

# **Developing small and medium enterprises (SMEs) in Vietnamese transitional economy: An operational model**

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## **ABSTRACT**

This paper examines the factors contributing to the growth of SMEs by using a conceptual framework derived from the concept of resource; cluster; networking; and institutional theories. The Vietnamese experience suggests that institutional weakness and lack of proper coordination between policy making and implementation has made the support regime ineffective. Most importantly, the effectiveness of government support policies can be analysed by the principle of resource theory.

The findings indicate that Vietnamese government has mainly focused on increasing the number of SMEs rather than improving the performance of SMEs and strengthening the business' competitiveness. This paper suggests that the clustering and networking approaches, as well as institutional reform may be the key success factors for overcoming the SME resource constraints in Vietnam.

*Keywords: SMEs, transitional economies, support policies*

## **Developing small and medium enterprises (SMEs) in Vietnamese transitional economy: An operational model**

### **INTRODUCTION**

SMEs in Asian developing countries and Central and Eastern European countries require strong aid from the government in terms of finance, technology, logistic, training, human resource development and entrepreneurship development. In Vietnam, however, the development of SMEs requires not only the aforementioned policies but also stronger support in the form of legal framework, information, credit, export promotion, tax, land, institutional and banking reform (US/Viet/95/004). Furthermore, a recent study that was conducted by Ha and Swierczek (2003) has found that the performance of SMEs in Vietnam was positively related to entrepreneurial culture. Thus, it seems that informal institutional development (in this case is the development of entrepreneurial culture) is as important as formal institutional development to the growth of SMEs in Vietnam. This paper examines how key physical, managerial, technological, strategic, cultural and organizational factors influence the business operation process of SMEs in Vietnam.

The resource based theory, aswell as clustering, networking, and institutional theories provide an analytical framework to explain how a well-defined support regime can provide policy support, resource, and institutional infrastructure for the growth of SMEs.

### ***SMEs Growth Pattern***

The growth of SMEs depends on many factors. These factors vary from country to country. McIntyre (2002) argues that a synergistic relationship between the SMEs and the larger enterprise sector is a critical factor. Havie (2002) observes that in China, the development of the Township and Village Enterprises (TVEs) is an important aspect for the growth of SMEs. McIntyre (2002) also recommends this synergistic relationship, and additionally, the process of urbanization, which is based on both

horizontal and vertical linkages such as industrial district and cluster (cited in Julien 1993, and You 1995), and the external economies of agglomeration and scope that played a large role in the post-World War II successes of Northern Italy. Regnier (1994) examines the overall experience of the four Asian newly industrialized countries (Singapore, Korea, Hong Kong and Taiwan) as examples for the need to promote the SMEs sector and also to encourage linkages between large and the small-scale enterprises. Empirical evidence in some developing Asian countries also support this trend: large firms (particularly state enterprises) sponsored and promoted local SMEs in Indonesia (Hill, 2002); the Department of Industrial Promotion (DIP) in Thailand implemented programs that promoted linkages between SMEs and large firms, and developed SMEs clustering and networking (Brimble, Oldfield and Monsakul, 2002).

Various theories have explained that SMEs' growth from different perspectives. However, in order for a SME to develop its core competency, adequate resources (both internal and external) are an importance prerequisite.

### ***Resource Based Theory***

Rindova and Fombrun (1999) and Simons, Tan, Wright, and Walsh (1997) argue that resources, capabilities and core competencies are essential for a firm's competitive advantage. Therefore, enhancing capability, via adequate resource support and policies, is critical for SMEs' growth as they are small in size and need assistance. Resource-based theory provides a framework to explain how businesses can identify suitable measures to overcome growth obstacles, obtain better access to technology resources, manpower resources, financial resources, natural, and infrastructure, and acquire access to the market. According to Barney (1991) and Grant (1991), the four types of tangible resources are financial, organizational, physical, and technological. The three types of intangible resources are human, innovation and reputational resources. An example is the TVEs model in China, where TVEs rely on the state sector as a source of capital, materials, equipment, specialised personnel, technology, subcontracting arrangement and sales revenues (Harvie, 2002).

### ***Approaches to develop a firm's resource***

### ***1. The clustering approach***

The term cluster is used to describe a geographic concentration of interconnected companies and institutions in a particular field. Porter (1998) proposes that industrial cluster policies can be a growth strategy for a firm. This argument is strongly supported by Enright and Robert (2001), Dijk and Sverrisson (2003), and Nadvi's (1995) since SMEs can receive external economic advantages (economies of scale and scope) if clustering and networking offer a potential growth path for SMEs.

Many Central and Eastern European countries have used the clustering approach for assisting the development of SMEs. Some examples of such countries are Poland, Hungary, Slovenia, the Czech Republic, Slovakia, Ukraine, Lithuania, Estonia and Latvia, (Ionescu, 2003). Examples of cluster theory being used in practice can also be found in Eastern Asia and Latin America. These include the surgical instrument clusters in Sialkot, Pakistan; the electronic clusters in Penang, Malaysia; knitwear in Tiruppur, India; software in Bangalore, India and leather shoes in the Sinos Valley, Brazil (Abonyi, 2003). Tambunan (2005) also suggests that experiences in many European countries show that the clustering approach can be a powerful means for overcoming SME resource constraints in transitional economies.

### ***2. The networking approach***

'Firms should not be seen in isolation but as being connected in business systems' (Ritter, Wilkinson, and Johnston, 2003, p.175). Lechner and Dowling (2000) define networks as the relationship between individuals or between organizations that have various functions.. Therefore, network relationships can be considered as an important intangible resource to support SMEs who do not have sufficient resources by helping them develop links with suppliers, distributors and customers, or utilize social contacts, including acquaintances, friends, family and kin.

The networking approach is applied in Moldavia, the Ukraine and Belarus (Smallbone and Welter, 2001); Thailand (Brimble, Oldfield and Monsakul 2002); Zhejiang, China (Krug and Hendrischke

, 2003); Taiwan (Ngui, 2001) and Korea (Gregory, 2002). In addition, Nadvi (1995) suggests that both local associations and government support bodies facilitated the development of clusters and networks of SMEs in Brazil, Mexico, India and South Korea.

### *The application of Institutional theory*

North (1990) emphasizes that market economies convert resources - land, labour, energy, and capital - into manufacture services and goods. To make this conversion a success, institutions must also help and guide those transformations in predictable ways. Kartz (1995) observes from the economic histories of both newer and mature markets based in Asia, North America and Western Europe, that private enterprises cannot emerge and prosper in an imperfect market without a conducive policy environment and institutional support system. Murrell (2003) also states that at the beginning of economic transition, institutional support is vital. Institutions must be designed so that they are able to work in the environment in which they are to be implemented. The success of China indicates that transitional institutions, formed by incremental change, can be helpful. In China, there was much enthusiasm for accepting new measures to improve the economic situation, but under the condition of not moving too far from the existing system.

The above examples suggest that resource based theory; clustering, networking approach and application of institutional theory are intertwined. The main argument is that, in gaining better access and utilizing resources, firms need to cluster in suitable locations, build strategic alliances or network in a cluster of firms. This is in order to attain the critical mass needed to create support infrastructure. These theories also emphasize the role of supporting institutions as agents for facilitating the development of firms' clusters and networks, with the assertion that improving technology flow, and knowledge is vital. The context of economic transition in Vietnam would require a conceptual framework in order to examine how: SMEs can pool their resources together and effectively use them; seek support from government and institutions (both formal and informal) to sustain the SMEs and, create a favourable business environment for them to grow.

## ***SMES IN TRANSITIONAL ECONOMIES***

### ***Transitional Economy and Market Reform***

Transitional countries in Central and Eastern Europe (CEE) applied the rapid change “shock therapy” to put the economy on “automatic–pilot.” As a result, the market determined supply, demand, prices, and economic transformation. Government sectors played no significant role in this economic system. Contrary to the CEE approach, the Asian “gradualism” approach was an incremental process. Although private enterprises and the free market were seen to be the driving forces for this process, the public sector still played an active role in supporting and moderating market-based reform and private sector development at a macroeconomic level (Katz, 1995). It is vital that a centrally planned economy moves to market-oriented economy through the reduction of government ownership and control in business. However, a small or weak public sector may also hinder the growth of the private sector, as experienced by CEE countries when private enterprises, operating in a framework of market-determined prices, continued after the involvement of the public sector were eradicated. In contrast, the public sector continues to play a key role in strengthening and sustaining the development of a dynamic private enterprise sector and efficient market (Katz, 1995) in Asian countries such as Japan, South Korea, and Taiwan and even in the United States, Germany and the United Kingdom

### ***Policy Regime in Central and Eastern Europe (CEE)***

Support policies for SMEs vary from country to country and from developed countries to less developed countries due to differences in business contexts, culture and the level of industrialization. Since East European countries are now EU members, there are various EU programmes for SMEs that cover a range of needs. These include vocational training and education, infrastructure projects, individual and information technology development (Konopielko and Bell, 1997). In addition, SMEs in these countries also receive direct support from local authorities and the government. Poland and Bulgaria are a

case in point where SMEs are provided with training and advisory services, management, market information, credit access, exports promotions and the introduction of high-tech production. In the initial stage of transition, these countries suffered some setbacks when SMEs operated in imperfect markets that lacked institutional support. The CEE experience suggests that business support, infrastructure, financial support, legal and institutional framework, cluster and network relationships all play vital a role in business development.

### ***Policy Regime in Asian Industrialised Countries***

SME development is becoming increasingly important to many industrialized countries such as Korea, Taiwan, Singapore, and Australia. The Singaporean government identified four key problem areas for SMEs: (1) access to technology, (2) manpower, (3) finance, and (4) market (Lee, and Tan, 2002). In 1998, the Korean government employed a number of policies to foster the growth of SMEs and their involvement in the global economy. This was done by ensuring SMEs had access to finance; supporting a human resource development program and developing technology and scientific achievements so that businesses could develop extensive relationships with the global market (Gregory, 2002). According to Ngui (2002), SMEs in Taiwan have the following features: network-based industrial systems, minimum efficiency sizes and entry barriers and low agency and transaction costs. In Australia, special attention is given to key issues affecting the development of SMEs. These are, access to finance, the importance of culture/networking in the conduct of business, access to technology and the adoption of information technology, and progress made in regard to human resource development (Nguyen, Gregory, Harvie, Lee, and Ngui, 2002). The most common key features among Korea, Taiwan, Singapore, and Australia are support for technology and financial access, manpower access, and networking. The Korean government paid attention to developing ties between large firms and SMEs and the fact that large and small electronic firms' network clustered in Seoul, Korea is a good lesson for other countries to study.

### ***Policy Regime in East Asian Developing Countries***

Harvie (2002) identifies the case of TVE in China as providing important lessons for other economies in transition. To support private sector, China has reformed its financial system, tax and revenue system, enhanced technical innovation system, improved legal protection of property rights, devised education and training program, and opened up more sectors for private investment and competition. The Malaysian government has supported SMEs by providing financial and credit assistance, assisting entrepreneurial development, improving business management and human resource management, allowing consultancy and marketing services to grow, introducing technical and vocational programs, offering location and infrastructure facilities and providing fiscal incentives (Abdullah, 2002). In Thailand, the government introduced a financial incentive package, a technology development program and a provision of benchmarks (in technology, marketing, management, and governance). Additionally, policies were devised so that SMEs could integrate effectively into various industry value chains or clusters and become involved in more supportive networks such as academic institutions, government agencies and other firms in related and supportive industries (Brimble, Oldfield and Monsakul, 2002). This network relationship created new information flow and knowledge base for SMEs. China, Malaysia and Thailand benefited from these policy reforms, network relationships and new supportive infrastructure. The Indonesians experience suggests that neglected cluster linkages to markets was one of the reasons for SMEs failure. That is, economic advantages can only be achieved if the cluster has a well-developed network both internally and externally (Tambunan 2005).

Kartz (1995) argues that the transitional countries of Asia - Laos, Mongolia, Myanmar, and Vietnam - enjoy a significant economic advantage. This advantage is due to the fact that they are able to learn from the experiences of other transitional countries within Asia and Central and Eastern Europe, who have all had less political change and step by step incremental processes. These countries enjoy cheap labor and strategic locations with a reasonably large market in Asia and the Pacific. However, they do not enjoy a high level of industrialization. As a result, the change to a market economy and the



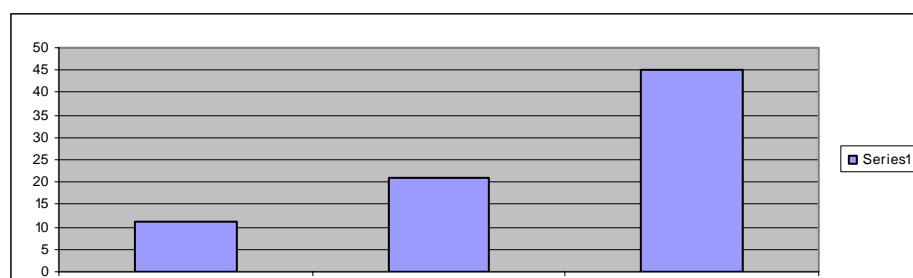
integration into a global market requires a gradual approach to change. The development of SMEs in Vietnam requires a well-designed policy package, infrastructure development program and effective institutional framework.

### ***THE VIETNAMESE POLICIES EXPERIENCE***

Recognising the important role that private sector can play in the transition process, Vietnamese government has made great efforts to encourage the development of the privately owned SMEs. Due to rapid change in the current international economy, further restructuring efforts and strategic policies for support are required for the development of SMEs. The development of SMEs through supportive infrastructure policies, as well as the legal and institutional frameworks, was of special importance.

#### ***The real situation of SMEs through the results of survey conducted in 2001, 2002, 2003 (GSO, 2004)***

While the number of enterprises is large, the size of enterprises is small and they are spread over the country with backwards technology. The figures show that about 48% of firms have lower than 10 employees, 32.9% have between 10 and 50 employees, and 14.1% have between 50 and 300 employees. Enterprises lack of resources (unskilled labour, small capital, and land, lack of supporting service on technology, legislation and information). Approximately 50.6% employees are not trained; 86.2% of firms have less than 550,000 USD; on average, a private firm uses only 0.17 ha of land while a state enterprise uses 1.61 ha; furthermore, there are about 48% of surveyed respondents informed that they met difficulties in gaining access to information; significantly, 72% informed that they had backwards technology. In accessing to credit, 49% of capital is capital of owner equity; only 4% is provided by government budget; 9% from other sources and 38% is from credit capital. Among this 38% of credit capital, state enterprises occupy 56.4%, of which 63.4% is concessionaire credit capital of state. A survey of 452 private SMEs conducted by the National economic management Institute in 2000 shows that:

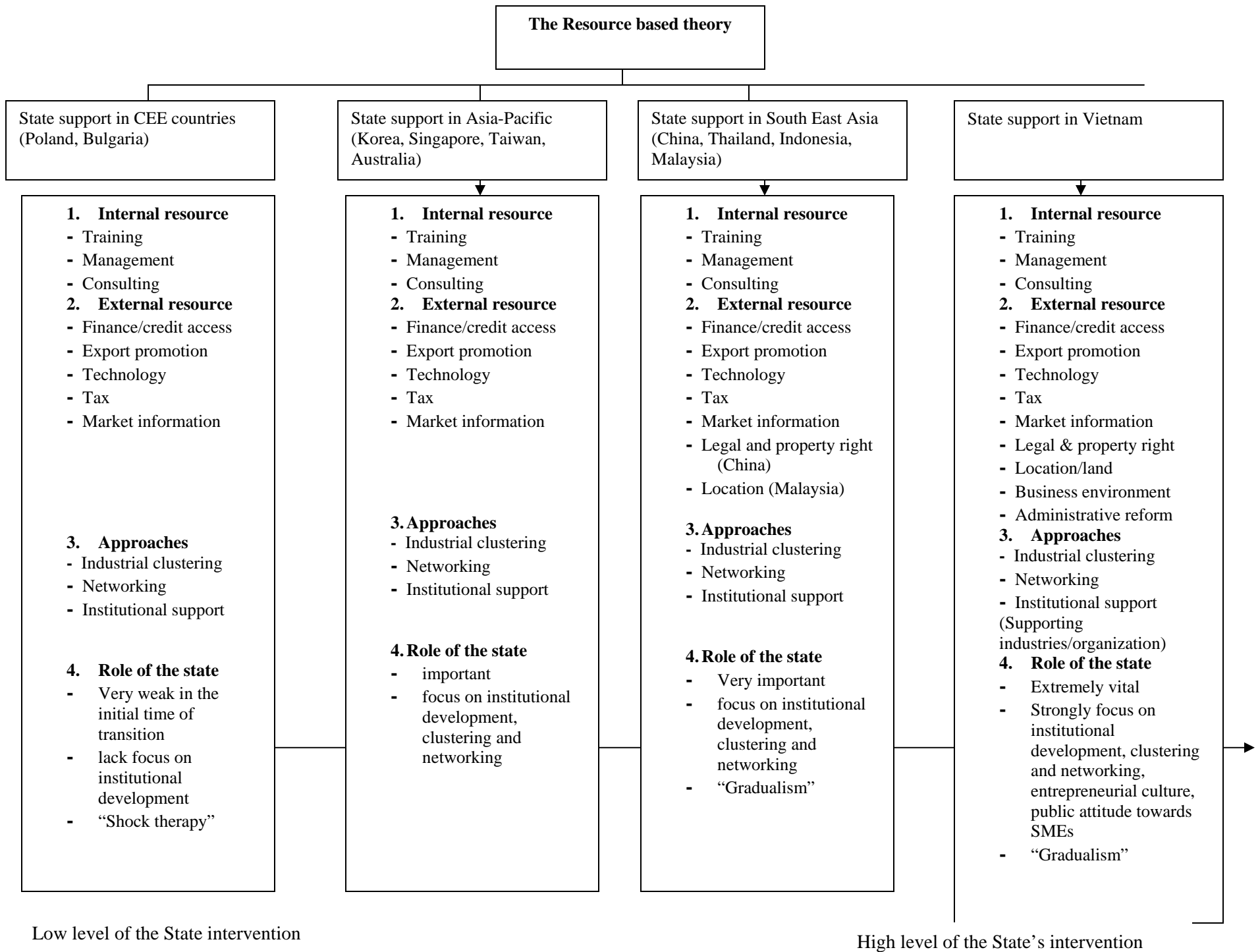


Source: Ho, Do, and Chu (2002)

According to Ho, Do, and Chu (2002) about 53% of the surveyed SME owners indicated that credit access was the most critical factor to private SMEs.

***An operational framework model for supporting SMEs***

A study on the effectiveness of supporting policies is crucial to identify the difficulties that SMEs have been facing in Vietnam.



## ***DISCUSSION***

### ***To what extent did government can support SME effectively?***

The policies of the government have not been strong enough to direct the firms for their investment. This has led to the situation that in many provinces and cities there are thousand of firms engaging in only on economic sector but they are not key sectors and do not affect local economy much. The Vietnamese government seems to focus on increasing the number of SMEs (quantity) rather than improving their performance (quality). According to GSO (2004), the contribution by the private sector to GDP did not grow much between 1995 and 2001 (8.6% and 8.8% respectively). This would indicate that the private sector does still not play a key role in driving the economy and, although the private sector is encouraged to be widely developed, the state sector is the firm foundation of the national multi sector economy. Additionally, the efficiency of doing business in private sectors is still not high. The ratio of profit per capital is only 2.3% in private firms. By 2002, the number of established enterprises rose to 63,000, but only 68% were real operating firms. This is consistent with the survival rate during 1996-2002 of private firms in the country economic report of Koko and Tingvall (2005) which is only 61.44%.

Land support is inequity between SMEs in private sector and SMEs in state sector. The reason is state SMEs is treated favourably, inadequate in land law with differentiated rules and incentives applying to various forms of business ownership and SMEs have to face severe limitation on the transfer of land. Similarly, the issue rose again for SMEs in seeking credit loans. Credit support from the government is mostly reserved for the state sector rather than the private sector. The private sector has had to face a lot of difficulties in accessing credit such as collateral procedure, credit term. SMEs heavily rely on informal credit and have no access to long-term formal credit and also have difficulties accessing foreign sources of finance.

Basing on the report of the GSO (2004), it seems that SMEs are in the embarrassing situation of finding supporting service on technology and information. A number of other studies Norad (2003), James and Chuong (1997) identified issues such as reveal the irrationality of the tax system and its

administration, bureaucracy and red tape, imperfect market regulation, inadequate property rights and competition as barriers for SME development.

With respect to the development of supporting industries in Vietnam, a recent study conducted by Mori (2005) suggests that appropriate policies may help domestic supporting industries overcome the obstacles of minimum efficient scale problem and information failure. In establishing a more level playing field for SMEs in Vietnam, Taussig (2005) asserts that “Most SME promotion programs have sought to balance the playing field by targeting more resources for select SMEs rather than aiming for systematic change in the form of fairer rules on how the game is played. The government of Vietnam and its development partners are both guilty of this “subjective approach”. The author intends to raise concern of the potential negative impact of Sakai and Tanaka (2000) in introducing the approach of SMEs credit guarantee funds, SMEs capital funds, and local government-managed SMEs promotion centers.

According to Koko and Tingvall (2005), in the ILSSA-SSE surveys of 1400 Vietnamese SMEs during 1997 and 2003, the findings indicate that legal advice or marketing assistance, and help in securing credit from government, during 1996 and 2002 has increased in Hochiminh city, Hanoi, Haiphong, Hatay, and Longan. However, while technical assistance for skill training has increased in Haiphong, Hanoi, Hatay it has decreased significantly (-67%) in Hochiminh city- the largest economic area in Vietnam which account for about 23.1 % of total firms in Vietnam in 2002. Similarly, the government assistance for hiring workers and managers has decreased (-47%) in Hochiminh city, (-8%) in Hanoi Capital, and (-100%) in Longan and Hatay provinces. The findings also indicate that, the distribution of government assistance in the South (Hochiminh city and Longan) seems to be less than in the North (Hanoi, Haiphong, Hatay) and incoherent. “There does not seem to be any clear urban-rural pattern in the provision of government assistance but there may be a north-south distinction” (Koko and Tingvall, 2005, p.38)

In general, it seems that the support policies for SMEs in Vietnam are inconsistent and SMEs in the public sector are treated more favourably. While private firms are being seen as a key driving force of the economy in many regional countries and CEE countries, and private firms in Vietnam are

allowed and encouraged to develop, State owned firms should still be considered to play a key role in the Vietnamese transitional economy. No specific strategies have been developed to establish links between SMEs in the public and private sector. No clear policies or guidelines have been designed to support SMEs to work in partnership with large businesses as suppliers, buyers or manufacturers. In addition, there is no clear policy direction on how businesses, in related and supporting industries, can support each other by transferring knowledge, infrastructure, and resources, all of which are critical. When formal institutions (e.g., laws and regulations) are weak, informal institutions (e.g., interpersonal ties) may play important roles in facilitating economic exchanges and therefore assert a more considerable influence on the performance of firms (Peng & Heath, 1996). The Vietnam experience could be the case in point where SMEs have to rely heavily on informal credit as a source of capital for overcoming resource constraints.

## ***CONCLUSION***

The paper is based on the base of resource theory and tries to suggest that clustering, networking, and institutional approaches can be powerful vehicles for overcoming resource constraints of SMEs. The operational model incorporates experiences from transitional economies in CEE countries and South East Asian countries with the Tanaka Sakai-Takada framework model that designed specifically for Vietnam's context. The policies framework is also an extension of the four-part policy framework proposed by Sakai and Takada (2000) since their model has not successfully addressed some of the critical support policies for the growth of SMEs in Vietnam. It has reviewed a number of concepts that apply to the new operational framework for examining the critical support policies for developing SMEs in Vietnam.

The operational policies framework is imperative for the following reasons:

Supporting policies for the development of SMEs may differ from country to country. A successful model in one country may be inappropriate if it is applied in another due to different political, legal, historical, economic, social, cultural, and resource conditions; although numerous studies have been conducted on SMEs in many transitional economies, few are in the context of

Vietnam. This paper hopes to fill the gap in existing literature by identifying critical support policies for SMEs in Vietnam.

From the above discussion, it could be concluded that an overall strategic policy is critical for supporting SMEs in Vietnam. The policy should be focus on how to support SMEs effectively rather than how to increase the number of SMEs in Vietnam.

In regard to future research, the conceptual model addresses a number of issues that need to be examined to identify factors contributing to the growth of SMEs in Vietnam.

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