



Eight lessons on small and medium-sized enterprises in Vietnam

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FINDINGS

SMEs have been key for growth in Vietnam, but their current way of operating poses challenges for future development

Inefficient credit allocation reduces growth and productivity of SMEs

Accessing formal credit is difficult for well-performing young, non-state firms

Managerial capabilities are important for the growth of SMEs

Currently the formal SMEs which have political connections obtain lucrative credit from formal financial institutions

The few informal SMEs with high productivity do not perceive positive effects of formalization for their business

Differences in provincial institutions matter for innovativeness of smaller firms

THESE FINDINGS AND RECOMMENDATIONS are meant to inform Vietnamese policymaking in promoting private sector-driven development in the years to come. In addition, the nuance and clarity of these findings underlines the importance of a comprehensive data revolution in developing countries for achieving Sustainable Development Goals. Without the requisite data work this type of analysis is not possible. Other countries and the international community can use the Vietnamese SME survey approach as an example of how to do this effectively.



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The structural changes of the economy in the past decades have been a significant contributor to Vietnam's impressive growth over the past 30 years. Labour has moved rapidly from agriculture into manufacturing, with important improvements in livelihoods as a result. The burgeoning private sector played a key role in this success story. Understanding how and identifying remaining challenges are essential for better policies in the future.

Eight lessons

Understanding how firms performed in a dynamic business environment under a complex set of constraints is essential for uncovering the factors behind Vietnam's economic success story. The following eight lessons are based on a regular survey conducted within Vietnamese non-state manufacturing enterprises covering more than 2,500 firms in ten provinces over the period 2005–15.

- 1 Misallocation of resources** Inefficient credit allocation reduces aggregate productivity and growth. The survey results show that SMEs with higher productivity are, on average, less likely to gain access to financing. This leads to clear inefficiencies that future policy reforms must address.
- 2 Access to credit** Accessing formal credit is difficult for well-performing young, non-state firms. Access to unregulated informal credit markets is currently very important for high profitability entrepreneurs. Improving the availability of formal credit and increasing the awareness among firms of the formal credit process could be an effective policy response.

3 Importance of political connections aggravates credit misallocation

Currently, it is very important for formal SMEs to have political connections when it comes to both the access to and the cost-of-credit obtained from formal financial institutions. Having close ties through membership of the Communist Party decreases the likelihood of being credit constrained. Moreover, politically connected SMEs accessing credit face lower cost-of-capital than non-connected SMEs. The impact of political connections is most notable during periods of financial distress.

4 Institutional capacity makes a difference

Differences in institutional and governance capacities across provinces matter for the innovativeness of SMEs. In locations with a more favourable business environment, the impact of financial resources is greater than the impact of human resources on SME productivity. This highlights the need for pursuing an effective balance between the allocation of scarce financial capital and the implementation of human capital policies.

5 Switching to formality is not obvious

The most productive informal household businesses are not always those that switch to formality. Tellingly, the reason for staying informal is that SMEs expect the costs from increased tax payments to outweigh the benefits from formalization.



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6 Managerial capabilities and perceptions of risk matter

There is a clear positive association between managerial capabilities and productivity in SMEs in Vietnam. The results also show that entrepreneurial perceptions of risk are more important for success than learning elementary business skills. This result has critical policy implications for the design of entrepreneurial training programmes for SMEs.

7 Certification and growth

Developing internationally recognized quality control systems and certification procedures would help protect businesses from downside shocks. Certification tends to assure a more stable customer portfolio, reduce informal payments, and prevent temporary business closure.

8 Unions can help promote social justice

In the absence of adequate institutional mechanisms, trade unions can help promote equity and social justice for workers. Survey results show that the wages of unionized workers are significantly higher than the wages of non-union workers. This points to a potentially important future role for trade unions to bring advantages to workers in SMEs. Yet the ability of unions to act in the interests of their members depends on the existence of a collective and inclusive culture of bargaining.

POLICY RECOMMENDATIONS

Developing internationally recognized certification systems would help protect businesses from downside shocks

In the absence of adequate institutional mechanisms, trade unions can help promote social justice for workers

Inefficient allocation of formal loans should be addressed as a key policy priority

There is a need to pursue a balance between the allocation of scarce financial capital and implementation of human capital development policies

Collusion between upper-tier informal SMEs and public officials should continue to be a policy concern

Collection and analysis of quality data is indispensable in finding optimal policy solutions for SME development and for the achievement of Sustainable Development Goals

