Chapter 4: The market environment in the periphery

4.1. Sales

Thus far, it is clear that periphery provinces have expanded their sales tremendously over the past few years, but to whom are they selling? Sixty percent of the firms in the sample have more than 25 customers. Only in the three high performing provinces of Da Nang, Dong Nai, and Binh Duong do firms average less than 25 customers. By contrast, 80% of the firms in Thanh Hoa and 71% in Long An have over 25 customers. This is quite an interesting finding, which may imply that as the products and services of firms become more sophisticated, firms must service narrower markets.

4.1.1. Sales to whom?

Who are these customers? Table 16 profiles the main customers of firms in each province. Of course, many firms listed more than one type of customer.

Table 16 : Main customers, by province
(Percentages)

Province	Foreign Individuals	Foreign Companies	Vietnamese Individuals	Private Vietnamese Firms	Coop-eratives	SOEs	Central Govern-ment	Local or Provincial Authorities	Others
TT Hue	18.52	11.11	53.70	24.07	7.41	38.89	5.56	31.48	0.00
Hai Phong	0.00	41.38	17.24	41.38	0.00	48.28	0.00	3.45	3.45
Ha Tay	8.47	18.64	59.32	44.07	6.78	55.93	5.08	18.64	8.47
Thanh Hoa	0.00	6.25	62.50	31.25	6.25	37.50	6.25	37.50	0.00
Long An	2.22	22.22	64.44	28.89	2.22	8.89	0.00	17.78	2.22
Nam Dinh	4.17	4.17	41.67	45.83	14.58	52.08	8.33	35.42	2.08
High Performers	10.05	27.51	46.83	40.48	2.91	33.33	5.03	6.35	3.17
Total	8.90	23.21	48.49	38.79	4.45	36.41	4.77	13.35	3.18

Across the board, the main customers seem to be Vietnamese individuals, other private Vietnamese firms, and SOEs. This is also the predominant pattern in the high performers. Many of the secondary provinces, however, diverge to some degree from this pattern. The study found that 41.38% of sales from Hai Phong firms are to foreign companies, while only 17% are to individuals. These figures result from the high proportion of large firms in the Hai Phong sample, and the presence of a world-class international port in Hai Phong, which facilitates exports and contact with foreigners.

Firms in TT Hue, Thanh Hoa, and Nam Dinh all have very close business relationships with local authorities; over 30% of firms in these three provinces claim local officials are among their main trading partners. Nam Dinh and Ha Tay also have close business relationships with SOEs, as over 50% of their firms cite major sales to them. This gives some insight into why Nam Dinh firms

Interview Insight Box 8: The state sector as the engine of private growth?
Representatives of the Provincial People's Committees in both Nam Dinh and Ha Tay stressed the importance of the state business sector in their development plans. Both provincial governments stressed that SOEs would be the engine of growth in their economies. Such growth they reasoned would create opportunities for the smaller private sector to provide intermediate goods and services. Both provinces correctly stated that such a role for the state sector was also articulated in the Enterprise Law and the 1992 Constitution, but it is worth asking whether such an explicit concentration on the state sector may create a disadvantageous environment for private sector firms as they seek to expand their businesses.

have a difficult time being critical of their government – over 80% of their private firms rely on the state as their primary business partner. Sixty-four percent of Long An firms, which are heavily involved in food processing and the service sector, see Vietnamese individuals as their primary market. This may result from their close proximity to HCM City. It also may account for the slow pace of sales growth in Long An.

4.1.2. Sales to where?

In other work, a significant relation between the size of the corporate private sector and the size of FDI inflows has been found.[16] To some extent this result should not be surprising, as we would expect that FDI inflows would create opportunities for private businesses, especially those supplying investors with intermediate goods or services. Most provincial officials interviewed for this study, however, saw little in the way of business relations between private domestic and foreign enterprises, which includes both firms abroad and ones based in Vietnam. Confirming these results, even with the domestic content requirements of the Vietnam government, economist Prema-chandra Athukorala found little evidence to suggest a clear economic relationship between inflows and private sector growth.[17] The survey appears to reinforce evidence of a limited relationship. Only 23% of the firms in the survey sold to foreign companies, but most of the sales are accounted for by the high performers and Hai Phong and Long An, where FDI is the highest. By contrast, sales to foreign companies are marginal in Nam Dinh, Thanh Hoa, and TT Hue.

Interview Insights Box 9: Sales to other provinces

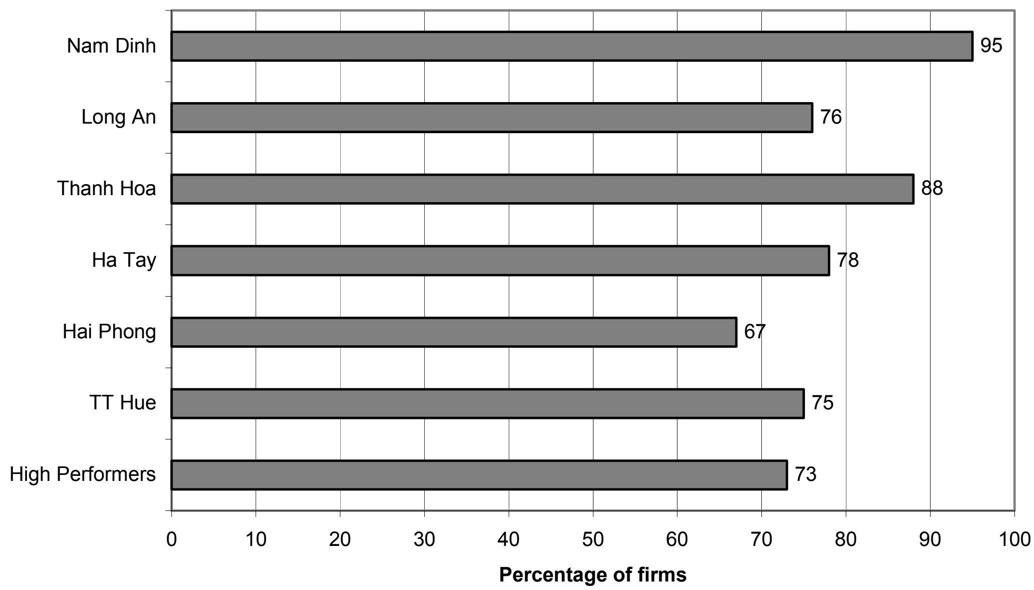
While firms in periphery provinces are likely to sell domestically, they are by no means confined to sell only to customers within their province. Firms in the periphery provinces are creative about managing their sales outside the province. A biochemical firm in Nam Dinh sells its shampoo and cleaning products in both the big northern and southern outlets. In Ha Noi, which is closer, the firm employs one agent; in HCMC, the firm pays for the services of a specialized private trading company; and in smaller provinces, the firm sends one of its two trucks to deliver directly to small stores.

Another LLC in Thanh Hoa employs sales agents in Ha Noi, Lang Son and Mong Cai, and rents agents in Hai Phong and HCM City. Though the CEO did not mention it, it is quite probable that the Lang Son and Mong Cai agents are selling product to Chinese customers.

Figure 7 gives even more insight into the markets of firms. Secondary provinces are much less likely to look overseas for sales than the high performers. As noted earlier, Hai Phong (with 33% of its sales to foreigners) is an exception. Nam Dinh and Thanh Hoa, which are quite far from Ha Noi, are notably locked in to domestic sales.

[16] See Malesky (2002a).
[17] See Athukorala (2002).

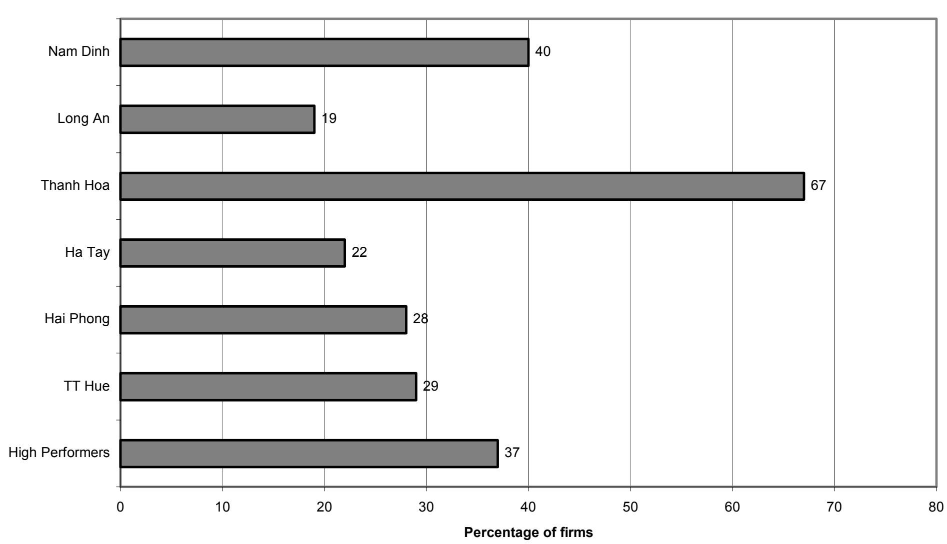
Figure 7: Percentage of firms with 100% domestic sales



4.1.3. Credit in lieu of payment for sales

Thanh Hoa and Nam Dinh, which are heavily dependent on government and state-owned customers are also the locations where private firms are most likely to offer credit to their customers in lieu of immediate payment (see figure 8). This is potentially unsustainable. According to the self-reporting of firms, the median amount of credit given by companies in the five high performing provinces has only grown 32% since 1998, to 500 million VND. By contrast, median credit given by Thanh Hoa firms has grown by 183%, to 850 million VND, nearly 70% greater than the high performers. Median credit given in TT Hue is nearly two billion VND, doubling since 1998. Nam Dinh firms give a much smaller amount of credit on average (128 million VND), and have actually reduced that amount by 47% since 1998.

Figure 8: Percentage of firms giving credit to customers



4.2 Sources of inputs

4.2.1. Where are firms in the secondary provinces getting their inputs?

Firms in the secondary provinces are much more likely to buy inputs from the state sector than firms located in the high performing provinces. There may also be a north-south divergence evident here, as only 18% of Long An firms buy inputs from the state sector. The rest of the periphery provinces, however, are highly dependent on SOE inputs, with Ha Tay (over 70%) clearly the most dependent. Relying on other registered private companies is also quite popular. All firms in periphery provinces, except Long An, are more likely to buy from the private sector than the firms in the high performing provinces. Hai Phong and Thanh Hoa firms buy from their peers in very high numbers. Self-production of inputs, rather than direct purchases is less popular, though still significant in Ha Tay, Thanh Hoa and Long An.

Interview Insights Box 10: Complicated business relations with the state sector

A private firm with seven employees in Nam Dinh province illustrates just how complicated sourcing relationships with the state sector can be. This firm operates as a sales agent of Bai Bang Paper Mill, selling material and processed paper. The firm receives a 0.8% commission for every million VND in sales. The mill's credit term is three to five days on average, although credit terms of one day, seven days or even a few months are possible. The firm does not have to pay any fees or penalty for delayed payment. There is a five-year agent contract signed between the firm and the mill. Accordingly, the mill holds the owner's certificate of title to her house as collateral for the whole contract life.

Table 17: Main suppliers of inputs by province[18]
(Mean Percentage)

Province	SOE	Registered domestic private firm	Local government	Unregistered domestic private firm	Cooperative	Foreign company	Household	Foreign joint venture	Self produced
TT Hue	59.3%	57.4%	5.6%	3.7%	0%	1.9%	9.3%	9.3%	16.7%
Hai Phong	51.7%	72.4%	0%	0%	3.4%	0%	6.9%	10.3%	6.9%
Ha Tay	71.2%	64.4%	6.8%	3.4%	1.7%	1.7%	17.0%	0%	25.4%
Thanh Hoa	56.3%	68.8%	0%	0%	6.3%	0%	6.3%	6.3%	31.3%
Long An	17.8%	44.4%	2.2%	6.7%	0%	4.4%	17.8%	11.1%	28.9%
Nam Dinh	54.2%	47.9%	0%	2.1%	0%	2.1%	22.9%	4.2%	18.8%
High Performers	34.4%	57.1%	2.6%	5%	3.8%	4.2%	12.4%	10.3%	19%
Total	41.6%	57.2%	2.9%	4.3%	1%	3.3%	13.4%	8.7%	19.9%

4.2.2 International sourcing

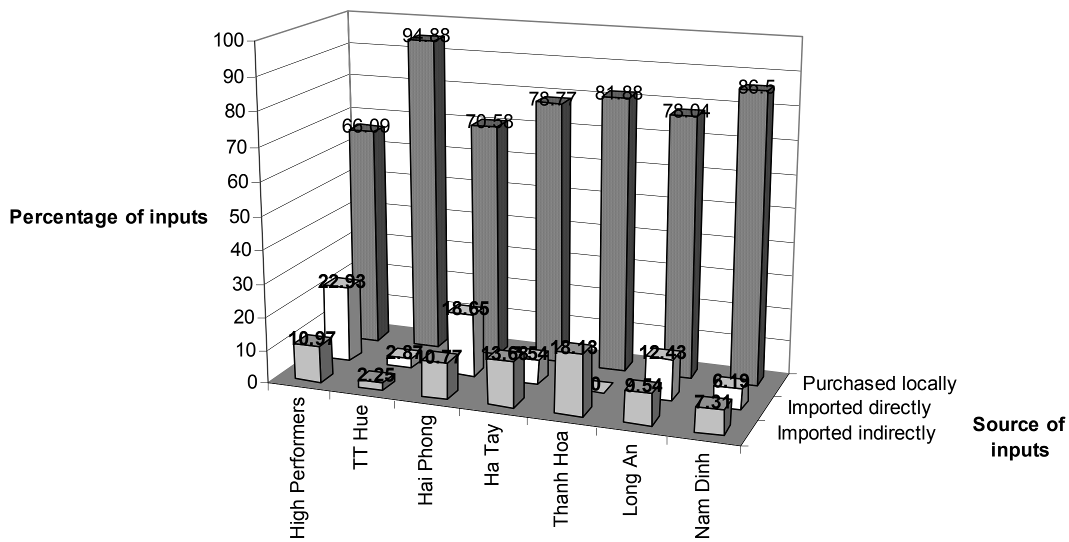
It is clear from table 17 that foreign companies supply very little of the inputs to the domestic private sector in the second and third level provinces. Similarly, periphery provinces import few of their intermediate goods from abroad. Figure 9 shows the percentage of goods purchased locally, as compared to those imported directly and through foreign intermediaries. As is to be expected, high performing provinces import roughly 34% of their inputs, 23% directly. This is in stark contrast to the periphery provinces, which purchase close to 80% of their inputs locally. TT Hue is especially locally dependent, purchasing 95% of its product locally from SOEs and domestic private companies. It is difficult to interpret TT Hue's complex results. Why have foreign firms had a difficult time entering this particular local market? One possible reason is the relative isolation of TT Hue on the central coast. A second reason may be the bad reputation of the central coast region in the investment community, due to a series of early investment failures.[19] A highly speculative

[18] The statistics provided in table 17 are the mean of firms' own estimations of how much they purchase from each supplier. This is not, however, a measure of the mean source of inputs for each province, and as a result, some rows add up to more than 100%.
[19] See Malesky (2002b).

theory may be the relative competitiveness of the domestic sector in TT Hue. As Yasheng Huang has shown in China, foreign investment tends to flow to areas where the domestic sector is weakest.[20]

Hai Phong firms are the sole exception among secondary provinces, with imports comparable to the average of the high performers. Once again, one can attribute this international outlook to its large port facilities, and a higher level of urbanization relative to its secondary peers.

Figure 9: Sources of inputs



4.2.3 Suppliers of imported goods to the domestic private sector

For the firms that do import, who is their major supplier of imported goods? Table 18 demonstrates that there is a great deal of variance. The high performing provinces, especially southern ones, prefer to purchase their imports from foreign suppliers directly, and as a second-best alternative, purchase from foreign companies operating in their province. Periphery provinces on the other hand, rely much more heavily on SOEs operating in their provinces. This is especially true of Ha Tay, Hai Phong, and Nam Dinh in the north. TT Hue and Thanh Hoa offer interesting exceptions, as firms in these provinces are most likely to buy inputs from other registered private firms. An intriguing question not asked in the survey, but important for further research and policy making, is whether the marginal cost of the inputs is higher for firms relying on the state sector as an intermediary. Most analysts speculate that SOEs indeed raise transactions costs when operating as middlemen. If this is the case, firms in Ha Tay, Hai Phong, and Nam Dinh are likely to be disadvantaged in competition.

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[20] See Huang (2002).

Table 18: Main suppliers of imported inputs, by province (Percentages)						
Province	SOE	Domestic Private Firm (Unregistered)	Foreign Supplier Directly	Domestic Private Firm (Registered)	Foreign Company	Private Trading Agent, Wholesaler
TT Hue	25.9	3.7	1.9	3.07	5.6	9.3
Hai Phong	27.6	3.4	13.7	17.2	17.2	10.3
Ha Tay	30.5	3.4	6.8	20.3	13.6	11.9
Thanh Hoa	12.5	0.0	0.0	18.8	11.1	6.3
Long An	4.4	4.4	11.1	13.3	17.2	15.6
Nam Dinh	25.0	2.1	6.3	20.8	6.3	14.6
High Performers	16.7	4.0	28.7	20.1	20.1	11.1
Total	18.9	3.4	20.0	21	15.9	11.4

Across the sample, LLCs are most likely to be importing their inputs. They account for 77% of the firms importing directly, and 71% of those importing indirectly. Their median percentage of inputs imported directly and indirectly is 30% and 10% respectively. This seems to be true across the provinces, except in TT Hue, where there are only a small number of LLCs. The small amount that TT Hue firms are importing is carried out by five individually-owned private firms. Of the importing LLCs, only 44 (or 21%) come from the second and third level provinces, and 12 of these are based in Long An alone.[21] Importing inputs is the domain of the big and established firms, and to date has been primarily concentrated in the provinces adjacent to HCM City and in Ha Noi.

Two possible conclusions can be drawn from these results. First, it is possible that LLCs simply have a higher need for sophisticated intermediate goods from abroad. But a second explanation is that they may be privy to market information not available to smaller private firms, who cannot afford to invest time or money in gathering information on the cheapest source of inputs. If the latter is true, there is a clear role for international donors to play in facilitating that kind of information gathering and collation.

4.3. Competition

4.3.1. Who is the major competition?

In Chapter 2, this report explored the potential effect of the large state sector in inhibiting economic development. There was speculation that the state sector possibly played a role in crowding out private sector development, but one cannot say this for sure without knowing how many potential private entrepreneurs were dissuaded from starting a business because of a strong state sector. One can pursue the issue further by asking, what is the role of the state sector on post-1999 private sector development in the provinces?

But the competitive environment is much more diverse than just competition between the private and state sector. Private firms must compete against an array of other ownership types, which include other private firms (some with very good government relations), foreign companies, joint ventures with some foreign capital, and even smuggled goods from neighboring countries, such as China or Cambodia. Table 19 looks at who firms deem to be their main competitors.

[21] Long An's LLCs import about 20% of their inputs directly and 27% indirectly.

In every province, the majority of competition faced by firms is supplied by the small and medium size private enterprises, which is a healthy development and suggests that a robust private sector is developing. Provided that firms are competing on a level playing field, price competition and innovation are likely to follow. But can there be a level playing field when so many firms have business relationships, either through sales or joint ventures, with the state sector and local government? This is an important question, which we will return to later.

Competition with SOEs is most fierce in the periphery provinces. Firms in Ha Tay (50.8%) and TT Hue (40.7%) face particularly strong competition from the state sector, followed closely by firms in Hai Phong and Thanh Hoa. If this competition is taking place on a level playing field, without SOEs benefiting from indirect subsidies in the form of cheaper utility inputs or favored access, then we can conclude that such competition is healthy. On the other hand, in provinces where SOEs are favored, such competition could be damaging to robust private sector development.

Table 19: Main competition, by province
(Percentages)

Province	No Competition	Domestic Private Firms (SMEs)	Domestic Private Firms (Large)	Foreign Invested Firms	SOEs	Smuggled Goods
TT Hue	9.3	51.9	16.7	3.7	40.7	3.7
Hai Phong	10.3	51.7	27.6	6.9	34.4	3.5
Ha Tay	6.7	61.0	13.6	11.9	50.8	15.3
Thanh Hoa	0.0	68.8	25.0	0.0	31.3	0.0
Long An	13.3	62.2	20.0	8.9	22.2	8.9
Nam Dinh	10.4	50.0	6.3	4.2	18.8	12.5
High Performers	9.5	50.0	23.3	18.8	20.6	13.7
Total	9.4	52.6	20.5	14.0	25.9	11.8

About 19% of firms in the high performing provinces face competition from the foreign-invested sector, but foreign competition is very small in Ha Tay, and virtually insignificant in the rest of the secondary provinces. The argument that foreign companies may be crowding out the nascent private sector, due to their better expertise and large sources of capital, is not supported by the evidence provided here.

4.3.2. Advantages of the competitors

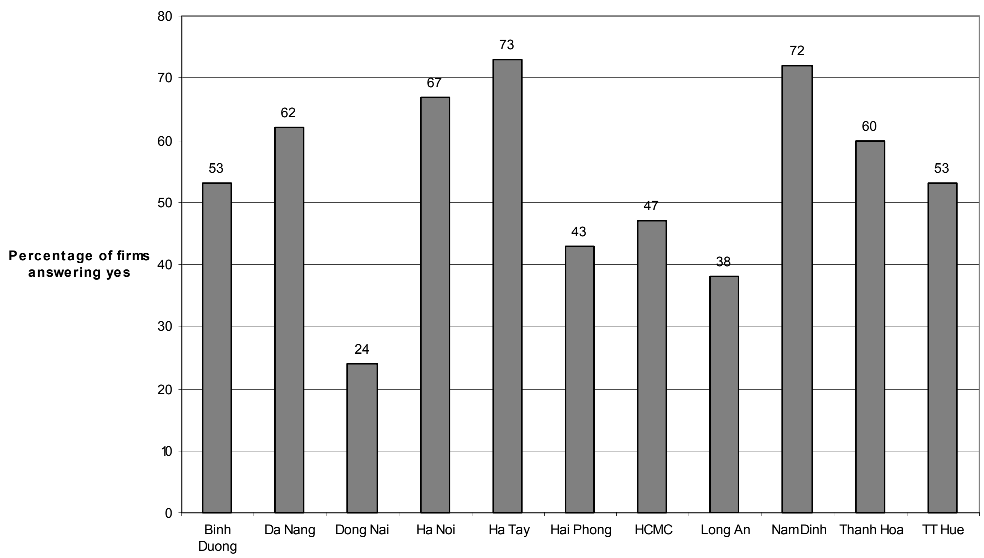
Once we better understand the competition faced by private firms, we can begin asking whether that competition will lead to healthy private sector development. A crucial factor here is whether provincial governments grant any special advantages to favorite firms, and which may tilt the playing field in favor of less and more inefficient companies. The survey reveals that private firms across the sample feel that they are at a competitive disadvantage on price with their main competition. Advanced technology is a factor in close to a quarter of the firms in the sample. Hai Phong is an exception to this 25% rule, which may result from the higher proportion of large joint-stock and limited liability companies, as opposed to individual producers. Quality of products is a notably significant factor in Thanh Hoa.

Government support to a competitor is an interesting source of variance. Only 16% of the firms in the high performing provinces cited this as a competitive disadvantage, but nearly 40% of the firms in Hai Phong, close to 30% in Ha Tay and Thanh Hoa, and 20% of the firms in Nam Dinh felt disadvantaged in this way. There is north-south divergence on this question as well. Including Ha Noi, northern provinces cited government support as their main competitive disadvantage 27.4% of the time, whereas southern firms cited government support as a disadvantage only 13.8% of the time. Ha Noi even has 19% of its firms claiming their main competitor receives help from government institutions (see Table 20).

Table 20: Main advantage of competition (Percentage of firms)				
Province	Low Price	Advanced Technology	Government Support	Better Quality
TT Hue	55.6	20.4	16.7	16.6
Hai Phong	55.2	10.3	37.9	6.9
Ha Tay	52.5	20.3	27.1	15.3
Thanh Hoa	56.3	25.0	31.3	37.5
Long An	42.2	24.4	13.3	17.8
Nam Dinh	41.7	27.1	20.8	20.8
High Performers (average)	54.2	25.4	16.4	17.7
Total (average)	52.5	23.8	18.9	17.6

Table 20 may be slightly misleading, as firms were only asked to pick their major competitive disadvantage. Low price, advanced technology, and better quality may only be the proximate cause of difficulties with competition. In fact, problems may be the result of government support itself. Government assistance with access to financing and land may lower the final price that a firm can charge for its products or services. As a result, figure 10, which is produced from the CEO interviews, simply records the number of firms who felt their competition received some government assistance, regardless of whether CEOs felt it disadvantaged them.

Figure 10: Is your main competitor receiving government support?



The provinces of Nam Dinh, Ha Tay, and Ha Noi are far above the others in the amount of support they give to firms, thus preserving the northern-southern dimension of this impact. The southern provinces of Long An, Dong Nai, and HCM City all have very little government intervention. The fact that the north-south distinction is stronger than the difference between high performing provinces and periphery provinces suggests that firms in provinces like Ha Noi survive in spite of government assistance to their competitors. One reason for their survival may be that they themselves are well connected to government—an issue that will be explored later in this section.

Interestingly, small private firms are the least likely to feel that government is aiding their main competitor. Generally, it is the larger-scale partnerships and shareholding companies, which are bothered by government intervention.

4.3.3. What types of assistance does the government supply to competitors?

The four main types of government assistance usually provided are: access to cheap land, help in receiving special licenses or permits, financing in the form of cheap or easier loans, and assistance through contracting. In every province except Ha Noi and Nam Dinh, the primary source of government support was assistance in obtaining financing. For Dong Nai, over 70% of firms felt their competitor was aided with government financial assistance.

Interview Insight Box 11: Unfair competition or flawed decisions?

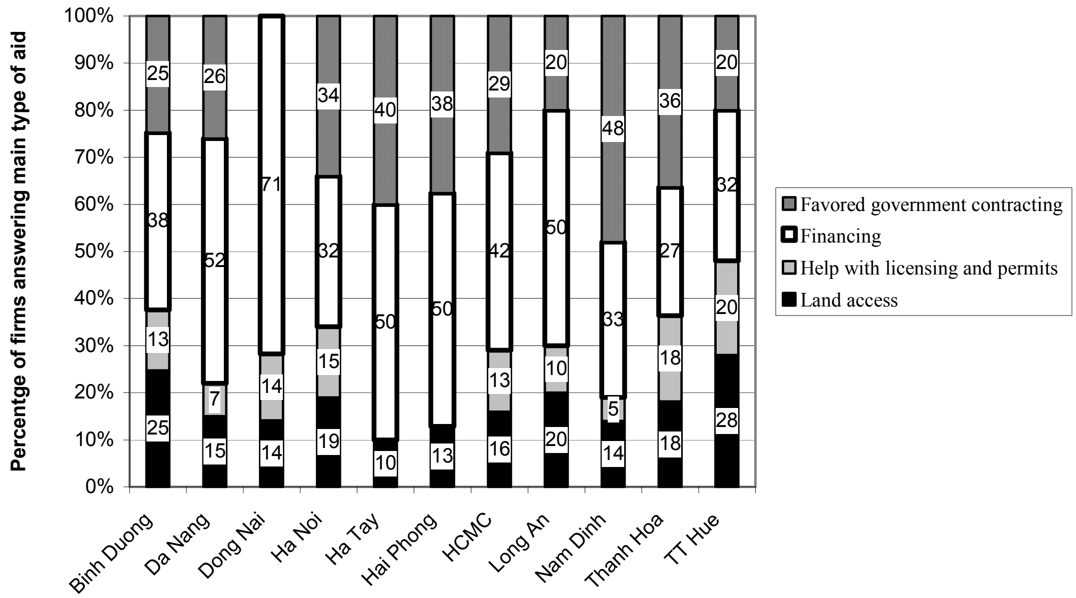
It is important to recognize that sometimes what a firm considers to be unfair competition may simply be a flawed business decision on its part. One example from this survey is that of a small private company (12 employees) selling bottled milk that has not fared well in competition against Vinamilk, a centrally-owned state corporation, and Dutch Lady, a multinational corporation. According to the CEO of the small firm, the large competitors have brand-name advantage, access to capital, and better distribution networks. The small firm relies on bicycles to transport its product and is heavily dependent on credit from its customers to continue production. The CEO believes that with improved access to capital, he could buy a truck and steal market share from these behemoths.

The travails of this firm are truly troubling, but should have been anticipated. The producer entered the market in 2000, long after Vinamilk and Dutch Lady were well-established in the province. Potential creditors of this firm are undoubtedly aware of this fierce competition as well.

The second most popular form of government help overall, and the most popular form in Ha Noi and Nam Dinh, was contracting. This form of assistance usually has to do with how local government officials allocate contracts in construction and manufacturing, choosing favored firms or state-owned enterprises, rather than awarding the contract through competitive bidding. Good relations with local officials can be quite important in helping firms to win lucrative long-term contracts.

In TT Hue and Binh Duong, over a quarter of firms felt that government assistance in obtaining land had aided their main competitor. Assistance in obtaining land can mean preferential access, favoritism in bidding procedures, or even insider information about infrastructure improvements, which will improve the value of land. Across the board, very few firms cited government help with licensing and permits, a clear sign that legal changes made under the Enterprise Law have spread to the periphery.

Figure 11: Types of aid to main competitor



4.3.4. Government support to the state-owned sector

> **Interview Insights Box 12: Declining support for the state sector in Long An**
> In Long An, discrimination in favor of SOEs has been reduced tremendously over time, as the province decided to equitize all 30 of its poor performing local SOEs. According to the Bank of Industry and Commerce officials in Long An, "in other provinces, a letter from the Ministry of Finance will be used in place of collateral, if the SOE uses funds from the central budget". In Long An, however, this is a very rare occurrence. Long An has been trying for several years (since 1997) to make their local SOEs accountable and business oriented as if they were private." In 1994, SOEs received over 75% of all loans. The loan gap has closed in Long An now, so that SOEs receive only 60% of Bank of Industry and Commerce loans, and the private sector receives 40%.

Of course, not all government support goes to the state sector. Figure 12 combines the two above questions, in order to determine what percentage of the firms that cited SOEs as their main competitor also believed their main disadvantage was lack of government support. We can say with some confidence, that northern provinces -- whether they be peripheral or high performers -- are more likely to get support from the state sector.

Figure 12: If main competitor is an SOE, is it receiving government assistance?