and better grow in scope and scale.

### **4.2.1. Continual improvement of the business environment**

#### **Social awareness and communications on the private sector development**

There are still a lot of differences between practical implementation and the political mottos over private sector development. There needs to have more propaganda on the role of the private sector in the country's economic development. Moreover, difficulties of the private sector should also be informed to policy-makers. These disseminating activities will pose social pressures on the governmental officers' mindset over the related issues.

The engagement of private firms in policy-making and consultation processes should be promoted as well. The private sector is the beneficiary subject of numerous policies and incentives. So, its participation in the policy-making process is very necessary. The Enterprise Law is one of the successful examples for this argument. Although, this process is to be prolonged, the quality of the policies and legal documents are to be ensured. In addition to a consultative source, the private sector also plays a supervisory role over the state agencies, making them to transform the 'ask-give' to 'service' working mind-set.

Anyway, the responsibilities of governmental officials need to be enhanced and clarified. They have to be in charge for the results and consequences of policies they made. Thus, inspection and audition are more frequently done.

Moreover, it should be aware that the efficiency and competitiveness of the private sector is not considered for competition with SOEs or FIES. In other words, they are not necessary to be competitors of private firms which are also hard to compete. On the contrary, the main issue is that the private sector's efficiency and productivity needs to be higher to enhance their competitiveness. The growth of scope and scale

in terms of finance or markets is also for better competitiveness. With greater productivity, the value added will be increased and the private sector can improve its share in GDP contribution. In regards to the SOEs and FIES, it might be very good if the private firms should could ways to connect, link or involve in their value chains or clusters to become supporting partners.

### **Legal framework**

The legal framework needs to be improved to provide a better and equal environment for private firms. The Enterprise Law (EL) and Investment Law (IL) ought to be specified and guided consistently. The quality of legal documents should be standardised by setting-up criteria. These will be used as foundations for legal drafting process, including handling the initiatives and consultation.

The regulatory impact assessment (RIA) is one of the international best practices that are highly recommended for application in Vietnam. In fact, it has been institutionalised in the Law on issuance of legal normative documents 2008. Yet, RIA has not been put in place fully except during the making process of the EL and IL. So, there needs to be a separate and independent institution overlooking RIA for all processes. The capacity building should be provided for Governmental agencies on policy analysis and policy-making.

Indeed, there have been changes during recent years to enhance the protection of investors and minority shareholders. Particularly, the EL raises the quantum needed for a approval of important decisions at shareholder meetings from 65% to 75% and for convention of a shareholder meeting to 65% for the first time calling. However, these positive adjustments have also caused difficulties for several public listed companies in their governance activities. For instance, such a diluted share- holding structure as SACOM company, recently could have not been able to hold its shareholder meeting since it is quite hard for them to convene enough shareholders as regulated by law as above mention.

Hence, there is a real need for a separate procedures requirements among large and small companies. While listed firms may need a more sophisticated governance mechanism with regulations which are its public characteristic, the smaller private ones need a much simpler procedures to keep their costs down.

Nevertheless, as we have observed, insider trading is one of the most headache problem in corporate governance in Vietnam at the moment. Rent seeking activities are widespread. The EL has regulations to limit these practices but compliance is low. So is it for the supervision of minority shareholders and the large investor community.

This has made the business environment in Vietnam unequal and left SMEs in vulnerable competition positions. In order to minimise the insider trading sphere, more detailed regulations need to be issued to tighten the control of and enhance the role of the Supervision Board, shareholders and the governmental agencies such as the State Securities Commission or Ministry of Finance. Information disclosure and transparency must be come vital contents in corporate chatter, especially of those are public listed. Regular auditing should become obligatory to all public companies.

### **Fighting against corruption and nepotism**

As previously discussed, corruption and nepotism should be considered as the number- one threats spoiling the business environment. Despite that the fight against corruption has been launched many times, the achieved outcomes are believed not enough. To fight against the corruption and nepotism epidemic effectively, there are several schemes as follows:

Firstly, nepotism issue should be put within top priorities in all agendas of legislation for business environment improvement.

Secondly, corruption cases must be strictly treated at high political determination to raise the awareness of the rule of law.

Thirdly, the public sector reform needs to put forth. Administrative simplification should be done and unnecessary business licenses cut. All governmental agencies and local authorities must apply the Transparency standards in their operation and addressing administrative procedures for businesses. Additionally, self-declaration of related parties should be obligatory for all officials.

Fourthly, within the business internal realm, the legal regulations of corporate governance must be subordinated to enhance the role of supervision board, independent audits and shareholders and employees. Corporate corruptions should be recognised. Insider tradings and negative transactions of related parties should be prevented by strictly application transparency and information disclosure principles.

It should be noted that corruption and nepotism is one of the leading problematic issues of the Korean and South east economies, which help initiate the Asia Financial crisis in 1997. Worriedly, nepotism used to be taken for granted by many as a cultural character of the Oriental societies. Yet, Korea has received the full prescription from the IMF including the Transparency pill to cure nepotism after the crisis, and they succeeded. Otherwise, South east economies are still stuck in the middle-income trap.

So, corruption and nepotism should be regarded as the leading issue in Vietnam business environment.

### **Taxation and procedures**

Since there are still several inadequacies in taxation regulations and implementation, the tax agencies should carry out some moves as follows:

During the tax policy-making processes, the stakeholders should be widely involved and consulted. To do this, there are two tasks being set. Firstly, right from the studying phase, the participation of the populations, especially the entrepreneurs must be highly evaluated. Only by that way the tax regulations become a kind of social agreement that makes both of the public servants and businesses respect and comply. Secondly, the tax agencies' services need to be improved by capacity building for their officials.

The present tax payment assignment scheme can be reconsidered to be abolished and replaced by an auto mechanism of tax registration in which firms can print their own bills, seals and self declaration and payment. Moreover, the Ministry of Finance should keep up with the roadmap of tax reform as designed in the PM's Decision No 201/2004/QĐ-TTg on December 6, 2004 for tax system reform program until 2010, including the following types of taxation:

- Valued – added tax: decreasing the good and service groups that are subject to tax relief or tax deduction which are linked within the value chain. The VAT rate should also be equalised while setting up the income level that is subject to VAT compliance. Additionally, the procedures need to be simplified as well.
- Corporate tax: while the rate can still be lower, it should also be equalised among businesses of all ownership types and sectors to create a level playing field for competition.

### **Access to Credit**

The weaknesses of the financial and banking sector in general has kept most of the private firms out of the credit services. So, improvement of the financial and banking sector should be placed as one of the top priorities. The following measures are to be recommended:

Firstly, international standards are applied to clarify the safety and healthiness of banking services; to improve the accounting criteria. Banking institutions and private

businesses should be audited annually by independent domestic or foreign auditors on international standards.

Secondly, the information technology network of Vietnam's banking system should be modernised, especially creating and connecting LAN for the whole system to enhance the efficiency and minimise the risks by collection of necessary information of customers during the decision-making processes for application of credit schemes.

Thirdly, the banking officials should be trained and re-trained for project- appraisal skills. Besides of that, appraisal criteria should also be set and customers be provided with project management consultation at banks to facilitate the private sector's access to credit.

Fourth, the commercial banks should consider to extend the payment methods without cash and other auto banking services which have not been applied at the moment.

Fifth, a system of collateral registration should be created and connected at nationwide scale to prevent negative activities in collateral practices.

Nevertheless, one of the most critical issues at present is the lack of capital for businesses, especially the private SMEs while there is a capital stagnant situation in some banks. To tackle this contradictory, both of the borrowers and lenders need to carry out the following moves:

- The usage of collateral by valued papers such as government and commercial bonds, saving books, stocks should be encouraged since they are highly flexible and convenient for both the borrowers and lenders with simple procedures. The banks must only assess the financial capability of the issuers while do not need to look at the one of the borrowers. More importantly, the liquidity of these assets are much higher than traditional ones.
- The Government needs to have proper policies to allow private firms to have more access to foreign capital sources. For example, the restriction on foreign ownership can be eased. This will help private firms mobilise the medium and long term capital for their investment projects.
- The financial lending markets should also be developed since it has not been equal to the potential needs. The financial lending is one of the basic investment schemes that can replace the banking credit. In fact, the businesses have used their own company as collateral for the borrowing. This allows the small companies which do not have large capital capability

and asset to carry on with business. In addition, the lenders will provide them with skills training and other assistance forms to bring the financial lending into full play. As a result, the asset will be used most efficiently.

- Legal framework should be developed to extend the appearance and operation of mutual funds and hedge funds which can be run either by private or state sectors.
- Until now, ODA have been reserved for SOEs only. Also, the government bonds and governmental guarantee commercial bonds are perceived for SOEs. There is increasingly question why the private firms are not subject to these cakes. According to the recent talk and speech on public press, the party management board is re-considering and supporting for open the ODA and bonds opportunities for firms of the private sector.

### **Access to Land and Infrastructure development policy**

The governmental direction in land policy is to promote the utility of land sources, improve the quality of planning and create favourable conditions for real estate markets growth to meet the demands of businesses.

- In the first place, land evaluation and compensation should be more practical to protect the governmental income whilst accepted by the population and businesses.
- Secondly, the policies to develop the real estate markets should be studied strategically. There should also be guidance on land usage as part of the financial mobilisation in infrastructure development.
- Thirdly, empty land must be completely withdrawn to keep all land highly in good use.
- Fourthly, the land usage renting and infrastructure leasing business should be separated in industrial zones, export processing zones, high-tech zones. As a result, the investment preferential schemes can only be applied.

### **Business- supporting services**

Thus it is necessary to improve the quality of and enhance the role of the business-supporting consultation market which has not been developed in Vietnam. The following measures should be done:

- To supplement and adjust the related legal framework to promote the growth of this market.

- To remove irrelevant regulations which limit the use of business-supporting services, for example those on the service fees or tax reduction for the service providers.
- To enhance the awareness of policies on business-supporting services through communications, educations, such as conference, trainings, or business associations' activities. The services should be considered by the private entrepreneurs as an indispensable part of the value chain creation rather than provided by themselves.
- The services providers should be assisted by the governmental agencies and other donors in terms of human resources, technologies and communications. A Decree on the management of the business-supporting consultation services development can be issued to create the cooperation mechanism for the State management on the business-supporting consultation market. It is necessary to solve one of the biggest challenging legal bottle-neck relating to establishment of the services providers which is still done separately among ownership sectors, causing unequal treatment.
- To develop a Strategy for the growth of the business-supporting consultation market. It needs to identify the objectives and growth rates of this market. Besides of that, it must initiate measures to develop the market effectively.
- It is also needed to note that export promotion scheme should not to violate the international commitments that Vietnam has joined. Consequently, the traditional export redeems and subsidies may be protested against by our partners as dumping methods. Thus, a policy framework of high quality that provide common backgrounds of favourable infrastructure for the whole exporting sector should be studied and developed.

#### **4.2.2. Enhancement of the private sector's efficiency and productivity**

##### **Technological promotion**

The policy framework for technology needs to be developed consistently with other socio-economic policies, especially the training which is closely related with human resources. To improve the technological transfer and transformation capabilities, we need to have upgraded level of business management and technological application of the scientists working for private firms in Vietnam. In other words, the technological

development must go along with the growth of the human resources to bring about sustainable improvement of competitiveness of the sector.

At present, several regulations of the Law on science and technology, Decree No 81 and No 188 and other legal normative documents have not been specified into ministerial- level circulars, hence deterring the implementation. Therefore, the relating ministries should speed up their drafting process to guide the above mentioned legal documents.

In addition to the human resources training for technological renovation and establish technological information network for all businesses, initiative contest and technological renovation competition or fair trades in large cities should be held especially for SMEs. The Government also needs to carry on communications and promulgation on legal information relating to technological policies, encouraging small firms to do technological transfers. To do that, one of the most essential conditions is to protect the intellectual and properties rights systematically, complying with international standards.

The Fund for science and technology development assistance should be implemented in practice. It should be partly spent on technological transfer projects to make them become reality. Moreover, the beneficiaries of the fund should open to businesses of all sectors. The State can also buy successful technological products which have large impacts on the whole economy to make them more popular use with cheaper prices. This can be applied especially in field of agriculture. The development bank may also help SMEs by providing them interest subsidies when they come to seek assistance in terms of technological acquisition. In addition to that, hedge funds are good choices to create chances for research and development with the engagement of technological institutions.

### **Human resources development**

The problem of the human resources is that we not only frequently lack skilled workers, but there are many cases that even the unskilled workers are lacked to meet the local demand.<sup>9</sup> Besides of current assistance programmes for human resources development, the Government need to have more touchy and flexible programmes which are customized for each labour market.

Firstly, the Government and each provincial authority should carry out specific survey over the demands of each market.

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<sup>9</sup> According to the representative of Binh Duong speaking at the PCI 2009 conference, Hanoi



Secondly, based on those surveys' results, training plans are to be developed, including land clearing for school establishment, calling for private sector participation.

Thirdly, the training schools must be in close linkage with employers since the beginning.

Fourthly, the Government should also provide free training courses for workers and population who have to change their professions due to restructualisation or land clearing, over-aged people, and the military men after service.

Fifthly, the basic salary level needs to be raised and made equal among sectors. In fact, the conditions and income of workers in IZ and EPZs are alarming. Many workers strike or quit their jobs. So, the local bureaus for social and labour affairs should pay more attention and supervision to protect the legitimate rights of the workers in their areas.

### **Clusters and linkages promotion**

Clustering is recommended by Michael Porter as one of the major competitiveness enhancer. He argues that clusters help create an effective value chain comprising of multi-sectors in which each of them is specialised to be efficient and competitive. Yet, clusters are rarely found in Vietnam. We have just observed the clustering model of FIES investing in EZ and EPZs. But, commercial villages in Vietnam indeed can be considered as a successful example of clusters. However, most of the participants in commercial villages are households so the linkages and governance within the clusters are not the one that Michael Porter advises. Therefore, we think that at least the clustering model should be studied more and tested in our country.

More obviously, we are convinced that the spillover effects of FIES are those that the private companies should take advantage. Nevertheless, in all cases discussed hereby the proactive role of the local authorities and business association is important. They must develop policies and programmes to encourage the private firms to have more linkages and form clusters if it brings about greater efficiency and competitiveness. Also, in attracting the FIES and IZ and EPZ planning, the provincial authorities should study to locate them in such places that can give the most spillover effects to the local enterprises.

### **4.2.3. Expansion supporting policies**

#### **Internal capacity building: strategy, quality control and branding**

The businesses should also develop their own business strategy with long-term vision. In modern markets, quality and branding are two greatest determinants. So, our private firms should invest more in R&D and technological transfers to renovate the products's design and quality. In order to have better brands, they must be awareness the branding since the beginning and protect it by a system of tight quality- control. In order to have good technologies, companies can connect with other bigger partners in the same value chain or link with research institutions and participate in application programmes.

### **Trade promotion**

It is the responsibility of the government to develop and involve the participation of private sector in trade promotion schemes, especially for international markets. However, in today globalised world with modern ICT means, the private firms can be active in looking for overseas market opportunities. There are many channels that they can go directly, such as international trade fairs, exhibitions, auctions, websites, forums, associations. In fact, the international markets are very near. At the moment, many Vietnamese companies are investing in Laos and Cambodia and become largest producers or services suppliers there. Hoang Anh Gia Lai Group and Viettel Mobile are two of these examples.

Moreover, when going out to international markets, our private firms should study not only the local rules and laws, but also the international laws. In many cases, the legal knowledge preparation is so important for them to avoid such cases and anti-dumping appeals from the local competitors, or even they have to protect themselves in courts.

### **M&As enabling environment**

One of the reasons why the private sector in Vietnam can not grow big is capital accumulation. To overcome this weakness, mergers and acquisitions (M&A) is a good channel. There are several ways for a firm to grow up in size: endogenously and exogenously. The first is to expand the market share, increase volumes and revenues; and the incomes will be re-invest to hire more workers and build new plants. But this way takes time and the company may lose business opportunity and in a competitive market, it can be others knock-off before it grows enough. So, the second way may provide a better choice. The company can earn growth and strength from the outside partners, or even from the competitors by taking M&A with them. Win-win solution is reached and surely capital accumulation achieved in a much shorter term. It is worth to note that the high- growth period of the US. economy in early twenty century was characterised by strong wave of M&A transactions. The capital accumulation through

M&A allowed companies to become TNCs with investment diversification and economies of scale.

In case of Vietnam, however, in order to carry out effective M&A, the private firms are necessary to equip for themselves knowledge of business and financial management. More than that, the financial markets must be developed to fund M&A plans of the companies; and legal framework should be improved to create legal lanes for transactions. At the moment, M&A activities have been already regulated by Enterprise Law, Investment Law, Competition Law, and other special laws. However, the regulations over ownership levels and related procedures, especially for those of foreign investors are still inconsistent among documents. Thus, the Government should amend the legal framework on M&A how to create the most favourable conditions for our private firms to take M&A as a means to expand in scope and scale more rapidly.

**In conclusion**, it can be said that the private sector in Vietnam has grown in quantity but not in quality in the last ten years. As a consequent, the competitiveness of private firms is still so limited in comparsion with other companies in the SOEs and FIES sectors, not to mention with the international competitors. Actually, the picture of the whole business sector is resembled with the urban landscape of Hanoi or HCMC where a mass of small houses crumbling around a few skyscrapers. It is because a majority of the private enterprises are very young in establishment and operation; hence they apparently lack of managerial experience and capital accumulation. Moreover, they are less advantageous than SOEs and FIES in capital formulation, access to credit, land and technologies. Meanwhile, the governmental policies to support the sector have been ineffectively implemented. Thus, the growth of the private sector is heavily depended on the improvement process of the business environment in Vietnam.

To enhance the efficiency and competitiveness of the private firms, we want to stress in several new issues (besides of the frequently mentioned policy proposals in mass media and other studies), such as the (i) nepotism, (ii) linkages, and (iii) M&A.

Firstly, the corruption and nepotism epidemics should be placed as priorities in improvement of the business environment. Legal framework should be improved to enhance the transparency of the public sector (both at governmental and provincial levels), the administrative procedures, and the corporate governance as well. There should be tighter regulations requiring the information disclosure of transactions of

related parties and the roles of the BOD, SB, shareholders and workers in supervision must be more valued in company charters.

Secondly, companies should expand their connection and linkages to participate with others in the value chain or clusters in order to approach better opportunities of technological transfer and specialisation.

Thirdly, private firms should enhance their managerial knowledge and skills to employ the opportunities of M&A which can be an effective tool helping the companies to rapidly achieve greater capital accumulation and market share. It is necessary to note that the role of the Government is so important in creating favourable legal framework and policies to enable these schemes to be done effectively.

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