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Introduction

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Over the past 30 years, Vietnam has experienced unprecedented growth and poverty reduction, turning the country into a middle-income economy over a relatively short time span. Most of this growth came from structural change, where a significant proportion of the labour force moved swiftly from the agricultural sector to manufacturing. During the pre-industrial transition stage in the late 1980s, agriculture accounted for more than 40 per cent of GDP and 75 per cent of employment (Malesky and London 2014). Three decades later the share of workers registered within agriculture has more than halved, with labour having shifted towards both industry and services—a process that is still ongoing (McCaig and Pavcnik 2016; McCaig and Pavcnik 2018a; Tarp 2018). Moreover, this change has so far happened without worrying trends as regards income inequality, especially within urban areas, where change has gone hand-in-hand with higher salaries in manufacturing and services and increased wage-job opportunities in those sectors (Benjamin et al. 2017).

Private small and medium enterprises (SMEs) have been key for the structural transition in Vietnam that followed the initiation of the Doi Moi reform process in 1986. A leading global expert on Vietnam uses the term ‘gradualist’ when describing the nature of the policy-making process underlying the impressive Vietnamese development performance (Rama 2008). By this Rama refers to the fact that Vietnam adopted early on a dual-track approach, and that policy makers allowed firms to expand alongside the state sector as long as they fulfilled their quotas at state-given prices (Malesky and London 2014). Also important for the development of a thriving private SME sector has been the innate reform design and willingness to experiment combined with the decentralized nature of the reform process. The government tried out larger scale reforms in selected provinces, before deciding whether to implement a given initiative at the national level. As such, experimentation and quality governance were crucial for the success of nationwide reform initiatives taking place in parallel with the policy to promote private SMEs. These initiatives included state-owned enterprise (SOE) reform, FDI and industrial zone policies, and business-related administrative initiatives, such as the introduction of one-stop shops (Rama 2008; Malesky and London 2014).
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Although Vietnam has throughout the reform process experimented with and allowed for an increased influence of the private sector, significant state influence remains a core feature of the Vietnamese development strategy. Large state-owned enterprises (SOEs) continue to receive government protection and highly favourable conditions compared to smaller domestic and foreign firms. This is so in spite of the observation that this may be detrimental to economic growth, as it discourages investment in skills for those without connections within the state apparatus (Phan and Coxhead 2013). This preferential treatment of SOEs in key industries has influenced the development of private industrial SMEs, as resource allocation for the most productive firms has been ‘politically constrained’.

The Vietnamese government has throughout acknowledged that especially industrial SOEs need to improve their efficiency, and though they have struggled to do so, it remains a key policy priority of the government to ensure significant state influence in key areas of the industrial sector. At present the SOE share in GDP continues to be about the same as it was in 1990 (approximately 30 per cent). In contrast, private SMEs account for around 95 per cent of all firms, about half of the workforce and approximately 40 per cent of GDP (GSO 2018). The large number of SMEs embodies a significant potential for dynamic and inclusive economic growth. This is so because SMEs can be a dynamic force in generating labour-intensive growth; in increasing competition in local markets; and in generating much needed savings and innovation. Moreover, structural transformation—the movement of workers from low-productivity to high-productivity activities and sectors—requires SME expansion and is as already noted an essential feature of rapid and sustained growth and development.

However, SMEs also represent a series of policy challenges for future economic development in Vietnam and elsewhere. Many small firms continue to operate as household enterprises at the border between formality and informality. They often remain credit rationed and/or constrained, with negative repercussions for an optimal allocation of scarce resources, productivity and the welfare of employers and employees. In addition, the potential and significance of SMEs normally stand in stark contrast with the widespread lack of understanding of the characteristics, dynamics and constraints faced by smaller firms. We conceived this volume to help promote a better understanding of what drives SME growth and develop insights into the underlying behaviour of SME owners, managers, and employees. We see this as an essential task and necessary for both the development profession and policy makers at large as they strive to address the objective of promoting sustainable private sector development—with a view to achieving key aims among the Sustainable Development Goals (SDGs) launched by the UN in 2015. Importantly, SMEs are central—not only in promoting inclusive and sustainable economic growth, employment, and decent work for all (SDG8); SMEs also promote sustainable industrialization and foster innovation (Goal 9) and can help reduce income inequalities (SDG10) if they receive support to provide good-quality jobs.
Finally, they can support achieving gender equality (SDG5) and women’s empowerment through female entrepreneurship.

In Vietnam, SMEs have (as already noted) been at the very core of the government strategy for inclusive growth and economic transformation. Yet, although Vietnam has seen a rapid increase in the number of registered enterprises, evidence also shows that only a small fraction of smaller household businesses have become registered during the past three decades. This means that the official statistics do not capture well some 30 million employees even if they form a critically important part of the SME dynamics, both in terms of job and income creation. It is therefore apparent that studying the dynamics and growth process of smaller (both formal and informal) firms is key for disentangling our understanding of Vietnam’s economic success story.

The roots of this volume grow from the time when the first Danida-supported SME survey of Vietnamese non-state manufacturing enterprises covering more than 2,500 firms in ten provinces began in 2005.¹ We focused from the start on the private manufacturing sector, and we included rural and urban as well as formal and informal enterprises. The success of the 2005 SME survey inspired the Central Institute of Economic Management (CIEM) of the Ministry of Planning and Investment (MPI) in Hanoi, the Institute of Labour Science and Social Affairs (ILSSA) of the Ministry of Labour, Invalids and Social Affairs (MOLISA), the Development Economics Research Group (DERG) of the University of Copenhagen and UNU-WIDER, together with Danida, to plan and carry out an ambitious series of SME panel surveys. Since 2005, we implemented the survey of these enterprises every two years, and it is on this extraordinary foundation that the present volume builds.

Importantly, since the survey tracked the same SMEs over time, the SME database is by now a very strong tool for gaining detailed and policy-relevant information about private sector firm dynamics and enterprise development in Vietnam from 2005–15. During this decade, the number of registered non-state SME manufacturing firms more than tripled and so did their labour force. The overall performance of the smaller firms shows a clear and promising trend of consistent growth, but the process is taking place in what remains a constrained environment that often results in a non-optimal allocation of resources. For example, while some companies face credit constraints, other challenges are the rigidities of the regulatory environment or institutional weaknesses. Understanding the circumstances under which both formal and informal SMEs operate and the constraints and opportunities they face is a key input into evidence-based

¹ We acknowledge inspiration from the 1991 survey by Ronnås (1992), and note that the ten provinces include Ha Noi, Ha Tay (now part of Ha Noi), Hai Phong, Ho Chi Minh City, Phu Tho, Nghe An, Quang Nam, Khanh Hoa, Lam Dong, and Long An. Further details on the data are available in Chapter 2.
policy-making for the future of businesses, the overall economy, and the welfare of the Vietnamese people in both urban and rural areas.

While six detailed descriptive cross-section reports for each of the SME survey years are available,² capturing change from one survey to the next, the present volume presents for the first time a comprehensive set of detailed analytical studies, which rely throughout on the complete and coherent data from more than 2,500 SMEs in ten provinces. Attention is on the time dimension rather than on individual cross-section information and descriptions. We carefully selected these papers from a UNU-WIDER call for research proposals, and we reviewed and discussed all papers in a joint workshop in November 2017 in Hanoi. Thus, all chapters in the volume—including this framework-setting introduction and the concluding chapter by the editors—rely extensively on the SME panel; owners, managers, and employees in the firms included in this panel have all lived through and experienced a critical period in Vietnam’s economic development process while managing their daily private and productive lives. How the firms coped and ended up performing in a highly dynamic macroeconomic environment under a complex set of constraints is key in what the research work tries to uncover.

ILSSA carried out the wide range of tasks related to the planning and implementation of the SME survey in the field and UNU-WIDER and DERG collaborated with CIEM in all aspects of survey design and data analysis. A full package of capacity-building activities by DERG—and later on UNU-WIDER staff—including both formal courses, on-the-job training and a wealth of seminars, were conducted in Vietnam and elsewhere throughout this process under ongoing institutional twinning arrangements. The shared scholarly aim was to ensure that the SME project developed both the data required to deliver policy-relevant research to decision makers and the research capacity within Vietnamese institutions to take advantage of that data.

We did not foresee in 2005—when we launched the SME panel survey—that the report of the UN Secretary General’s High-level Panel of Eminent persons on the Post-2015 Development Agenda (HLP), would call—more than ten years later—for a data revolution for sustainable development post-2015 as follows:³

We also call for a data revolution for sustainable development, with a new international initiative to improve the quality of statistics and information available to citizens. We should actively take advantage of new technology, crowd sourcing, and improved connectivity to empower people with information on the progress towards the targets.

(Chapter 4, Implementation, Accountability and Building Consensus, p. 21.)

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The HLP call for a data revolution is most pertinent, and it forms the rationale for the UNU-WIDER project on structural transformation and inclusive growth in Vietnam under which we pursued the SME panel surveys over the years. While substantial improvements in statistical systems took place in many developing countries over the past decades, performance remains poor in far too many sectors and countries. The call for ‘increased support for strengthening data collection and capacity-building in Member States’ was rightly reiterated in the Sustainable Development Goals (SDGs). It is this background—and recalling UNU-WIDER’s long-standing expertise in innovation in data collection and analysis—that leads us to believe that data will be at the epicentre of development action in the coming decades. At the same time, while the logic of a concerted push towards a data revolution is compelling, these calls are often somewhat ‘fluffy’—and it is not entirely clear from ongoing debates that it is widely understood what such a revolution actually demands and means in concrete practice.

We developed the aims of this volume with these concerns in mind using Vietnam as a fascinating case due to the concrete and unique, and coincidental, availability of the SME experience and panel dataset. Furthermore, Vietnam’s contemporary similarities to a large number of developing economies, including its strong private sector performance after the Doi Moi reforms, make its experience and policy recommendations, based on analysis of microeconomic data, highly relevant for many regional and extra-regional stakeholders. In fact, Vietnam provides an exceptionally informative environment in which to observe and consider the importance of key factors and mechanisms influencing SME performance and development, including:

- credit access and management practices;
- political connections, institutional quality, and innovation; and
- certification, working conditions, and union membership.

These dimensions therefore make up the three core-components of this volume, and the associated Chapters 3–11 identify throughout the policy challenges in each area. They follow this scene-setting introduction and a detailed description of the data in Chapter 2; and we conclude by drawing up a series of policy implications in Chapter 12.

In sum, the aims of this volume are to:

- Provide an in-depth evaluation of the development of private sector formal and informal manufacturing SMEs in a developing country—Vietnam in this case—over the past decade, combining a unique primary source of panel data with the best analytical tools available.

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- Generate a comprehensive understanding of the impact of business risks, credit access, and institutional characteristics, on the one hand, and government policies on SME growth performance at the enterprise level, on the other, including the importance of working conditions, informality, and union membership.
- Serve as a lens through which other countries, and the international development community at large, may wish to approach the massive task of pursuing a meaningful data revolution as an integral element of the SDG development agenda.
- Make available a comprehensive set of materials and studies of use to academics, students, and development practitioners interested in an integrated approach to the study of growth, private sector development, and the microeconomic analysis of SME development in a fascinating developing country.

Finally, we hope that the volume can provide a comprehensive analytic contribution to a crucial topic within the discipline of development economics based on some fifteen years of continued efforts. In addition, we wish to help persuade national and international policy makers (including donors) of the need to take the call for a data revolution seriously, not only in rhetoric, but also in concrete plans and budget allocations, and in the necessary sustained action at country level. This is where inclusive socioeconomic development takes place and benefit poor and discriminated people who are struggling to make ends meet; and private sector progress is fundamental in this effort.

Focusing next on the specific context of the individual chapters, and relating to selected literature in the field rather than going in chronological order, one of the most significant challenges encountered by private industrial SMEs in Vietnam in developing their potential is restricted access to credit. This topic is of particular importance, and has led to a variety of papers on the topic over the years using different data sources. As an example, Rand (2007) used the pilot data of the data utilized in this book volume to analyse the extent to which borrowing constraints restrict firm access to credit. Based on information from 1,106 Vietnamese manufacturing SMEs, his paper suggested that approximately 25 per cent of enterprises are credit constrained, and that these small firms would increase their debt demand by 115 per cent if borrowing constraints were relaxed. His analysis also suggested that informal credit markets in Vietnam play an important role especially for fast growing firms, as successful entrepreneurs do not have the time to go through the administrative difficulties faced in the formal credit system. Another contribution by Malesky and Taussig (2009a) analyses the dynamics of relationship-based lending in the country’s financial system. Using data from the Vietnam Provincial Competitiveness Index (PCI) initiative, covering around 6,400 firms in all provinces in Vietnam, they assess the extent to which firm
owners’ political connections are determinants of bank loans. The results show that these connections increase the likelihood of accessing loans by 4 per cent. Their paper moreover finds that political connections have a distortive impact on capital allocation mechanisms and that the most profitable private firms actually opt out of the formal financial system, and choose to use informal means to access credit.⁵

Three chapters in this book volume extend and deepen this literature. First, Christina Kinghan, Carol Newman, and Conor O’Toole look in Chapter 3 at capital allocation and credit access for SME growth, and find that capital allocation in Vietnam is sub-optimal. Firms with higher returns to capital are less likely to access formal finance, confirming on a much stronger data set the results in Rand (2007). Enrico Santarelli and Hien Thu Tran address in turn in Chapter 4 the interaction between human capital and institutional quality in determining the dynamics of capital structure. The authors find that it is very hard for non-state firms to access formal financing, and the ones capable of doing so rely on their influence, using tax benefits against financial distress. At the same time, whilst human capital encourages more loans, its interaction with institutional quality favours other financial resources over debt financing, again consistent with the early results in Rand (2007). Chapter 6 by John Rand links to the issue of credit allocation by studying the effect of political connectedness on credit constraints. Controlling for unobserved time-invariant firm-level heterogeneity, as well as self-selection and access to alternative credit markets, his chapter shows that political connections decrease the likelihood of SMEs being credit constrained by 4 per centage points, basically confirming the findings in Malesky and Taussig (2009a) using different analytical approaches.

While work on assessing the relevance of political and economic institutions in influencing a sound and stable business and investment environment has been a core research topic for decades, the direction of causality has remained a challenge, and this is also so in the context of Vietnam (Malesky 2010). Yet, since the early 1990s, business/government relations in Vietnam have been highly decentralized towards the province level. Exploiting this variation across different provinces Malesky et al. (2015a) utilize the Annual Enterprise Survey published by the General Statistical Office (GSO) in combination with data from the Provincial Competitiveness Index (PCI) to determine the extent to which local institutions affect the environment for firm investment. They identify transparency—i.e., making available provincial planning documents—as the most robust predictor

⁵ This is in line with the analysis by Steer and Sen (2010), who find that informal institutions in Vietnam have contributed to expanding the private sector, in particular given the absence in this process of complete and trustworthy formal institutions. Using primary data from 305 firms collected in 2004, the authors show how informal institutions such as social networks, friends and families have helped Vietnamese firms gather information on their trading partners in the absence of formal means to access this information.
of private firm investment in Vietnam, and more relevant than property rights, contracting institutions, and corruption. This effect is particularly significant for small domestic private firms (SMEs). Another element affecting the quality of the investment environment is corruption. Rand and Tarp (2012) used two rounds of the data underpinning this book volume to develop a better understanding of the nature, evolution, and potential impact of bribe-paying behaviour. Based on data for 1,659 manufacturing SMEs in the ten provinces they show that bribe incidence is highly associated with firm-level differences in visibility, sunk costs, and ability to pay. Formality correlates positively with bribe incidence, so ‘visibility’ in this sense seems to dominate the ‘bribes-to-hide’ effect in determining corruption.

Chapter 6 as well as Chapter 8 in this volume follow directly in the footsteps of the work about institutional quality and investment behaviour. We already commented on Chapter 6, and Tam Thanh Nguyen and Chieu Duc Trinh look in Chapter 8 at how slack resources affect investments in innovation for Vietnamese SMEs, and find that whilst financial slack hinders innovation, human capital slack stimulates innovation in the direction of new business processes or products. Moreover, firms located in more favourable business environments experience less positive effects from human capital slack, and lesser negative effects of financial capital slack. Chapter 9 by Neda Trifković links indirectly to the discussion of institutional quality and corruption by looking at the role of international private standards in reducing business risks, defined as financial loss or physical damage related to business activities. As the chapter shows, international standards have the potential to increase productivity for Vietnamese SMEs, as international certification correlates with lower risk of temporary closure, informal payments, and customer risk.

The institutional context not only matters for firm access to credit and investments. Institutions play a key role in a firm’s decision to formally register and pay taxes. In the case of Vietnam, Malesky and Taussig (2009b) argue that improvements in institutions have a strong impact on the likelihood of SMEs registering formally from the very commencement of their activities. At the same time, they reduce the amount of time informal firms choose to remain informal. Informality affects state-revenue. It also affects the health and safety of firm employees, as they lack access to a number of non-wage benefits, such as contributions for pension, paid holidays, right to minimum wages and to a maximum number of weekly working hours. Many do not have access to a written contract. This weakens the conditions of the institutional structure, which in turn encourages more informality. To address the problem of endogeneity in the relation between formality and quality of institutions, Malesky and Taussig (2009b) rely on a two-stage instrumental variable approach, using the experience of the Vietnam War as an exogenous determinant of today’s institutions. The results support a causal relation going from institutions to formalization. Moreover, in a disaggregated analysis it emerges that property rights are the most relevant institution in Vietnam
when it comes to drivers of formalization, more important than regulatory frameworks and contract enforcement work.

Rand and Torm (2012a) also offer evidence on the benefits of formality. They found that being formal increases profits for Vietnamese SMEs by about 10 per cent, once they control for firm size, firm location, workforce and owners characteristics. These results also hold for informal firms in 2007 that formalized by 2009, and which saw their profits increase by 16 per cent. The Rand and Torm study finds evidence as well for formalization leading to higher capital stocks, and a more empowered workforce, where workers’ rights and duties are set out in formal contracts. Combining qualitative with quantitative evidence, the authors show as well that informality is often the result of lack of awareness of the benefits of formality. Most informal SMEs are only aware of the financial costs of formalization. Furthermore, Rand and Torm (2012b) find that formalization brings forward salaries that are between 10 and 20 per cent higher for formal workers compared to informal firms, a result driven mostly by observed characteristics, such as firm size, workforce characteristics, and location of the firms.

McCaig and Pavcnik (2018b) is another study of the financial benefits of formalization, and they use data from three rounds of the Vietnam Household Living Standard Survey (VHLSS). They show that registration does not bring about particular benefits for Vietnamese SMEs, which is contrary to the findings in Rand and Torm (2012a). McCaig and Pavcnik (2018b) utilize data that enables them to observe whether firms that choose to formalize are significantly different in terms of growth rates prior to formalization compared to firms that choose not to formalize. Moreover, they document that very few firms formalize to hire more paid employees. They rather choose to employ unpaid family-members. These results are partly in line with those of Cling et al. (2017), who find that many household businesses do not perceive any growth benefits of formalization. They state that procedures are complicated, and they are unable to determine how taxes are calculated, reinforcing the perception of taxation as an arbitrary process.

Finally, some scholars argue that informality is the consequence of lack of information on behalf of SMEs and blurry regulations in place in relation to registration. In fact, as Cling et al. (2017) argue, informality is the result of complex and unclear registration procedures, rather than an intention to evade taxation. To support their argument, the authors use first-hand data from a survey implemented in Ho Chi Min City and Hanoi, combined with qualitative interviews from a sub-sample of the survey. The evidence shows that almost all informal SMEs are generally unaware of regulations, though they appear to be aware of the fact that they would be less subject to corruption if they registered. In addition, the Cling et al. paper finds that the incentives beyond the setting up of

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⁶ For a detailed discussion of Vietnamese formal/informal wage gaps at worker-level, see Nguyen et al. (2013).
the business are quite important when it comes to formalization: if the business has been set up because of an independent choice and not in response to the lack of any other viable alternative, the likelihood is higher that it is registered. The location of business premises also matters, as businesses with fixed premises are more likely to be registered. Whether institutions, information or trade affect informality in Vietnam, the accumulated evidence seems to point to the notion that the benefits of formality have to be more clearly communicated and understood by SMEs.

Informality can also exist at the employee level (within a formal firm). This is so even if registration should be compulsory for all formal workers. Accordingly, not many employees enjoy social insurance as present, as a vast majority of them tends to collect their benefits upon termination of employment. This means that very few meet the requirement of twenty or more years of contributions necessary for claiming a pension at a later stage. Salaries for employees also tend to be underreported to reduce contributions from employers, and employees often agree to receive slightly higher salaries on the condition of remaining unregistered (Castel and Pick 2018). This is problematic as formality and employee registration bring forward a number of other benefits for both firms and employees, including stable wages, decrease in casual labour, better access to less expensive credit, higher profits, and increase in customer demand. Formal firms are much more productive than informal firms partly due to higher levels of education recorded amongst formal firm owners (La Porta and Shleifer 2014).

Three chapters are directly relevant to these reflections about firm informality and labour conditions. In Chapter 7, Thi Bich Tran and Hai Anh La address the reasons that push household businesses to remain informal. They find that informality amongst top-tier firms results from household businesses perceiving the tax cost of formalization to be larger than the benefits of formalization. As government officials do not promote formalization amongst this category of firms, the authors hypothesize that corruptive behaviour between top tier firms and government officials may perpetuate the former’s condition of informality. Turning to Christophe J. Nordman and Smriti Sharma in Chapter 10, they look at economic returns derived from working conditions and shows that no mechanism is in place in Vietnam to compensate labourers working in unfavourable conditions and lacking a formal contract. In addition, employees hired through formal procedures, and lacking a formal contract, earn less than similar employees hired relying on social network channels. Finally, Nina Torm deals in Chapter 11 with the benefits of trade union membership. She finds that, controlling for firm and worker characteristics, the wages of unionized workers are between 9 and 22 per cent higher than wages of non-unionized workers, with gains increasing progressively towards the upper end of the distribution. Axel Demenet and Quynh Hoang in Chapter 5 also touch upon informality, though indirectly. They study the degree of informality and firm performance looking at the importance of management practices for
SMEs productivity; and they show a positive and significant association between managerial capital and firm productivity, particularly relevant for micro (informal) and small enterprises, as opposed to more formal firms of medium size.

In sum, we reiterate that the Vietnamese economy has undergone dramatic changes in the last thirty years or so since Doi Moi began in 1986. Whilst the country has on the one hand opened up to the global economy, a number of wide ranging domestic changes have also taken place, which have contributed to increasing the general wellbeing of the population. Structural reallocations of the labour force from agriculture to manufacturing has increased the number of domestic firms; combined with an increase in the number of foreign firms and foreign direct investment. The introduction of the Enterprise Law in 2000 played a key role in this, in particular for small and micro-enterprises, easing the procedures for firm registration. Nonetheless, these procedures remain rather complex and ambiguous, especially when it comes to smaller firms, which do not need to register fully, depending on the size of their turnover and the location of their premises.

Arguably, the blurred lines between formality and informality have negative consequences for the future of the Vietnamese economy, especially as evidence demonstrates that small informal firms have lower levels of total factor productivity, are more credit constrained, and the wages of their employees are significantly lower than the wages of their formal counterparts. However, formalization encounters a number of obstacles. Going forward it seems policy makers will have to promote SME-formalization, whilst at the same time improving the institutional environment for formalization. In the meantime, SMEs must adapt to the changing character of the Vietnamese economy. Highly relevant success stories from the early stages of privatization and transition show that those Vietnamese SMEs that were capable of adapting their strategy to the needs of the export-oriented and labour-intensive manufacturing sector are those that managed to achieve sustainable growth (Taussig 2013). Yet, as seen above, the process of adaptation, renewal and growth remains paved with challenges. We try in this book to shed further light on the nature of these challenges and suggest new perspectives on how to tackle them.

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References

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