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## Conclusion

*John Rand and Finn Tarp*

Structural change has been a significant contributor to Vietnam's impressive growth experience over the past three decades. Labour has moved rapidly from agriculture into manufacturing, with important improvements in livelihoods as the result. The private sector has played a key role in this success story, and especially SMEs have shown the necessary dynamism to adapt to an economic policy and institutional reform design, characterized as decentralized experimentalism. This dynamism of private SMEs has played a crucial role for the pace of diffusion of experimental successes—upstream and downstream along the value chain. Whether this success will carry into the future when innovation of new technologies (instead of diffusion of existing technologies) and TFP/productivity growth (instead of structural change) will have to become core drivers of Vietnam's growth prospects (as argued by Dang et al. 2019) stands out as a major challenge for future success.

In this book volume, we addressed this challenge striving to develop a better understanding of what drives SME growth and progress, as well as uncovering insights into the underlying behaviour of SME owners, managers, and employees. Coming to grips with these issues, is essential for both the development profession and policy-making community in figuring out how to address the task of promoting continued and sustainable private sector development. The roots of this volume grew from a time when the first Danida supported SME survey of Vietnamese non-state manufacturing enterprises covering more than 2,500 firms (formal and informal) in ten provinces began in 2005.<sup>1</sup> The success of the 2005 SME survey became an inspiration. It led 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 have together implemented the survey of these enterprises every two years. It is on this extraordinary foundation the present volume builds.

<sup>1</sup> The original survey drew inspiration from the work in 1991 by Ronnås (1992).

Importantly, since the surveys tracked the same SMEs during a decade characterized by significant economic and institutional changes and transformation, the SME panel data is a very strong tool for gaining detailed and policy-relevant information about private sector firm dynamics and enterprise development in Vietnam from 2005 to 2015. Moreover, all chapters in this volume cover owners, managers, and employees in these SMEs. They lived through and experienced a critical period in Vietnam's economic development process while managing their daily private and productive lives. How firms coped and ended up performing (or not performing) in a highly dynamic business environment under a complex set of constraints is key in what the chapters of this volume tried to uncover. In general, understanding the circumstances under which SMEs operate and the constraints and opportunities they face is an indispensable input into sound evidence-based policy-making for the future of the SMEs, the overall economy, and the welfare of the Vietnamese people in both urban and rural areas.

The SME data are exceptionally informative regarding particular themes and mechanisms influencing SME performance and development. This is why this volume was organized in three component parts, including: (i) credit access and management practices; (ii) political connections, institutional quality, and innovation; and (iii) certification, working conditions, and union membership. Throughout, the authors were determined to bring out the underlying dynamics and on identifying associated policy challenges.

What did we learn from following the same Vietnamese SMEs over a decade? A general, crosscutting, and telling insight from the chapters in this volume is that around 10 per cent of SMEs close their business every year. Given the steady increase in the population of SMEs recorded during the period 2005–2015 together with increasing average performance and productivity among survivors and new entrants, this suggests that a process of positive creative destruction forms part of the Vietnamese success story. On the other hand, we also found coherent evidence supporting that there is significant heterogeneity among smaller firms. One group, 'the necessity entrepreneurs', stays informal with low productivity and lacks better opportunities, while 'opportunity entrepreneurs' often seek formality and perform better in terms of both employment growth and productivity in the longer run. Accordingly, a key lesson here is that many of the informal micro firms stay in operation out of 'necessity', not because of 'opportunity'. The policy implication is that entrepreneurs, driven by respectively necessity and opportunity, need different policies to prosper. A one-size-fits-all approach does not work. This is a conclusion that emerges in different ways as well in the more specific findings of the chapters in this volume. They include nine more specific sets of conclusions.

First, resource misallocation reduces aggregate productivity and growth significantly. Several of the chapters in this volume directly or indirectly address this theme. One key result is that SMEs with higher marginal returns to capital are on

average less likely to get access to financing, confirming that misallocation of capital is indeed a concern with real economic implications. Moreover, and importantly, rejected credit applications constraining investment activity are especially limiting at the upper end of the investment efficiency distribution. This leads to clear inefficiencies that future reforms of policy must surely address.

Second, one reason for economic inefficiencies is that the capital structure of Vietnamese firms reflects that firms balance between the ‘trade-off’ and the ‘pecking order’ theory. Accessing formal debt is extremely difficult for well-performing young (new entrants) and non-state firms. They bootstrap themselves out of financial constraints by stretching and making the most of their internal resources and assets. In contrast, established incumbents with access to formal loans use their influence, and exploit tax benefits in response to financial distress. Another key finding in this context is that informal debt markets are very important for high profitability entrepreneurs, and while human capital encourages entrepreneurs to obtain formal loans, its interaction with institutional quality deters debt financing, and favours other financial sources. We reiterate that this leads to in-optimal loan allocations that policy must address as a key priority.

Third, managerial capabilities are an important determinant for the growth path of SMEs in Vietnam. Utilizing a multidimensional measure of managerial capital, which combines both practices and attitudes of entrepreneurs, we see a clear positive association between managerial capital and productivity. We also see how changes in management practices support firms in becoming more efficient over time. Importantly, ‘entrepreneurial attitudes’ 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. Furthermore, effects are very heterogeneous across firm size, with improvements in managerial capabilities having significantly more impact on smaller inexperienced SMEs than on larger incumbents. Key insights for effective policy design flow from these observations.

Fourth, having close ties to government officials may not only be beneficial for smaller businesses wanting to stay ‘under the radar’. It may also be of importance for SMEs operating at a larger more formal scale. Our data reveal that 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 of Vietnam decreases the likelihood of being credit-constrained by 4 percentage points. Moreover, politically connected SMEs accessing credit face lower cost-of-capital than non-connected SMEs not excluded from formal financial markets. Finally, the data shows that the impact of political connections is most valuable during periods of financial distress, and less prevalent during business cycle upswings. These findings are important. They reinforce the above finding that credit-allocation is not optimal and that policy change would lead to greater economic

efficiency. It also suggests that it is wise policy to consider expanding credit in periods of distress as Vietnam did in 2007–08.<sup>2</sup>

Fifth, we have already observed that differential impacts across firm size matter. So do different degrees of formality. Taking into account previous experience with the Vietnamese licencing system, the most productive informal household businesses are not always those that ‘switch’ into formality. Many of these highly productive informal SMEs do not perceive the potential positive effects of formalization as relevant for their business going forward. Tellingly, they state that the reason for staying informal is that they expect the net costs from increased tax payments to surpass the net benefits from formalization, also in the longer run. We stress though that the data also give rise to an alternative explanation.<sup>3</sup> Government ‘push’ initiatives towards increased formalization are heterogeneous across informal household businesses, with the upper tier informal entrepreneurs most likely to ‘escape’ civil servant demands for improved business licensing. Combined with information from bribe incidence data, this raises the possibility and critical policy concern of collusion between upper tier informal SMEs and public officials. This highlights that no single policy can ensure proper balance between the need for generating public revenue and the critical importance of furthering firm efficiency.

Sixth, differences in institutional capacity/quality across the ten provinces covered by the SME survey matter for the innovative capacity of SMEs. The same goes for the interaction with human and financial capital scarcity in these locations. This volume therefore zoomed in on the relationship between the innovative capacity of SMEs and the relative abundance of resources available (slack resources) to the SMEs across different locations. This reveals that in locations with a more favourable business environment the impact (on innovation rates) of relative human resource abundance is less pronounced than the impact (on innovation rates) of relative abundance of capital. In terms of policy, this calls attention once more to the need for pursuing an effective balance between the allocation of scarce capital and human capital policy—and associated institutions.

Seventh, a promising policy-tool to protect especially mid-sized businesses from downside shocks and minimize risk is the development of internationally recognized quality control systems (i.e., certification). Interpreting business risk as variability in revenue, variability in customer base, a practice of making informal payments, and temporary firm closure, our data document that certified firms experience lower levels of business risk. We once again find significant heterogeneity across provinces with firms located in rural areas and in the northern

<sup>2</sup> See Thurlow et al. (2011).

<sup>3</sup> See also see Rand and Tarp (2012).

provinces of Vietnam as those most likely to benefit from such internationally recognized certifications. The policy implication is that further expansion of such systems is highly recommended both with a view to expanding exports and from the perspective of minimizing business risk in a challenging environment.

Eight, a particular strength of the SME panel data is its employer-employee component. This made it possible in this book volume to add value to the literature on the effect of different labour market conditions on individual earnings. In the absence of adequate institutional mechanisms, trade unions can help promote equity and social justice for workers through higher wages and other worker benefits. The results show that the wages of unionized workers are 9–22 per cent higher than the wages of non-union workers, controlling for both firm and worker characteristics. This points to a potentially important role for trade unions that could bring future advantages if further developed in Vietnam.

Ninth and finally, the employer-employee data makes it possible for analysts to establish whether workers obtain compensation through higher wages for working in vulnerable jobs and in unfavourable working conditions. The results indicate that there are no clear compensating mechanisms for working in poor conditions, for having an informal contract, and for having few financial benefits. In addition, workers in the upper tail of the wage distribution are more likely to suffer due to working in adverse working conditions. Finally, employees recruited through official hiring channels with an informal contract earn less compared to employees, relying on a social network hiring channel. Such differences are clearly a concern and they suggest that decisive policy action is required to address them.

In sum, the need to develop the private sector and the importance of ensuring that the motoring capacity of private initiative and entrepreneurial spirit is mobilized to the maximum in support of sustainable development took a central place in the Sustainable Development Goals (SDGs) approved by the UN General Assembly in September 2015. While the development community across a wide spectrum recognizes the need for private sector dynamism, we know much less about how to ensure this happens in practice, and what is required in concrete terms when it comes to policy action. We put forward the present volume with the ambition to help fill this gap with a series of insights from a dynamic East Asian country that has managed to combine aggregate growth, structural transformation, and poverty reduction. We hope this will help inspire action elsewhere as we believe researchers and policy makers can learn a great deal from this experience. We also hope that our findings and recommendations will help inform Vietnamese policy-making in the continued search of how to promote private sector driven development in the years to come and how to achieve the SDG aspirational goal of leaving no one behind.

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