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Performance of export-oriented small and medium-sized manufacturing enterprises in Viet Nam

By

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Abbreviations and acronyms

ASMED	Agency for SME Development
CAGR	compound annual growth rate
IE	Institute of Economics
ILSSA	Institute for Labour Studies and Social Affairs
MPDF	Mekong Private Sector Development Facility
MPI	Ministry of Planning and Investment
OLS	ordinary least squares
SME	small and medium-sized enterprise
SMME	small and medium-sized manufacturing enterprise
SOE	state-owned enterprise
WTO	World Trade Organization

Executive summary

Liberalization of the business environment as well as increased international integration in Viet Nam have resulted in the rapid expansion of small and medium-sized enterprises (SMEs) in general and export-oriented small and medium-sized manufacturing enterprises (SMMEs) in particular, especially since 2000. More than 95 per cent of formal enterprises belong to the SME category. Around 17 per cent of SMMEs are involved in export activities. The export-oriented SMMEs account for 36 per cent of workforce and 45 per cent of total assets, and contribute to around 42 per cent of industrial output of all SMMEs.

Export-oriented SMMEs tend to be larger in size and mainly belong to the medium-sized category. They are unevenly distributed among regions and are mainly concentrated in the south-east of the country. They are owned both by domestic private companies and by foreign investment enterprises. Among SMMEs, the export-oriented firms are more likely to survive in business, expand their operations, generate jobs and become large enterprises. Although they perform well in terms of growth rate, especially foreign investment enterprises, the profitability of export-oriented SMMEs is relatively low. The promising findings are that among export-oriented SMMEs there is increasingly sustainable development, and that this sector is becoming more efficient and productive.

Those SMMEs in the medium-sized category, and which are owned by foreign investors operating export-oriented industries located in the South-East and the Red River delta, have a higher probability of participating in the export market. SMMEs also gain benefits from international integration in the improvement of their performance, and the large manufacturing enterprises within the industry play an important role in increasing export participation by SMMEs.

In addition to the traditional factors determining the performance of export-oriented SMMEs, i.e., capital and labour, this study finds ownership form, company location, previous experience in the export market (but not the type of industry in which they operate) to be significant determinants of export-oriented SMME performance – expressed in terms of revenue and revenue growth in this paper. The findings do not appear to support the hypothesis that financial constraints hinder export participation by SMMEs and the performance of export-oriented SMMEs. This is probably because export-oriented SMMEs are the best performers among SMEs and therefore have better access to financial sources than other SMEs. Analysis of the 2004-2005 data shows that export-oriented SMMEs are more likely to create jobs than those that are not, as well as to become large enterprises.

The study recommends the formulation of policies that support the development of business linkages and networking, and which promote subcontracting arrangements between small and large enterprises or between domestic firms and foreign investment enterprises. It is also necessary to support and facilitate the direct involvement of SMMEs in exporting or indirectly through large manufacturing enterprises. Moreover, it requires substantial investment in infrastructure and industrial support facilities and services (i.e., roads, ports, logistics facilities and services, and market information) in the underdeveloped regions with priority being given to those areas with the greatest potential for development, i.e., the North central coast, the South central coast and the Mekong delta.

Introduction

Since 1986, liberalization of the business environment and increased integration into the world economy has been a key theme in the open-door policy of Viet Nam. Most notably, the central Government has made great efforts in promoting and facilitating the development of the private sector by promulgating and implementing a number of business and investment promotion laws since the early 1990s, and has been especially successfully with its introduction of the Enterprise Law¹ in 2000. Furthermore, trade policy² in Viet Nam has changed significantly from inward-oriented import substitution towards outward-orientation (Oostendorp and others, 2006). Most recently, Viet Nam became an official World Trade Organization (WTO) member in January 2007.

During this process, the SME³ sector has developed at a remarkable pace in terms of the number and performance of enterprises. The highly dynamic SMEs created about 28 per cent of the total of 7.5 million newly created jobs during 2000-2005 (Government of Viet Nam, 2006). However, a review of the literature indicates that there are several major concerns regarding the SME sector:

- (a) Although the number of private domestic firms registered under the Enterprise Law increased steadily each year (e.g., from 14,441 in 2000 to 39,881 in 2005), only half of the firms actually exist. In addition, existing enterprises are very small whereas “middle and importantly high end” firms are missing (Viet Nam Development Report, 2005; Ministry of Planning and Investment, 2005);
- (b) The emerging private sector is still, to a large extent, inward-oriented, and a very small proportion of private manufacturing SMEs are participating in the export sector (Viet Nam Development Report, 2005; Kokko and Sjöholm, 2004);
- (c) Most SMEs do not realize the great impact that globalization and integration have on their businesses with regard to the continuous improvement of their competitiveness as well as the new opportunities provided by the integration (Ministry of Planning and Investment, 2005; Institute of Economics, 2003).

These concerns would suggest that small domestic businesses face obstacles in operating, expanding and eventually making it to the top (Viet Nam Development Report, 2005). The inward orientation and small scale of the SME sector are expected to pose a big challenge for the future contribution of SMEs to economic growth, export performance, job creation and poverty reduction targets, as pointed out in the Social Economic Development Plan, 2006-2010.

In Viet Nam, previous studies on the development of the private sector and SMEs have been conducted by Riedel and Tran (1997), Webster (1999), Webster and Taussig

¹ The most important aspect of the Enterprise Law was the simplification of the business registration procedure for new private enterprises and the elimination of more than 160 business licences and permits as well as thousands of sub-licences and conditions issued at the ministerial and local levels since 2000.

² It included a shift from a state monopoly of foreign trade towards a more competitive system, with increasing participation by the private sector, the abolition of non-tariff barriers, integration with the world economy via regional and multilateral trading agreements, and the unification of the multiple exchange rate system.

³ SMEs in Viet Nam are defined as businesses and production establishments that have a registered capital of less than Dong 10 billion (about US\$ 625,000) or annual permanent employees numbering less than an average of 300, or both. In this paper, SMEs in Viet Nam are defined in terms of labour.

(1999), Ronnas and Ramamurthy (2001), Steer and Taussig (2002), Ministry of Planning and Investment (2005), and Hansen and others (2005). These studies typically focused on analysing the changes in the role of the SME sector over the past few decades and on providing a comprehensive picture of the benefits, obstacles and challenges in the development and internationalization of SMEs in Viet Nam, and the important determinants of their performance. Recently, Kokko and Sjöholm (2004) reported that economic internationalization had little direct impact on SMEs, i.e., only a few SMEs actually benefited from internationalization with regard to the expansion of their markets and increased revenue. The study also noted that successful enterprises had gradually grown and no longer belonged to the SME category.

It is a fact that export-oriented manufacturing SMEs⁴ are viewed as a dynamic, flexible and innovative sector, contributing to exports and industrial development. In Viet Nam, these enterprises tend to be larger in size, perform better and enjoy more opportunities for becoming large enterprises when compared to the majority of SMEs in general, and manufacturing SMEs in particular. They also have very different characteristics in terms of ownership, regional distribution and industry of operation to those of other SMEs, especially manufacturing SMEs (annex 1a and 1b). A better understanding of this type of enterprise as well as how to support and promote them will be the key to the success and further industrial development of Viet Nam in the future.

Moreover, the literature review shows that to date none of the previous studies comprehensively analyses the performance of export-oriented manufacturing SMEs⁵ in Viet Nam. Therefore, it is an excellent opportunity to study this issue in Viet Nam in terms of the dynamic changes resulting from integration into the world economy.

The main objectives of this study were to reveal the factors behind export participation by manufacturing SMEs and the performance of export-oriented manufacturing SMEs, and to identify a set of measures that would enable SMEs to more easily and directly participate in global trade, especially in the post-WTO context.

To achieve the main objectives discussed above, this study seeks to answer the following questions:

- (a) What was the development and performance of export-oriented manufacturing SMEs in Viet Nam during 2000-2005?
- (b) What are the determinants of export participation by manufacturing SMEs in Viet Nam?
- (c) What are the determinants of performance by export-oriented manufacturing SMEs in Viet Nam?
- (d) What are the implications for formulating a set of administrative and regulatory measures and systems that would enable SMEs to more easily and directly participate in global trade?

⁴ Export-oriented manufacturing SMEs in Viet Nam are formally registered enterprises that have an average number of annual permanent employees of less than 300, are operating as manufacturers and are involved in direct export activities in the surveyed year.

⁵ *Ibid.*

The analysis in this paper is based on the availability of six enterprise surveys⁶ of enterprises that are in actual operation at the end of each previous year, which were conducted annually from 2001 to 2006 by the General Statistical Office of Viet Nam. The surveys collected information related to business industry, performance, labour, capital, taxation, and involvement in export and import activities of enterprises. Some extended sections regarding skilled labour, intermediate inputs, research and development expenditure, technology level, ICT applications, technical training for employees of enterprises and investment climate were collected separately.

Chapter I provides an overview of the SME sector and a review of SME support policies that have significant effects on the development of the SME sector in general, and an analysis of the development of export-oriented SMMEs since 2000 in particular. Chapter II quantitatively analyses the export participation of manufacturing SMEs and the performance of export-oriented SMMEs in Viet Nam during the past few years. Chapter III discusses the policy implications drawn from this study.

⁶ In 2001 and 2006, 42,288 and 113,352 enterprises were surveyed, respectively. Manufacturing enterprises accounted for around 22 per cent of all the enterprises surveyed. Some 89 per cent of all manufacturing enterprises were within the small and medium-sized categories. The panel enterprise data can be constructed from these surveys.

I. Development and performance of export-oriented SMMEs

A. Characteristics and development

The development of the SME sector in Viet Nam can be divided into two phases, with the turning point in 2000 when the Law on Enterprises came into effect. Since then, the Government has adopted more reform policies to accelerate development of the private enterprise sector (box 1). As a result, the SME sector has achieved significant development (box 2).

The rapid expansion of the SME sector resulted in the rapid increase in terms of the number of export-oriented SMMEs at a compound annual growth rate (CAGR) of 16 per cent between 2000 and 2004. Table 1 shows the number of export-oriented SMMEs increased rapidly from 1,551 enterprises in 2000 to 2,225 enterprises in 2004. Although only around 17 per cent of SMMEs were involved in export activities, they accounted for 36 per cent of the total employees working in all SMMEs and 45 per cent of total assets utilized by all SMMEs. These shares have not changed much during the past few years.

Table 1. Export-oriented SMMEs in Viet Nam, 2000-2004

	2000	2003	2004	CAGR 2000-2004 (%)
Enterprises				
Number of export-oriented SMMEs	1 551	2 225	2 810	16.0
Percentage of all SMMEs (%)	17.3	16.0	17.2	
Employment				
Employment of export-oriented SMMEs (persons)	163 057	222 242	282 851	14.8
Percentage of all employees of all SMMEs (%)	36.9	33.0	35.9	
Persons engaged per export-oriented SMME (persons)	105.1	99.9	100.7	
Assets				
Total assets of export-oriented SMMEs (billion dong)	35 032.7	55 030.4	7 6903.4	
Percentage of total assets utilized by all SMMEs (%)	45.6	43.3	44.7	

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