

Developing Small and Medium-Scale Enterprises in Vietnam

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At the request of the Vietnamese government, NRI last year devised a set of policy proposals to foster the development of small and medium-scale enterprises. The methodology we adopted was twofold: a deductive approach applying foreign experience to Vietnam's current stage of development was combined with an inductive approach based on an empirical study of Vietnamese industry and business. As part of the study, we carried out interviews at more than 300 companies in seven different industries (e.g., garments, electrical and electronic goods, and machinery and components). The topics included the challenges facing the private sector in Vietnam and the need for more administrative support. Using this information, we devised proposals for each industry, which in turn served as a basis for more general proposals for small and medium-scale enterprises as a whole. These proposals range from enacting an SME Basic Law and establishing a system for fostering the development of SMEs by means of a Small and Medium-Scale Enterprises Promotion Agency at its center to establishing a system for financing such enterprises, establishing industrial estates especially for such companies, setting up a system to help SMEs export, and providing training support. Hopefully, these proposals will serve as a basis for more detailed measures by the Vietnamese government and contribute to the development of the country's small and medium-scale enterprises.

I Background to the Study

As a socialist country, Vietnam has made state-owned enterprises the mainstay of its industrial system. However, at its Sixth Congress in 1986 the Communist Party of Vietnam adopted its *doi moi* (or “open door”) policy of allowing the market mechanism to operate and permitting private and individual ownership of businesses. Since then, there has been an influx of foreign investment, and the economy has grown rapidly. Following the Asian currency crisis of 1997, however, the influx of foreign investment has fallen off sharply, and even the economy has suffered.

As a result, Southeast Asian countries are looking for policies that will enable their economies to grow independently of foreign investment. One of the areas of greatest interest to them is the development of small and medium-scale enterprises.

As such companies develop, they provide a host of benefits, such as an improved balance of trade as a result of rising exports and import substitution, as well as increased employment opportunities. The Japanese government has also done much to support the development of SMEs in other Asian countries. In 1999, for example, the Ministry of International Trade and Industry put forward some proposals for fostering the development of such enterprises in Thailand, and this year has been assisting the Indonesian government.

This is the background against which NRI was asked by the Japan International Cooperation Agency (JICA) to carry out a *Study on the Promotion of Small and Medium-Scale Industrial Enterprises in the Socialist Republic of Vietnam*. This is partly connected with the fact that, since it adopted its *doi moi* policy, the Vietnamese government has tried a variety of approaches to developing the country’s economy and has been receiving assistance from the United States and European countries since the late 1990s.

The present study was carried out jointly with Vietnam’s Ministry of Planning and Investment. Its aim was to devise policies for fostering the development of SMEs, especially in manufacturing, while taking account of the state-owned sector, where reform will continue. We put forward proposals aimed at fostering small and medium-scale enterprises in general as well as those in particular industries, while considering both the current situation facing them as well as the effects of related policies.

II Need for Policies to Foster the Development of SMEs in Vietnam and the Basic Approach to Be Adopted

1 Ninety-Seven Percent of Non-State-Owned Companies Are SMEs

In June 1998 the Vietnamese government provisionally defined small and medium-scale enterprises as “companies with less than 5 billion dong in paid-up capital and fewer than 200 employees” (as of March 2000, 1 dong = ¥0.0075). According to this definition, such enterprises account for 91.3 percent of all Vietnamese companies in terms of capitalization and 74.2 percent in terms of number of employees. (See Table 1.) Particularly in terms of capitalization, 97 percent of (i.e., nearly all) non-state-owned companies fall under the category of small and medium-scale enterprises.

There are no accurate publicly available data on the contribution SMEs make to GDP. The Ministry of Planning and Investment estimates that altogether (i.e., including those owned by the state) such companies account for 24 percent of the economy. Data from the Department of Statistics suggest that private-sector manufacturing, which consists largely of small and medium-scale enterprises, contributes only just over 2 percent to GDP—an extremely low level.

Table 1. Classification of Vietnamese Companies by Capitalization and Number of Employees (as of 1995)

Ownership	Total	Capitalization (dong)					Number of Employees			
		Less than 5 billion	5–10 billion	10–20 billion	20–30 billion	More than 30 billion	Less than 100	100–199	200–499	More than 500
State-owned	5,873	4,376	691	421	141	253	4,087	190	263	1,333
Foreign-owned	692	353	104	96	42	97	406	15	33	238
Privately owned	10,916	10,882	26	4	1	3	8,120	165	351	2,280
Joint-stock	118	90	12	9	4	3	92	3	3	20
Limited liability	4,242	4,123	72	26	10	11	3,276	105	142	719
Cooperative	1,867	1,827	22	12	3	3	1,096	38	97	636
Household	1,879,402	1,879,402	—	—	—	—	1,879,402	—	—	—

Notes: (1) The figures for foreign-owned companies include those for joint ventures; (2) 1 dong = ¥0.0075 (as of 1999).
Source: Industrial Department, Ministry of Planning and Investment, 1999.

2 Four Criteria

In devising these proposals, we tried to ensure that they satisfied the following four criteria:

- (1) The need to address the many problems facing SMEs.
- (2) The need to foster an entrepreneurial spirit that has been suppressed by factors such as disparities in the conditions under which state-owned and privately owned companies operate as well as by bribery and harassment.
- (3) The need to make rapid improvements in the international competitiveness of Vietnam's SMEs in order to be ready for the country's entry into AFTA (the ASEAN Free Trade Association) and the World Trade Organization.

- (4) The need to improve the generally low social standing of private-sector companies in Vietnam compared with that of state-owned enterprises and end a situation where the managers and employees of such companies are often treated as "second-class citizens."

3 Four Projected Stages of Development

In devising our proposals, we projected four stages of development: (1) the immediate future (until 2002); (2) the short term (2003–2005); (3) the medium term (2006–2010); and (4) the long term (2011 and thereafter). (See Table 2.)

During the first stage (until 2002), the basic framework for fostering the development of small and medium-scale enterprises would be put in place and preparations made

Table 2. Projected Stages of Development of Small and Medium-Scale Enterprises in Vietnam

	Aims of SME Development Policies			Long-Term Development Vision
	1999–2002	2003–2005	2006–2010	2011 and beyond
Policy aims	<ul style="list-style-type: none"> • Establishing the basic framework for the development of SMEs • Improving the social standing of SMEs • Preparing to join WTO and AFTA • Using ordinances as policy instruments 	<ul style="list-style-type: none"> • Seeing the initial effects of policies • Improving the systems for developing SMEs • Preparing to join WTO and AFTA • Adopting policies based on the SME Basic Law 	<ul style="list-style-type: none"> • Adopting SME development policies nationwide • Boosting the development of SMEs • Bolstering the competitiveness of SMEs under the WTO/AFTA regime 	<ul style="list-style-type: none"> • Establishing a new development path for SMEs • Strengthening the international networks of SMEs
Source of competitiveness	<ul style="list-style-type: none"> • Labor-intensive operations (e.g., CMP business) 	<ul style="list-style-type: none"> • Labor-intensive operations (e.g., CMP business) 	<ul style="list-style-type: none"> • Agglomeration and network effects (e.g., FOB business) 	<ul style="list-style-type: none"> • First high-tech venture businesses (knowledge-based SMEs)
Focus of development	<ul style="list-style-type: none"> • Labor-intensive operations (e.g., CMP business) • Training of existing managers 	<ul style="list-style-type: none"> • Agglomeration and network effects (e.g., FOB business) • Training of entrepreneurs 	<ul style="list-style-type: none"> • Technology • Growth-oriented managers and entrepreneurs 	<ul style="list-style-type: none"> • International networks
Types of assistance	<ul style="list-style-type: none"> • Creating a level playing field and basic operating environment • Establishing the main entities, organizations, systems and mechanisms connected with SMEs • Starting the development of SMEs in major cities and urban areas • Improving the export infrastructure • Establishing successful examples of SMEs and SME policies 	<ul style="list-style-type: none"> • Improving coordination among the entities involved in developing SMEs • Making full use of the main entities, organizations, systems and mechanisms connected with SMEs • Accelerating the development of SMEs in major cities and urban areas • Creating more successful examples 	<ul style="list-style-type: none"> • Offering assistance nationwide • Actively involving local people's committees in the development of SMEs • Accelerate the development of SMEs in rural areas • Encouraging cooperation among SMEs 	<ul style="list-style-type: none"> • Facing new challenges • Adopting policies to encourage regional competition • Seeing the effects of policies in rural areas (full use) • Improving cooperation between industry and academia, and establishing international networks

Note: AFTA (ASEAN Free Trade Association).

Source: *Study on the Promotion of Small and Medium-Scale Industrial Enterprises in the Socialist Republic of Vietnam*, JICA, December 1999. (The study was written by NRI staff.)

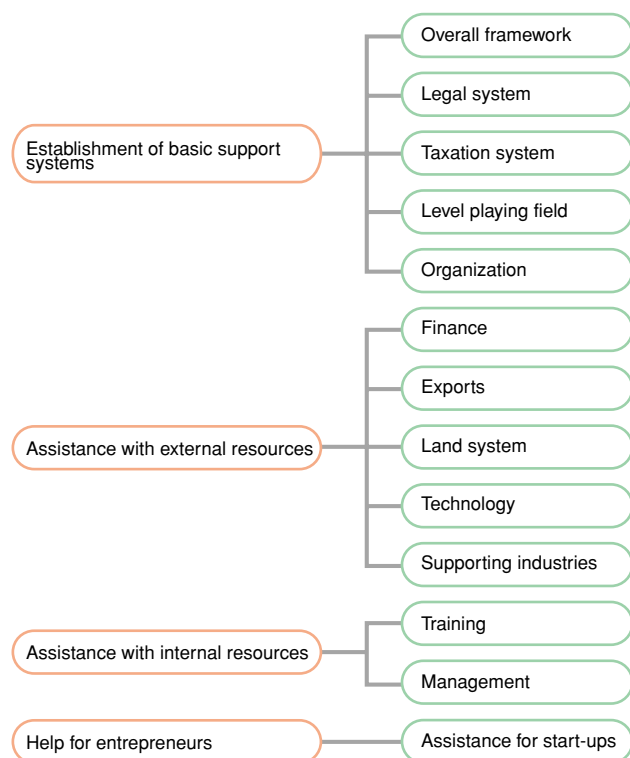
for joining AFTA and the World Trade Organization. During the second, short-term stage (2003–2005), the aim would be to adopt the proposed policies as widely as possible. During the third, medium-term stage (2006–2010), the objective would be to adopt the policies not only in urban areas but also in rural areas. Finally, during the fourth, long-term stage (2011 and thereafter), the goal would be to foster the development of high-tech venture companies and other new small and medium-scale enterprises.

4 Four-Part Framework

In order to achieve these aims, we divided the basic framework for fostering the development of small and medium-scale enterprises into four parts: (1) certain basic systems must be in place before further progress can be made; (2) more assistance is required with certain external resources; (3) small and medium enterprises also need assistance with some internal resources; and (4) entrepreneurs should receive more assistance when starting a new company. (See Figure 1.)

As far as the need for certain basic systems is concerned, there has to be an overall framework for fostering the development of such companies as well as better legal and taxation systems. Regarding the need for more assistance with certain external resources,

Figure 1. Four-Part Framework for Fostering the Development of SMEs



Note: "Supporting industries" provide machinery and metal-manufacturing companies with material-processing services such as cutting, pressing, polishing and plating.
Source: JICA, op. cit.

small and medium-scale enterprises need help with such things as finance, exports and technology, and the laws governing land have to be reformed. In terms of assistance with internal resources, such things as training would help to improve the quality of management. And finally, more needs to be done in providing assistance with starting a new company. Some of the most important of these aspects are examined in greater detail in the following.

III Details of Proposals for Fostering the Development of SMEs

1 Need for Legal Framework—Especially a Basic Law for SMEs

Vietnam lacks a proper legal framework. Moreover, the fact that similar applications may receive quite different responses depending on the official dealing with the matter and the fact that bribery is widespread mean that laws are applied inconsistently. To improve this situation, we made the following four proposals:

- (1) Rules on how laws are implemented should be as detailed as possible in order to minimize the discretion of individual officials.
- (2) Legal contradictions should be removed and more information provided to make it clearer what law takes precedence.
- (3) Public officials should undergo training.
- (4) The kind of discriminatory treatment and language to which the private sector is subject in some laws should be corrected as soon as possible.

The new Enterprise Law, which combines the previous Company Law and Private Enterprise Law and is expected to improve the conditions in which private-sector companies operate, came into effect in January of this year. However, in order to ensure that small and medium-scale enterprises enjoy equally attractive opportunities, we also made a number of proposals, including the following four: (1) detailed implementation rules should be adopted as soon as possible; (2) more clarification is needed regarding what public agencies are responsible for registering companies; (3) company inspections should be simpler and less frequent; and (4) it should be made clearer when the new law will be extended to include the Cooperative Law and State-Owned Enterprise Law.

In addition, we proposed that an SME Basic Law be enacted. This would (1) specify the need to foster the development of small and medium-scale enterprises, (2) determine the basic approach to be adopted, and (3) define the role of government in trying to achieve this.

2 Need for Coordination Among Government Entities Involved with SMEs

A number of different entities, including various ministries and the Vietnam Chamber of Commerce and Industry (VCCI), have begun to give assistance to SMEs. They are receiving support in these endeavors from developed countries. If this assistance is to be continuous and coordinated, these efforts must be organized systematically. With this aim in mind, we made the following proposals (Figure 2):

- (1) The fact that existing government agencies such as the Ministry of Industry and the Ministry of Trade are themselves in charge of some state-owned enterprises means that they can hardly be expected to stand up for private-sector companies. There is therefore a need to set up a Small and Medium-Scale Enterprises Promotion Agency at the central government level.
- (2) Small and medium-scale enterprises register with the Department of Planning and Investment of their local people's committee. However, there is a need for Departments of SME Promotion that would cater specifically to the needs of small and medium-scale enterprises.
- (3) The involvement of different agencies in the provision of services to SMEs tends to result in a lack of continuity as well as a lack of coordination. There is therefore a need to set up Small and Medium-Scale Enterprises Support Centers at a regional level to provide such services.
- (4) Government-backed industry bodies such as the VCCI and the Central Council for Cooperative Alliances and Small and Medium-Scale Enterprises in Vietnam (VICOOPSME) have been providing support to SMEs

in the form of training and information, but these services could be improved.

- (5) Many SMEs singled out the lack of access to finance as the biggest problem they faced. There is therefore a need to set up an SME Finance Corporation and a Credit Guarantee Fund as well as to ensure access to venture capital in order to improve this function.
- (6) In Japan, the development of small and medium-scale enterprises has benefited from the formation of trade associations, as these have made it easier for them to cooperate. There is therefore a need to support the work of the Union Association of Commerce and Industry (UACI) and trade associations.

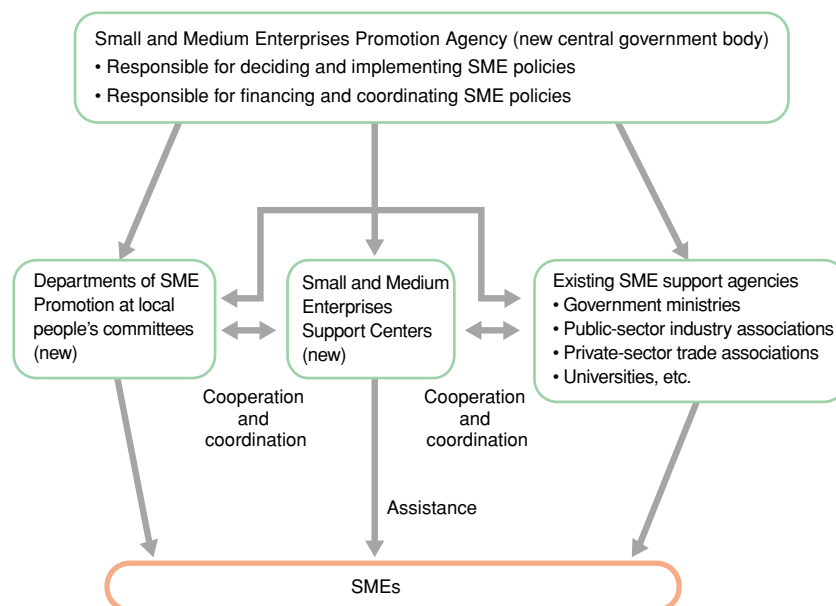
In addition, we recommended that there should be One-Stop Advisory Desks at local people's committees and the VCCI so that small and medium-scale enterprises would be able to refer to a single source for information about all the services available to them.

3 Improving Access to Finance

Lack of financing is one of the biggest difficulties facing small and medium-scale enterprises. It is particularly difficult for them to borrow from banks, which prefer to lend to state-owned enterprises. To improve this situation, we proposed the following: (1) that the system for providing security for loans be reformed; (2) that an SME Finance Corporation be set up; (3) that a system for promoting exports be established; and (4) that the state provide venture capital.

In particular, we suggested the following as the basic requirements for a system of credit guarantees (based on the system used in Japan): (1) a public agency with a

Figure 2. Framework for Fostering the Development of SMEs



Source: JICA, op. cit.

nationwide network; (2) a special independent agency that would provide appropriate levels of guarantees; (3) unrestricted access to credit guarantees for small and medium-scale enterprises and financial institutions; (4) the setting of an effective ratio for maximum guarantees and the holding of a large amount of liquid assets; and (5) well-trained and honest staff. As a result, the Vietnamese government is now drafting an ordinance on such a system. (Ordinances are often used instead of laws in Vietnam, as legislation is a protracted process.)

4 Finding Premises

Most SMEs in Vietnam do not have their own land or premises and have to lease facilities that state-owned enterprises no longer need. This means that they cannot be certain whether they will be able to continue their operations for any length of time and that many are unable to undertake any new investment. Finding premises is therefore a major problem for them. To help solve the problem, we made the following proposals:

- (1) The system currently operating in Ho Chi Minh City (whereby state-owned developers construct an industrial estate and then sell off individual plots to companies that receive assistance from the local people's committee) should be adopted in Hanoi and then, gradually, in the rest of the country.
- (2) There is a chronic lack of finance for acquiring industrial premises. The problem is compounded by pollution in major urban areas such as Hanoi and Ho Chi Minh City. The authorities can therefore be expected to adopt policies to encourage companies to move their factories by offering tax incentives and providing financing to help them purchase the necessary land and facilities.
- (3) Smaller companies would be encouraged to move into buildings that offer space for both residential and light-industry use.

5 Improving Export Promotion Policies

Although the conditions under which SMEs try to export have improved considerably during the past few years, they still face numerous obstacles. In addition, they have to become more competitive in export markets before Vietnam joins AFTA and the World Trade Organization. Similarly, garment manufacturers (see below) will have to make the transition from low-wage sewing on commission (so-called Cut-Make-Pack [CMP] business) to develop-and-export schemes (FOB business). With these aims in mind, we made the following proposals for fostering the development of SMEs:

- (1) The new Small and Medium-Scale Enterprises Support Centers should serve as sources of advice on business and marketing.

- (2) Small and medium-scale enterprises should have access to specialized information and advice via the VCCI (for a fee), and to general information collected by VIETRADE, the export promotion agency within the Ministry of Trade, through the Department of SME Promotion at their local people's committee (free of charge).
- (3) The eight regional branches of the VCCI should offer advice to exporters.
- (4) Funds should be made available by the Export Credit Fund and the new SME Finance Corporation to help exporters with cash flow problems.

6 Fostering the Development of Technology and Supporting Industries

In view of the very low technological level of Vietnam's SMEs, something must be done to foster the development of technology. It is particularly important that manufacturers of machinery and components upgrade their processing technology so that they can supply to foreign companies. With this in mind, we proposed (in addition to the two points below) that such companies receive more help with technology transfers and joint research, more plant auditing, advice about quality control, and training for their technical staff.

- (1) Technical Support Centers should be established to enable SMEs to share production and testing equipment, and receive training in production technology, advice on their plant, and information on technology.
- (2) Centers for the Promotion of SI (supporting industry) Transactions should be established to enable SMEs to do more business with foreign and state-owned companies as well as to broaden the range of business among such companies themselves.

7 Training

Most owner-managers of small and medium-scale enterprises know little about managing a company, and go about it in their own way. Nor are middle managers well trained, either. We therefore proposed the following three policies for developing staff who are directly or indirectly involved with SMEs in order to improve the quality of management: (1) training programs for government employees involved in fostering the development of such companies; (2) corporate diagnosis and advisory services; and (3) training programs for owner-managers and managers.

All the above proposals for helping such companies were based on the development plans for particular industries such as garments, electrical and electronic goods, machinery and components. The following sections outline these proposals.

IV Proposals for Fostering the Development of SMEs Involved in the Garment Industry

1 The Domination of the State Sector

According to data from Vietnam's Ministry of Industry, roughly 300 (or some 50%) of the 602 companies involved in clothing manufacturing are small and medium-scale enterprises. Of these 300, about 200 are thought to be privately owned SMEs (excluding cooperatives and family businesses). By way of comparison, according to 1995 figures for the number of plants in operation, there are about 80,000 plants (including family-owned ones) involved in garment manufacture.

In terms of production and exports, Vietnam's state-owned enterprises still dominate garment manufacturing by virtue of their superior facilities, technology, information, access to finance and business know-how. Also, it is normally state-owned enterprises that act as export-processing suppliers for Japanese companies.

As of 1996, garment manufacturing made up 44 percent of private-sector manufacturing—compared with only 25 percent for textile manufacturing. Similarly, garment manufacturing accounted for 80 percent of the \$1.45 billion in exports from textile and garment manufacturing—compared with textiles (especially cloth), which accounted for only 20 percent. The largest state-owned group, VINATEX, generated \$400 million in exports (or some 30 percent of the total for the entire industry), of which \$250 million comprised garments and \$150 million textiles.

However, the dominance of the state-owned sector is unlikely to continue. First, the decision-making process at state-owned enterprises is cumbersome. For example, if an investment project is due to cost more than 500 million dong, government regulations require that the work be put up for tender. Similarly, any major decisions have to be approved by either a general corporation (e.g., in the case of the textile and garment manufacturing industry, VINATEX's holding company) or the government.

Second, presidents, vice presidents and treasurers of state-owned enterprises are appointed by the government at regular intervals and can hardly be said to be entrepreneurially minded.

Third, the socialist principles according to which state-owned enterprises operate mean that workers cannot be laid off even if the ratio of workers to output and sales is high, and that fringe benefits tend to be excessive.

Fourth, if state-owned enterprises were eventually to lose some of the privileges that they currently enjoy (e.g., their monopoly of export quotas and their access to preferential loans from the State Bank of Vietnam), their earnings would suffer and they would be forced to restructure.

2 Dependence on CMP business

Although there are no statistics on the size of the domestic garment market, it was estimated to be worth about \$1 billion in 1998. Roughly 60 percent of the market is the preserve of (mainly family-owned) Vietnamese garment manufacturers, and neither the state sector nor the private sector has made a serious effort to make inroads into it.

Among the various reasons for this, the following three may be pointed out: (1) as garments manufactured by family businesses or smuggled into the country sell for a quarter to a third of the more than \$10 per item for garments produced by state-owned and privately owned manufacturers under export-processing agreements, the domestic market at the moment is largely out of bounds to such companies; (2) even in urban areas such as Ho Chi Minh City per capita expenditure on clothes averages only \$3 a month (as of 1998); and (3) as a result of the Asian currency crisis of 1997 and the recession that followed, domestic demand is concentrated at the low end of the market.

The remaining 40 percent of the domestic market is dominated by illegal imports (mainly from China) and second-hand clothes smuggled into the country. Vietnam's inability to produce and supply materials across the entire spectrum of demand—as China has done—means that Vietnam has lost this segment of the market to China.

In contrast, garments earned Vietnam some \$1.2 billion in foreign currency in 1998, making it the top export item—bigger even than oil or natural gas. Of this, 90 percent is CMP business on an OEM (i.e., purely value-added) basis by state-owned and privately owned enterprises, while 10 percent is estimated to be FOB business on an own-brand basis.

The main reasons Vietnam's garment industry is so dependent on the CMP business are that (1) its design capabilities and ability to produce its own materials are underdeveloped and (2) it lacks the funds that would be needed to make the transition to FOB business (i.e., bridging finance for all the stages from purchasing raw materials to inventory, sales and collecting cash). Fifty percent of the CMP business represents orders by Hong Kong, South Korean and Taiwanese companies that are exporting to the European Union, while the other 50 percent is to the order of Japanese companies shipping to Japan.

3 Need for a More Level Playing Field and More Competitive Exports

In the course of the present study we carried out interviews at a large number of SMEs and identified a wide variety of problems and policy needs. We then divided the latter into the following three main categories and devised a system for categorizing policies on small and medium-scale enterprises: (1) the need to become more

competitive (this applies also to the textile industry); (2) the need to be able to compete against state-owned enterprises on a more level playing field; and (3) the need for a basic development policy for SMEs.

The first of these needs (i.e., becoming more competitive) is, of course, also true of state-owned enterprises. However, it was clear from our interviews with privately owned small and medium-scale garment manufacturers, who derive some 90 percent of their sales from exports, that they were hoping for policies that would make it easier for them to capture a share of export markets and compete with China, and thereby make the transition from low-wage CMP business to FOB business.

The second of these needs (i.e., competing against state-owned enterprises on a more level playing field by eliminating discriminatory borrowing conditions and having equal access to export quotas) stems from the very unequal terms on which privately owned companies have to compete with state-owned enterprises.

The third of these needs (i.e., formulating a basic development policy for SMEs) relates to aspects other than the need to be able to compete against state-owned enterprises on a more level playing field and includes the following: (1) help with skills training; (2) help with organizing exhibitions in Vietnam itself to improve the availability of materials; (3) help with collecting information on foreign markets; (4) better design skills and easier access to finance so as to be better able to develop and export; and (5) help with the formation of regional associations to facilitate horizontal and vertical integration of production.

The reason Vietnam's small and medium-scale garment manufacturers need a more level playing field on which privately owned companies can compete with state-owned enterprises, and why they need assistance in such areas as producing more competitive exports, is that Vietnam's textile and garment manufacturing industries will face a series of major changes in their international operating environment from 2005.

The first of these is AFTA's agreement on common effective preferential tariffs (CEPT). Under this agreement, Vietnam will have to abolish non-tariff import barriers and cut import tariffs to a maximum of 5 percent by January 1, 2003.

The second of the major changes is the World Trade Organization's Textile Agreement, which will come into effect on December 31, 2004. Under this agreement, export quotas will be abolished as of the following January 1.

Finally, by joining the World Trade Organization, Vietnam will be committing itself to fulfilling all the terms of membership by about 2010. These include: (1) guaranteeing the convertibility of its currency; (2) stopping any dumping or export subsidies; (3) cutting tariffs and non-tariff barriers and ensuring that any trade measures are transparent; (4) abolishing any requirements that foreign-owned companies must export their products; and (5) protecting intellectual property rights.

Unless Vietnam satisfies each of these requirements in good time, it will find itself unable to adapt to the major changes that are taking place in the outside world and unable to compete on international markets.

4 Policy Proposals for Fostering the Development of SMEs

Table 3 shows the first two stages of our policy proposals for fostering the development of small and medium-scale enterprises: the immediate future (until 2002) and the short term (2003–2005). In view of the importance for Vietnam of the changes in the outside world that will take place by 2005, we have omitted the medium stage (2006–2010).

As far as the order in which these policies should be adopted, the need to be able to compete against state-owned enterprises on a more level playing field is clearly the top priority. The second goal should be to adopt policies that make it easier for SMEs to develop and export, while the third should be to adopt policies that enable Vietnam to produce more of the materials it needs itself. It is important that all the policies listed in Table 3 be implemented with the help of trade associations.

V Policy Proposals for Fostering the Development of SMEs in the Electrical and Electronics Industries

1 Electrical and Electronics Industries as Well as Their Supporting Industries Lack Know-How and Staff

Vietnam's electrical and electronics industries include 114 small and medium-scale enterprises—roughly 80 percent of the total. In addition, there are about 20 companies involved in support industries such as plastics molding as well as about 500 companies engaged in activities such as distributing IT equipment, assembling hardware, and developing software.

Small and medium-scale companies have the following in common: (1) obsolescent and obsolete production technology and facilities; (2) problems in obtaining short-term working capital and long-term investment capital; (3) a shortage of staff capable of coping with technological innovation; and (4) a lack of management experience.

Although few and far between, there are some well-managed SMEs that have enough internal funds to attract and retain staff without having to rely on bank loans as well as some that have expanded aggressively into information technology, including software development, in the hope of achieving a high rate of growth. Similarly, there are some state-owned SMEs that are only too eager to rid themselves of the mantle of state control and list on a stock exchange.

Table 3. Examples of Policies to Foster the Development of Small and Medium-Scale Garment Manufacturers

Main Policy Aims	2000–2002	2003–2005
Training	<ul style="list-style-type: none"> • Improvements in training curricula and actual training by foreign specialists • Training at local overseas operations 	<ul style="list-style-type: none"> • Adoption of a skill-accreditation system • Expansion of overseas training
Creation of business opportunities	<ul style="list-style-type: none"> • Assistance from trade associations with participation in exhibitions at home and abroad • Expansion of the VIETRADE overseas network and greater use of private-sector sources to obtain information on overseas developments 	<ul style="list-style-type: none"> • Matching business needs through foreign membership in VCCI
Growth of FOB business	<ul style="list-style-type: none"> • Overseas training for designers • Better financing for inventory and equipment for FOB business and encouraging its utilization • Tighter control of quality and delivery • Joint (production and sales) ventures with foreign garment manufacturers 	<ul style="list-style-type: none"> • Opening up the VINATEX design center to private-sector companies • Carrying out of all customs procedures at plants
Domestic production of raw materials	<ul style="list-style-type: none"> • Establishment of material development centers 	<ul style="list-style-type: none"> • Incentives for foreign investment in fabric-processing operations
Greater coordination among local manufacturers	<ul style="list-style-type: none"> • Establishment of joint distribution centers, cutting plants and product development centers as well as assistance in the form of finance and tax incentives • Establishment of associations to foster the development of subcontractors and provide assistance in the form of advice, arbitration and marketing 	<ul style="list-style-type: none"> • Use of the Internet to disseminate information on subcontractors and to match business needs
Level playing field	<ul style="list-style-type: none"> • End to discriminatory export quotas and borrowing terms 	<ul style="list-style-type: none"> • Closer coordination between state-owned and private-sector companies (privatization of the VINATEX import-export organization and its materials technology development center)

Notes: VIETRADE (Vietnam Trade Promotion Commission (in the Ministry of Trade)); VINATEX (Vietnam's largest state-owned textile and garment manufacturer).

Source: JICA, op. cit.

On the other hand, there are some areas (e.g., the metal molding, plastics molding, metal processing and surface treatment industries that support the electrical and electronics industries) where most SMEs, with the exception of a few with Japanese shareholders, do not have the technology to compete on international markets.

However, given that the domestic market is underdeveloped and that the provision of education and training is inadequate, this situation is hardly surprising. Nor is it by any means the case that Vietnam is not trying to foster the development of supporting industries. If anything, our survey of local companies would suggest that Vietnam has more potential to develop such industries than any other member of ASEAN.

2 Need to Foster the Development of Three Different Types of SMEs

Ideally, Vietnam's electrical and electronics industries should develop in two basic directions: (1) by substituting homegrown technologies and products for imports

and (2) by fostering the development of strategic export industries with the help of foreign capital. This means that Vietnam has to nurture the development of different types of small and medium-scale companies.

In view of the structural characteristics of Vietnam's electrical and electronics industries as well as the situation in which the country finds itself, it would seem appropriate to concentrate efforts on developing the following types of SMEs:

- (1) Type A: Companies that assemble and process electrical goods and components.
- (2) Type B: Companies that process and assemble special-purpose electronic components.
- (3) Type C: Companies that form a supporting industry for the assembly of electrical and electronic goods and components.

Type-A companies would assemble and process basic IT equipment (including software), low-end consumer electronic goods and household electrical appliances (such

as audio-visual equipment and white goods), and a wide range of electrical components. During the next 10 years or so it will suffice if Vietnam acquires assembly and processing technologies of a standard high enough for its own market. In the longer term, however, it will at the very least need to develop the skills to be able to hold its own as a supplier to AFTA's common market. These skills will require the transfer of foreign technology and actual business experience.

Type-B companies would be Vietnamese-owned component manufacturers. The components would be assembly-type special-purpose components, and the companies would have a very labor-intensive image. Inasmuch as the companies concerned would have to win the confidence of foreign manufacturers, the most likely candidates in the first instance would be state-owned enterprises that had passed some sort of selection test. In order to achieve this, the companies would have to acquire assembly technologies and management skills from Japanese and other foreign-owned companies as well as assistance with acquiring the skills that come from actual business experience.

While the short- to medium-term aim must focus on increasing local content, the longer term objective should be to increase exports via the various channels to overseas markets provided by the foreign-owned companies that offer their assistance. Although this is not an area where a large number of Vietnamese companies can be expected to compete on equal terms with foreign-owned companies, it is important that those Vietnamese companies that are selected be successful in view of the country's overall dependence on foreign investment. Hopefully, this will create a virtuous cycle whereby these component manufacturers themselves eventually become major companies and foster the development of their own suppliers.

In order to induce Japanese and other foreign-owned companies to set up subsidiaries in Vietnam to assemble electrical and electronic goods and components, however, Type-C SMEs will have to raise their standards and integrate their operations more. The most important supporting industries for the production of electrical and electronics goods will be metal processing (including molding), plastics processing (including molding) and surface treatment—areas that other ASEAN economies are already making an effort to develop in order to become more competitive. It would also be in Vietnam's long-term interest to adopt such a policy.

Before any plans for fostering the development of SMEs involved in the electrical and electronics industries can be drawn up, however, more needs to be done to improve the conditions in which such companies operate. For example:

- (1) Policies for developing the electrical and electronics industries must be formulated on the basis of a master plan for developing the economy.

- (2) The domestic economy needs to be revitalized in order to create more demand for infrastructure and demand from low-wage earners, thereby creating more opportunities for manufacturers of goods and components.
- (3) More foreign direct investment is needed in order to create more opportunities for component assemblers and supporting industries.

Once these basic conditions are in place, appropriate policies have to be adopted in order to foster the development of small and medium-scale enterprises. These should include the following: developing more legal provisions in related areas and providing assistance to companies in attracting investment and working capital as well as in acquiring basic technological and business skills.

3 Appropriate Policies for the Three Types of SMEs

In the case of Type-A companies, continuing progress can be expected as a result of the efforts of individual entrepreneurs, provided the domestic market expands in line with economic growth and it becomes easier for them to acquire the technology and capital they need. This in turn should speed up the substitution of local technologies and products for imports and eventually lead to the stage where Vietnamese companies are able to export to other ASEAN countries.

In the case of Type-B companies, there is a need for assistance—particularly from foreign-owned consumer electronics companies—with the technology of assembling and processing components as well as with orders. Although making the improvements necessary to graduate from the domestic to export business is not easy, both foreign-owned and Vietnamese companies stand to benefit if this can be achieved. Also, tax incentives related to how much such companies or joint ventures contribute to Vietnam's exports would be an appropriate way of fostering the development of SMEs.

In the case of Type-C companies, the main need is for training to produce a better-skilled work force and for basic technological know-how—hence the need for long-term policies that would gradually introduce the following:

- specialist training
- Technical Support Centers
- schemes for providing technical information
- assistance to enable companies to take part in overseas trade fairs
- industrial standards
- a more thorough system of monitoring safety standards

VI Policy Proposals for Fostering the Development of SMEs in the Machinery and Component Industries

1 Three Different Types of Small and Medium-Scale Enterprises

Vietnam's machinery and component industries, which are dominated by state-owned enterprises, produce most types of goods with a few exceptions (e.g., high-tech items). However, these state-owned enterprises do not carry out all production processes on an in-house basis, nor do they have a high level of productivity.

The small and medium-scale enterprises involved in manufacturing machinery and components are of relatively recent origin and number only 1,255. They either (1) manufacture and sell non-technology-intensive items such as metal goods for domestic use and replacement parts for motorcycles and bicycles or (2) produce replacement parts for production equipment on an individual-order basis.

Although the number of SMEs is rather limited, there are some 30,000 businesses with fewer than 10 employees. Many are run by households and tend to be involved in the same kind of business as small and medium-scale enterprises. Such companies are growing rapidly in number and are found in increasing concentration in areas such as Districts 5, 6 and 11 of Ho Chi Minh City, as well as that city's Tan Binh district. A division of labor is developing in such areas, whereby companies cooperate to counterbalance each other's strengths and weaknesses.

In terms of their business activities and customers, Vietnam's SMEs can be divided into the following three types:

(1) Companies that manufacture and sell goods for the retail market

These companies manufacture and sell retail goods such as relatively basic replacement parts for motorcycles and bicycles, and metal goods for domestic use (e.g., pots and pans, tubular chairs, cupboards, knives and scissors).

(2) Companies that order-make replacement parts for industrial machinery

These companies process and fit replacement parts to order for machinery used by food processors and farmers, for example. At one time, they used to manufacture rather technology-intensive agricultural machinery, but nowadays this type of company includes state-owned small and medium-scale enterprises that produce mainly replacement parts.

(3) Repair shops

These businesses repair motor vehicles, motorcycles and bicycles, and some even have basic plant and equipment

with which they can manufacture and process replacement parts to order.

2 Six Different Future Types of SMEs and the Policies to Foster Their Development

We see these three types of companies developing into six new types: first, three completely new types (i.e., assemblers, component manufacturers and companies that form supporting industries); and, second, more sophisticated forms of the present three types (i.e., retail goods manufacturers, manufacturers of replacement parts for industrial machinery, and repair shops). The following describes how we see these six types of companies emerging and the policies we would advocate to achieve this. (See Table 4.)

First of all, various types of assistance will be required to foster the development of assemblers, including: (1) training in management and technology designed to improve marketing and product development skills; (2) information on markets and technologies; and (3) trade fairs designed to help companies expand their customer bases.

Second, in order to nurture the development of component manufacturers, test centers where companies can have their products examined should be set up and training in quality control provided so that companies can improve the quality of their products and their ability to control that quality. In addition, consulting services for factories should be provided as well as training in production planning and control so that companies can plan for the mass production of components. Companies would also benefit from technology consulting services designed to improve their ability to develop components, as well as from shared access to and training in the use of CAD facilities.

Meanwhile, in order to encourage the development of companies involved in supporting industries, Technical Support Centers for Supporting Industries should be set up where companies would be able to use the production and testing facilities they need to carry out low-cost, but high-quality processing. In addition, technical consulting services should be provided as well as training in quality control, while companies should have access to databases run by the Centers for the Promotion of SI Transactions as well as assistance with marketing to help them expand their customer bases.

Similarly, retail goods manufacturers should receive basically the same kind of assistance as assemblers to help them compete. Particularly helpful would be assistance with trade fairs to enable them to boost sales.

Like component manufacturers and companies that form supporting industries, manufacturers of replacement parts for industrial machinery need to upgrade their specialist technology and receive help with quality control and production control if they are to compete more effectively.

Finally, if repair shops are to compete more effectively, expand their customer bases, and eventually become retail goods manufacturers or manufacturers of replacement

parts for industrial machinery, they need to have better facilities and technology. Here, too, they will require assistance.

Table 4. Policies for Assisting SMEs in the Machinery and Component Industries

Type of Assistance	Examples of Policies
Marketing	<ul style="list-style-type: none"> • Introductions to prospective customers ☆ • Information on different areas of business ☆ • Assistance with participation in trade fairs ☆ • Assistance with raising in-house awareness of the importance of public relations ☆
Technology	<ul style="list-style-type: none"> • Establishment of test centers ★ • Training in the use of new technology ★ • Information on technology ★ • Advice on plant and equipment from accredited technical experts ★ • Assistance with technology transfers
Plant and equipment	<ul style="list-style-type: none"> • Assistance with the use of second-hand machinery • Accelerated depreciation of plant and equipment • Assistance from business cooperatives with the joint use of facilities
Information	<ul style="list-style-type: none"> • Assistance with the establishment of associations • Collection and dissemination of all kinds of information • Meetings with foreign-owned companies to exchange technological information
Start-ups	<ul style="list-style-type: none"> • Assistance with start-ups by technical specialists • Encouragement of entrepreneurial spirit • Financial assistance for start-ups (venture-capital fund) • Advice on setting up one's own business
Training	<ul style="list-style-type: none"> • Training in business planning and control • Training in mass production and production technology ★ • Training in development and design ★ • Better training centers
Foreign investment	<ul style="list-style-type: none"> • Incentives for foreign investment • Assistance with technical cooperation
Trade	<ul style="list-style-type: none"> • Assistance with exports • Tighter controls on smuggling • Abolition of tariffs and regulations

Note: (☆) indicates assistance to be provided mainly by Centers for the Promotion of SI Transactions, while (★) indicates assistance to be provided mainly by Technical Support Centers for Supporting Industries.
Source: JICA, op. cit.

VII Response of the Vietnamese Government

The main feature of our *Study on the Promotion of Small and Medium-Scale Industrial Enterprises in the Socialist Republic of Vietnam* was the fact that it was an empirical study (based on numerous questionnaires and interviews) of the situation facing small and medium-scale enterprises in that country's private sector, and contained a number of proposals drawn from the experience of other countries for developing policies to address the needs of these companies. As a result, the Vietnamese government (and the Ministry of Planning and Investment, in particular) has decided to set up a Small and Medium-Scale Enterprises Promotion Agency and draw up guidelines for creating a Credit Guarantee Agency.

In its response, the Ministry mentioned the following points:

- (1) The study's proposals are comprehensive and wide-ranging.
- (2) The study's analysis is the most detailed of any comparable study ever carried out for the Vietnamese government by an international agency.
- (3) Many of the proposals are appropriate to the current situation in Vietnam.
- (4) The study describes how the New Miyazawa Plan (proposed to the Vietnamese government by the Japanese government) could be implemented.

The study was the product of the combined efforts of specialists in each of the various fields covered, and we hope that it will contribute to Vietnam's economic development. We also hope that the study's methodology and results will serve as examples for other developing countries in devising policies to foster the development of small and medium-scale enterprises and of particular industries.

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