

Industrial Development Planning by Local Government: Cluster-Based Development Approach Policy Seminar

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1. Overview of Economy and SMEs

1.1 Macroeconomic Environment

Population, GDP. Vietnam is a big country in term of the population, which is 83,12 million as of 1 July 2005. The total GDP in 2005 is about US\$ 225.5 billion at an average growth rate of 8.4 % per year. The GDP per capita is US\$ 620. The structure of GDP consists of agriculture 20, 9% at an annual growth rate of 4%, industry sector 41% and service sector 38, 1%. Due to the policy of shifting to industrialization, the contribution value of the industry increased rapidly from 22.7% in 1991 to 36.6% in 2000 and reached 41.1% in 2005, in response, that of agriculture decreased from 38.7% to 24.3% and remained at 19% in 2005.

Macro-economic policy. The public expenditures in 2005 was about 24.9 billion US\$ and accounted for 11,% of GDP. The exchange rate between the VND and US Dollar has been gradually stabilized around 16.000 VND per one US Dollar. The average rate of inflation was 3.1% in 2004, 9.5% in 2005 and 8.3% in 2006.

Major industry. Industry contributed annual 40% to GDP, 70% to export performance of the country. From 2000 to 2005, industry continued to remain at two-digit growth level, which ensured the GDP growth of the whole country. In 2005 Industrial output value was 416,863 billion dongs (at constant 1994 price). Together with export and tourism, industry is considered an impressive growth sector of the country in 2005. During the period of 1996-2000 the growth rate of the average industrial output value reached 13.57% and 2001-2005 reached 15.7%. The Industrial output value consists of mining industry 10.3 %, processing industry 82% and Electricity, gas and water 7.7%. In 2005, there was estimated over 20,000 industrial enterprises in whole country, nearly doubled compared to the year 2000. They concentrated on agricultural, forest, aquatic product processing industry (39.2% of total), textile and footwear (12.7% of total). In main industries, the number of mechanical enterprises always accounted for approximately 58-59%, chemical industry and its product made up 33.1%. The processing industry (food and beverages, tobaccos, textiles, garments, leather, wood and bamboo, papers, coke coal and refined petroleum products, chemicals, rubber, building materials, metal, other machinery and equipment, electronic products, health equipment, motor vehicles, transport equipment, furniture, recycling) had the largest number of enterprises, accounting for 89.41% of the total industrial enterprises, in which enterprises with the size of 10-200 employees made up the highest rate. Mining industry (coal, crude oil and natural gas, metal ores, stone and other mining) made up 5.44%, in which enterprises with the size of 10-200 labours are majority. In Electricity, gas and water supply industry, the number of enterprises accounted for only 1.34% of the total industrial enterprises with small size of employees. The total number of industrial labour force was 5.6 million people and the annual average growth rate was 11.2% during the period 2001-2005. Garment and textile, footwear used the largest number of labours (38.1% of the country), processing industry made up 25.0%. Four main industries accounted for 18.8%, followed by construction material and mining industry, the lowest was electricity, gas and water supply industry which accounted for 3,21%.

Industry policy. The policy of double transformation from a central bureaucracy and subsidy mechanism to a socialist-oriented market mechanism and from agriculture to industry has laid great impact on the industry. The main of industrial policies is to orientate manufacture toward

the market, gradually increase the share of industries, especially value added ones, speed up export, increase accumulation as well as tackle with social problems.

By June 2005, Vietnam has had 122 IPs and EPZs with over 3,108 investment projects. The equitization of state enterprises has been stepped up rapidly in recent years. Many important enterprises in such fields as electricity, coal, and oil & gas previously dominated by the state are now also on the equitization process. In the whole country, the proportion of value produced by the state enterprises sector decreased from 50% in 1995 to 41.8% in 2000 and then remained at 35% in 2005. On the contrary, that of the non-state enterprises sector increased from 22.3% in 2000 to 29.5 % in 2005.

After the introduction of Foreign Investment Law, the amount of FDI capital has increased rapidly. The industry, thereby, have been improved by acquiring advanced technology, management skills and practices in some industrial joint venture companies, especially ones operating in the fields of oil & gas, chemical, cement, electronics, telecommunication and automobile-motorbike. The foreign-invested sector has played an increasingly important role in industrial structure and continued to become the core in Vietnam's policy for industrial development. The year 2005 was marked by the ratification of amended Investment Law, in which it continues to lay focus on one-door mechanism and creates more open and transparent environment for domestic and foreign investment.

Comparative advantage industry. Like many other nations in the early stage of industrialization process, Vietnam has comparative advantages in such typical fields of intensive-labor industries, but Vietnam seems to have advantage on skilled labor. Review of SWOT analysis on Industry of Vietnam is as bellow:

<p style="text-align: center;">Strengthen (S)</p> <ul style="list-style-type: none"> - Stable politic and society - Active administration reform - Strong science and technology research and development capabilities - Young and abundant population - Intensive skilled-labor - Good potential on several precious raw materials - High domestic demand - High position of some exports commodities in the world 	<p style="text-align: center;">Weakness (W)</p> <ul style="list-style-type: none"> - Poor supporting industries - Near 100% raw materials in most of export sectors - Low added value - Lack of Vietnamese label and brand name - High transaction costs - Obsolete technology and instruments - Poor management skills - Effectless links among region and sectors - Heavy concentrated economic mechanism
<p style="text-align: center;">Opportunity (O)</p> <ul style="list-style-type: none"> - WTO accession - Geographical position in region - Access to US market - Small scale of production accords with small contracts skilfull commodities (niche market) for some industries such as garment, footwear. 	<p style="text-align: center;">Threaten (T)</p> <ul style="list-style-type: none"> - Higher competition to exports industrial products - Sharp competitor of China with very low production costs - Heavier trade barrier of all countries - Tougher competition in the domestic market

Major export and import goods and partners

During the 2001-2005 periods, industrial products and handicraft products reached the highest growth rate of 20% per year, accounting for 38.6% of the whole country's total export turnover. The proportion of these products have increased rapidly over the years, many of which have achieved high export turnover such as garment & textile, footwear, wood products, electronics products and computer components. The share of these products increased from 33.9% in 2001, to 33.9% in 2005 with their turnover of over US\$ 12.3 billion. These products are now considered to have the highest growth rate as well as the most potential for growth in the forthcoming years. However, in general, the effect of export is still low and its growth is unsustainable due to unreasonable export structure. Vietnam mainly exports raw products or processed ones of low added value and technology content. The rate of trade deficit continued to increase from 7.6% in 2001 to 18.2% in 2002 and to 25% in 2003, but in 2004, it decreased slightly to 20.6% and to 17.7% in 2005.

Vietnam's industrial products have been exported to many markets. Beside traditions markets as Japan, EU, since 2002 Vietnam has penetrated into American market. However, Vietnam's export is now coping with fierce competition from other nations in the region, especially China because of similar import structure and market. Some products manufactured for home consumption (import-substituted products) are still at high price, of uncompetitive quality and unable to compete with imported products, thus still need the State's protection.

1.2 Status of Small and Medium Enterprises (SMEs) in Vietnam

A. Current status of SMEs

Definition of SMEs. Decree 90/2001/ND-CP dated November 23, 2001 on supporting the development of SME, "SMEs are those independent business and production establishments that have registered under the current legislation and have registered capital of less than VND 10 billion and/or have an annual average number of permanent employees of less than 300".

Micro enterprises:	< 10 persons,
Small enterprises:	10 to 49 persons,
Medium sized enterprises:	50 to 299 persons
Large enterprises:	≥ 300 persons

The following tentative size grouping based on number of employees/persons engaged would be used in some statistics that describe the situation of SMEs in Vietnam:

Vietnam, 2002	SME				LSE	Total
Establishments	Micro	Small	Medium	Sub-Total		
Number of business establishments (1,000)	2,660	46.7	11	2,718	2.5	2,720
Percentage of all establishments (%)	97.8	1.7	0.4	99.9	0.09	100
Employment						
Employment (1,000)	4,375	887	1,221	6,483	1,909	8,392
Percentage of persons engaged (%)	52.1	10.5	14.5	77.3	22.7	100
Average Size of Establishments						
Persons engaged per establishment	1.6	19	112	2.4	773	3

Source: GSO Establishments Census, 2002, classified as per tentative size groupings.

Development of SMEs in Vietnam.

Since 2002 to the end of 2004, there were about 121,000 newly registered enterprises, most of which were SMEs. To date, the number of non-state enterprises has increased to 170,000, not to mention over 2.6 million economic households and about 18,000 co-operatives. The total newly registered capital from 2000 to 2004 is 7.9 times that in 9 previous years (1991-1999) increased to VND 213,039 trillion. The investment ratio of private enterprises (which were mostly SMEs) in the total social investment has increased from 20% in 2000 to 23% in 2001; 25% in 2002; over 27% in 2003. The investment capital of domestic private enterprises has exceeded foreign direct investment capital. Unlike foreign direct investment (FDI), which was mainly focused on lucrative places in some provinces and cities, SME investment was made in all areas, provinces and cities with different conditions.

Contribution of SMEs to the national budget also tended to increase in the recent years, from about 6.4% in 2001 to over 7.4% in 2002 (that of FDI enterprises and SOEs were 5.2% and 21.6% in 2001 and 6% and 23.4% in 2002, respectively). SMEs have been active and dynamic in almost all sectors. However, the largest number of SMEs was active in distributing goods to consumers through wholesale and retail trade. Leading SME sub-sectors that follow, in number of establishments, are manufacturing, hotels and restaurants and transport, storage and communications. By 31st October 2004, the number of exporting and importing SMEs accounted for 80.6% and 84.2% respectively out of the total number of enterprises participating in import-export activities in Vietnam¹.

During the past time, despite some of the achievements thanks to the encouraging policies of the Party and the State, SME development efforts and tasks, and SMEs remained weak in some aspects, specifically:

Most SMEs do not realize the great impact of globalization, the international and regional integration process on the domestic economy, on the commercial and manufacturing activities of enterprises, including those producing goods for exports and domestic consumers². In

¹ Source: Ministry of Trade.

² "Internationalization of Vietnamese SMEs" by Ari Kokko and Fredrik Sjöholm, June 2004.

reality, the integration process requires the economies in general and enterprises in particular to be deeply aware of its level of influence, and to continuously strive to improve competitiveness to exist and develop.

Most SMEs are of a small scale, have limited capital, a small number of employees, operate dispersedly, and do not have enough skills to compete effectively in increasingly liberal markets because of lack information on input markets, limitation in market access, weaknesses in equipment, science and technology capacity. As a result, the goods and services provided by SMEs are often of poor quality and of low competitiveness, and face difficulties in domestic and export markets, and at the same time cause damages to the environment and the eco-system. Investment in technology innovation of SME is at a low level compared with the development demand. While there is not concrete evidence, there seems to be hardly any research and development activities (R&D) among SME sectors.

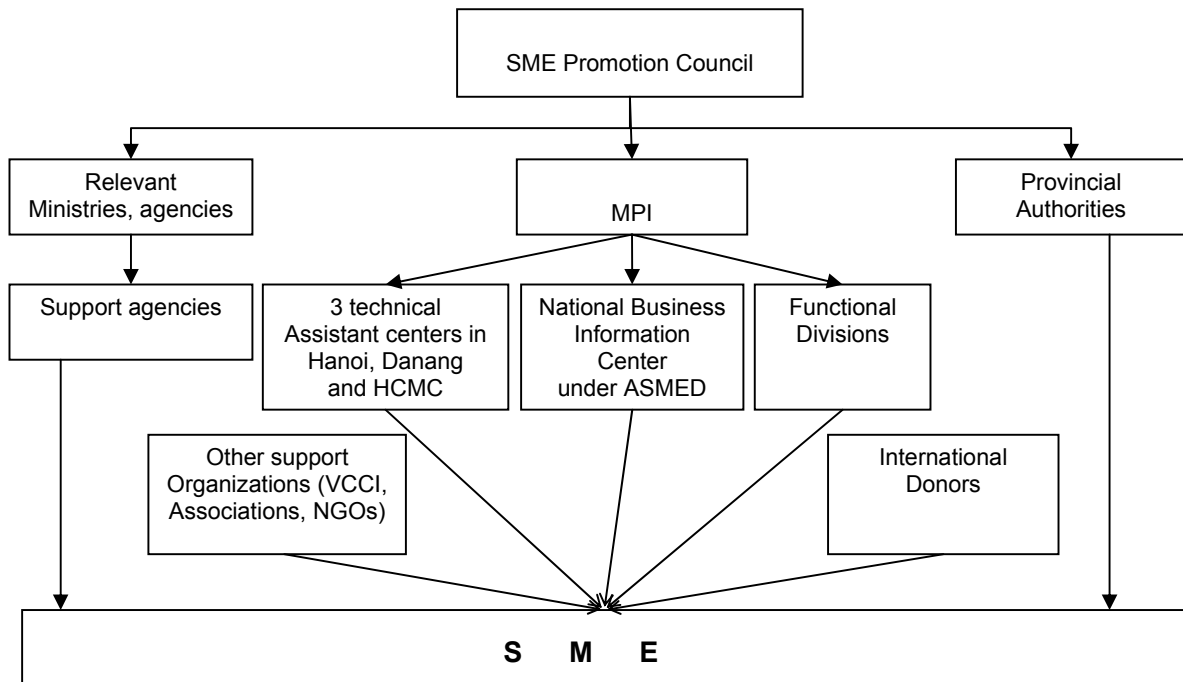
Furthermore, unreasonable protective policies, unlevelled business environment between economic sectors, the subsidization and privilege mechanism for some enterprises, the instability in legal regulations lead to the fact that many Vietnamese enterprises tend to try to obtain privileges from policies to gain short-term benefits rather than building long-term business strategies.

There are a lot of constraints in relation to linkages between business and production units along sector lines and within regional economic agglomerations. There is lack of sufficient cooperation between large-scale enterprises and SMEs, leading to the limitations in business quality and efficiency and competitiveness of both SMEs and large-scale enterprises, and in an inability to make use of economies of scale for both of these sectors.

Internal management of SMEs is often underdeveloped, unprofessional and weak, and mainly based on the limited, personal experiences of the owner(s). There is usually no clear distinction between the possessions of the enterprise and those of the owner of the enterprise. The owner of the enterprise is also the manager of the enterprise. There is usually not a clear legal distinction between the rights and duties of owners, employers and employees. Most enterprises lack strategies and long-term business plans, and try to operate with untrained professional staffs.

Financial management in SME usually lack of transparency. The reported data do not reflect the real financial conditions of enterprises and is not reliable. Some enterprises are confused with tax registration, tax enumeration, tax paying and other financial duties. Some financial representations are dishonest or late. Underreporting of financial results and perceptions of non-transparency prevent a large number of SMEs from getting loans from banks, especially unsecured loans available through policy lending instruments.

B. SME policy and institution



Structure of the institutional SME support infrastructure

2. Business Environment of SMEs

2.1 Legal and Regulatory System

During the past 5 years, the State has promulgated a great number of legal documents on enterprises in comparison with the previous planning periods. The legal framework has gradually been improved, creating positive changes in enterprise development. These legal documents have created the legal framework for operation of different types of enterprises, including SMEs, and made favorable conditions for enterprises to develop. However, there are remaining problems in the legal frameworks regulating enterprise development, for instance, the SME development regulations and policies of the State are fall short of resolving many bottlenecks; many administrative procedures fail to be reformed to meet the requirements of enterprise development; the procedures tend to be too administrative-based without proper adjustment to market mechanisms; the outcomes are limited, because quality, effectiveness and international integration capability are not properly paid attention to.

Regulations on conditional business lines. The legal normative documents relating to the authority, procedures and conditions of business registration and licensing for conditional business lines are promulgated by different state management agencies in the form of various legal documents, which are very complicated and not integrated in a systematic manner. These cause difficulties in monitoring and updating legal normative documents. On the other hand, the promulgated documents are insufficient, inconsistent and even contradictory to others. For example, there is no regulations stipulating conditional business lines like job intermediation, debt recovering services, marriage consultancy services, etc; there is lack of guidelines in some business lines subject to licenses such as legal consultancy, transport vehicle designing

service; there exist contradictions among regulations on conditions, orders and procedures of new issuance, amendment, supplementation and withdrawal of licenses in the electricity sector; regulations on industrial explosives licensing, on business conditions for asset evaluating services, etc. According to business community reports, there are over 300 sub-licenses that prevent investors from entering markets. There are contradictions between Decree No 125/2004/ND-CP and the Enterprise Law on capital contribution of foreign investors in limited liabilities companies, joint stock companies; between the Commercial Law, Decree No 54/2000/ND-CP and the Enterprise Law on the name of the enterprise, etc.

On the other hand, according to Enterprise Law, the conditional business lines and the conditions thereof are prescribed in Laws, Ordinances and Decrees, but in fact, the concrete conditions are usually stipulated in Circulars and Decisions promulgated by Ministries, People's Committees that result in regulations on conditions, procedures and timeframe of license issuance that are not clear and transparent, cause obstacles to state management as well as to those who have the intention to or are already operating in such fields.

Business registration implementation. In many provinces nationwide and for most business lines, business registration offices have complied with the regulations on business registration without any additional requirements for documents and procedures other than those stipulated in Enterprise Law. The response time of business registration in reality has been reduced (in most provinces, the response time for business registration is reduced to 10 days in comparison with the 15 days statutory limit); on-line exchange of business registration information has been implemented on a pilot basis in some provinces.

The procedures and costs of market entry. The procedures and costs of market entry (including money and time costs) are still high. According to current regulations, in the simplest case, in order to complete the market entry procedures, enterprises have to carry out at least 4 steps in 3 different offices (including business registration, seal making, tax code registration and financial invoice purchase). And in order to complete the above steps, on average, one has to spend nearly 50 days and incur an expense of about 2 million VND (and this expense will be much higher when contracting a service enterprise for registration and for handling other procedures). In addition, the main business registration contents must be publicized in the press on 3 consecutive days with the expense of 600,000 – 700,000 VND depending on the province and the type of newspaper. So the total cost for market entry for the best case in Vietnam is not lower than VND 3 million (excluding business registration tax), which is equivalent to 49% of the annual per capita income. In general, the market entry expenses are high, with a tendency to increase further. This situation has affected the business environment in Vietnam adversely in recent periods.

Competition legislation. The 2004 Competition Law has created a legal basis for regulating competition activities in the market to assure equal and healthy competition in the activities of enterprises in different economic sectors and in different kinds of enterprises. However, so far there have been no implementing guidelines for this law to come into life.

Bankruptcy legislation. The 2004 Bankruptcy Law has solved some problems and limitations of the 1993 Enterprise Bankruptcy Law, such as simplifying the concept of the bankruptcy conditions to facilitate bankruptcy proceedings; enlarging the scope of the subjects entitled to submit requests for starting bankrupt procedures; regulating many different kinds of applicable

procedures for debtors in bankruptcy. However, the 2004 Bankruptcy Law still have some limitations which need further research to improve, viz. business households and individuals are not eligible to declare bankruptcy; secured creditors are not entitled to file petitions to start bankruptcy proceedings; the State has over-intervened in the bankruptcy solving procedures; there are no regulations about the mechanism for debtors to recover when they are in financial difficulties unless bankruptcy proceedings are underway; the regulations about the responsibility to continue settling debts indefinitely, even after selling all existing operating and own assets are considered too strict.

2.2 Business Development Services

The study of GTZ and Swisscontact in Vietnam in 2002 had identified the BDS market in general:

Most private enterprises (93%) have tried purchasing business services at least once. There are some transactions in all of services market studies, private sectors suppliers, state owned companies and government agencies are active in all markets to varying to degrees. The services most used are internet information, advertising and promotion, legal services, computer related services, accounting and auditing,

Trade fair related services... The overall of market size in the study is about 30 million USD. It is importance to note that SMEs are still small part of the overall BDS market. Over 90% of SMEs spending on BDS are from Hanoi and Hochiminh city.

The outlook for growth of BDS market in Vietnam is positive. Over the last years the number of customers using BDS grew yearly about 7% on average and 10% for those markets with highest usage. The market in provinces is weaker than those in big cities, even in Dong Nai, Binh Duong, or Da Nang. There is a lack of supply of some services in this area.

2.3 SME Financing

The financing sector in Viet Nam has experienced substantial improvements and increasingly become more professional to meet the requirements of economic transition and growing demand for credit from enterprises, including the private sector. The restructuring of state commercial banks, the development of joint stock banks and operation of foreign bank branches in Viet Nam have, step by step, directed the banking sector towards the market mechanism in order to better meet the demand of customers. However, some credit policies have not been studied to make the necessary amendments and supplementation aiming at further mobilization of capital for the requirements of the economy.

Although the Government gives priority to some SMEs to get loans from credit institutions without collateral (Resolution No. 02/2003/NQ-CP regulate that the credit institutions are allowed to lend up to VND 30 million to farm owners; to VND 50 million to enterprises operating in fishery seeding production and trading; to VND 100 million to co-operatives providing services of material, trees, breeding animal supply for agricultural, afforestation and fishery production; to VND 500 millions for cooperatives producing exporting goods, specialized in traditional sectors), the implementation of regulations on lending guarantee mechanisms for other entities face difficulties and obstacles. These are delays in land use right certificate issuance, which limits enterprise's capability in mortgage and collateral based lending; the asset evaluating system is under-developed and not based on market principles;

the secured transaction registration procedures are cumbersome as mentioned in section (i) of this document.

In addition to traditional lending, State Bank of Vietnam has promulgated regulations on other credit provision such as guarantees, financial leasing, export documents purchase/discount, commercial note discounts and rediscount, factoring, etc., opening up diversified financial instruments. Furthermore, the Government has initially promulgated legal policy specialized for establishment and operation of financial companies, financial leasing companies with strategic targets of providing medium and long term financing opportunities for customers, mainly SMEs (Decree No. 16/2001/ND-CP). Although there are 8 financial leasing companies (5 of which are under state commercial banks), the preferential policy for this industry has not been issued and the financial leasing companies themselves fail to mobilize long-term capital for their operations. The operation of financial leasing companies, therefore, remains at small scale.

Under developed venture investment and stock market has constrained capital mobilizing channels of SMEs. While some foreign venture capital funds have started investing in Viet Nam since early 1990s in some FDI companies, there is no legal framework on this. Under the Decree No. 99/2003/ND-CP of 28 August 2003 on regulation on high tech industrial parks, the Government has instructed to establish Venture Capital Fund to invest in high-tech sectors, the implementing guidelines has not been issued. Furthermore, underdeveloped stock market is also among the factors that cause impact on development of venture capital funds and limit the capability of capital mobilization for SMEs.

Regarding the Credit Guarantee Funds (CGF) for SME (as stipulated in Decree 90/2001/ND-CP): Since late 2001, Prime Minister, Ministry of Finance, State Bank of Vietnam promulgated implementing guidelines for the establishment, organization and operation of CGF, but so far, according to local reports, CGF are only present in two localities (Tay Ninh and Tra Vinh). The delayed establishment and development of CGF was reportedly due to shortcomings in policies such as the unclear regulations on legal capital contribution, the imposition of fixed guarantee fees, the regulations on collaterals, etc.

Micro-finance institutions. Government promulgated Decree No 28/2005/ND-CP dated 9th March 2005 on the organization and operation of microfinance institutions in Vietnam in order to facilitate households and low-income individuals, particularly poor-income ones, to have better access to some microfinance and micro-banking service.

3. Industrial Cluster

In the viewpoint of Industrial Cluster as the meaning of the agglomeration, there are not any studies about in Vietnam. However such different kinds of clusters in sub-industries do exist spontaneously in long time in Vietnam: handicrafts, textile and garment, food processing, furniture, handicraft... Most of those clusters locate in provinces: Ha Tay (textile and garment, food processing), Binh Dinh (Furniture), Binh Duong, Bat Trang (ceramic), and the latest one is cluster on home appliance in Hochiminh/Dong Nai/Binh Duong. Most of participants to clusters are small enterprises and households.

The relation and cooperation between SMEs is basically a spontaneous and market driven

mechanism. In general, there are still very few linkages between BDS suppliers, universities, research and support institutes, large sized SOEs, FDI with SMEs of those industrial clusters; Several ministries and agencies have instructed their affiliated large sized enterprises to establish linkages in research, technology transfer and business links. However, these instructions are just commands and are imposed without incentives to encourage such linkages.

The current general regulations about signing and implementing contracts are mainly stipulated in 3 legal documents: the 1995 Civil Code, the 1997 Commercial Law and the 1989 Economic Contract Ordinance. This situation has led to contradictions and overlapping (in terms of contract forms, responsibilities arising from breach of contracts, etc), and has caused many difficulties in application. The Civil Code is the principal code used for general regulation, and uses the concept of civil contracts, which has led to the concept that civil contracts and economic contracts are of two different kinds and under the regulation of two different legal documents, namely the Civil Code and the Economic Contract Ordinance. The Commercial Law also has provisions about contracts in commercial activities, but the role of commercial activities in the contract system is not well defined and there has been a lot of controversy about the relationship between commercial, civil and economic contracts.

In sub-sector of electronics and home appliances, the Ministry of Industry is trying to develop business linkages between contractors (FDI assemblers) and sub-contractors (are mainly the local SMEs).