

## Chapter 6: Financial status of firms

### 6.1. Sources of financing in the periphery: The prevalence of informal credit.<sup>29</sup>

#### 6.1.1. Capital structure

Tables 28 and 29 provide the median sources of finances for firms in periphery provinces, compared to the high performing provinces.<sup>30</sup> As with firms in the high performing provinces, firms in periphery provinces are still heavily dependent on personal savings, both for start up capital and to finance their existing operations. Despite all the supposed alternatives, if they do not use their own savings, they are likely to draw on the savings of friends and family. Whether this can be considered an actual loan is a matter of some debate, and varies according to provincial norms. Hai Phong and Thanh Hoa were the most diversified of the sample, relying on moneylenders for 7% and 11% of their respective start up capital. The two provinces continue to rely heavily on moneylenders as sources of finance. TT Hue firms were the most likely to use bank loans to finance their start-up, with over 11% of start-up capital derived from bank credit. TT Hue continues to use bank loans at that rate, but has been joined by firms from Thanh Hoa (12%) and Long An (11%). Borrowing from suppliers, clients, and government loan programs are hardly represented at all in the capital structure.

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<sup>29</sup> Kellee Tsai used the term 'back-alley banking' to describe similar informal money markets in China. See Tsai (2002).

<sup>30</sup> It is important to note that firms were asked to supply their own estimation of their capital structure. Tables 28 and 29 simply take the mean percentage of firms in that province. Therefore, the statistics do not represent the total breakdown in the province, but rather the mean of individual firms. Due to rounding, this led to some provinces recording means greater or less than 100%, though in most cases it was very close. The initial capital structure of Long An is far less than 100%, as some firms neglected to fully complete the entire questionnaire.

**Table 28 : Capital structure at time of establishment  
(Mean % by Province)**

Province		Personal Savings	Private Savings from Friends and Family	Institutional Investors	Borrowed from Friends and Family	Informal Money Lender	Bank	Government Loan Program	Borrowed from Suppliers	Borrowed from Clients	Other	Total
Hai Phong	Average contribution	66%	9%	4%	3%	7%	2%	0%	2%	0%	5%	98%
Ha Tay	Average contribution	85%	5%	2%	1%	0%	5%	0%	1%	2%	1%	102%
Nam Dinh	Average contribution	77%	7%	6%	3%	3%	1%	0%	0%	0%	4%	101%
TT Hue	Average contribution	71%	5%	4%	3%	4%	10%	0%	3%	0%	0%	100%
Thanh Hoa	Average contribution	59%	11%	0%	11%	8%	7%	0%	0%	4%	1%	101%
Long An	Average contribution	41%	6%	3%	4%	1%	2%	0%	0%	0%	5%	62%
High Performers	Average contribution	76%	9%	4%	4%	1%	4%	0%	1%	0%	1%	100%
Total	Average contribution	68%	7%	3%	4%	3%	4%	0%	1%	1%	2%	95%

**Table 29: Capital structure at present  
(Mean % by Province)**

Province		Personal Savings	Private Savings from Friends and Family	Institutional Investors	Borrowed from Friends and Family	Informal Money Lender	Bank	Government Loan Program	Borrowed from Suppliers	Borrowed from Clients	Other	Total
Hai Phong	Average contribution	56%	4%	5%	8%	9%	6%	1%	3%	3%	7%	102%
Ha Tay	Average contribution	76%	5%	1%	3%	2%	9%	0%	1%	1%	1%	99%
Nam Dinh	Average contribution	69%	3%	4%	8%	6%	4%	1%	0%	2%	3%	100%
TT Hue	Average contribution	68%	5%	2%	7%	3%	11%	0%	3%	0%	0%	99%
Thanh Hoa	Average contribution	54%	7%	0%	11%	5%	12%	0%	2%	6%	2%	99%
Long An	Average contribution	73%	2%	3%	7%	0%	11%	0%	1%	0%	3%	100%
High Performers	Average contribution	71%	6%	4%	4%	2%	9%	0%	2%	1%	1%	100%
Total	Average contribution	67%	5%	3%	7%	4%	9%	0%	2%	2%	2%	100%

### 6.1.2. Sources of loans

The picture changes somewhat if we look simply at the sources of loans for companies, shown in table 30, rather than the magnitude they represent in the total capital structure. The most important trend is that firms in periphery provinces are more dependent on state commercial bank loans than firms in high performing provinces, which appear to have an alternative source of financing from private commercial banks. Only firms in Long An (11.1%) and Hai Phong (10.3%) received a significant amount of loans from private commercial banks. Firms in the periphery provinces -- with the exception of Long An -- compensate for the lack of financing from private commercial banks by turning to informal moneylenders and loans from friends and family. Firms in Hai Phong are much more likely to receive loans from suppliers than others, which most certainly results from the city's heavy interaction with international suppliers. Thanh Hoa offers another interesting anomaly, with its high proportion of investment fund financing in the province.

Province	State Commercial Banks	Government loan program	Private commercial banks	Loan provided by suppliers	Foreign Banks	Informal loans/money lenders	Investment funds	Friends/Family	Credit Funds
TT Hue	55.6	3.7	0.0	7.4	0.0	37.0	5.6	29.6	0.0
Hai Phong	27.6	3.4	10.3	13.8	3.4	31.0	3.4	34.4	0.0
Ha Tay	44.1	3.4	3.4	3.4	0.0	10.2	6.8	37.3	5.1
Thanh Hoa	37.5	6.3	0.0	6.3	0.0	25.0	12.5	37.5	6.3
Long An	37.8	0.0	11.1	0.0	4.4	6.7	8.9	24.4	2.2
Nam Dinh	20.9	0.0	0.0	2.1	0.0	22.9	4.2	25.0	0.0
High Performers	23.0	0.5	22.8	7.1	1.3	13.5	1.6	27.2	1.9
Total	29.3	1.3	15.3	6.2	1.3	16.5	3.5	28.6	1.9

## 6.2. Bank Loans

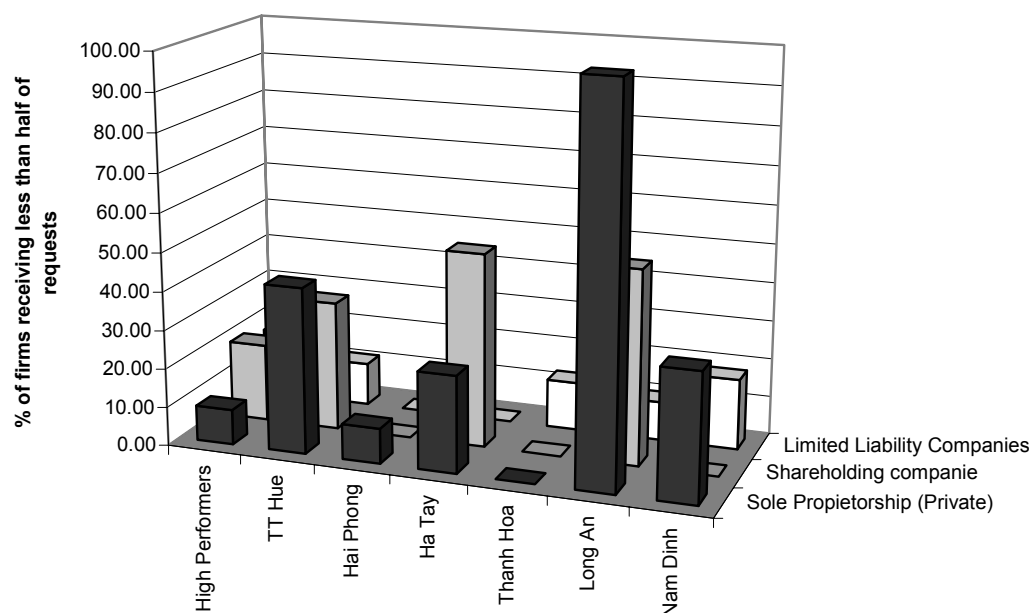
### 6.2.1. Are periphery firms accessing bank credit at all?

Bank financing plays only a minor role in the total capital structure of private firms across the country. Anecdotal evidence and traditional explanations have often focused on the difficulties firms have in applying for bank loans. Indeed, this is usually the primary complaint of companies and provincial officials alike. Of course, one would suspect that "not enough capital" would be a high-ranking complaint of small, private companies worldwide.

However, data from this survey appears to show that this is not the case. The mean success rate for loan applications across the entire sample population was 65% and, in fact, many of the periphery provinces bettered that rate. For example, Ha Tay and Thanh Hoa firms received over 80% of their loan applications; much higher than the average in the five high performing provinces. One might argue that it is only large or advanced firms that are applying for, and thus receiving, bank loans. To judge the validity of this statement, figure 18 charts the percentage of firms, which received between 0 and 50% of their loan requests, by type of firm. In other words, which firm types have been most unlucky in their loan requests? In Ha Tay, Long An, and Nam Dinh, there were quite large spreads. Limited

liability companies in Ha Tay and Long An have been far more successful than smaller private companies. In Long An, 100% of private companies have had poor luck in receiving loans, while less than 10% of LLCs have faced difficulties. In Ha Tay, not a single LLC fell into the unlucky category. In Nam Dinh, the bias was in favor of joint-stock companies, which were very unlikely to face rejected loan applications. The Nam Dinh bias may result from the importance of joint-stock companies in the Nam Dinh economy. (According to the 2001 Enterprise Census, the largest revenue producers by firm type in Nam Dinh province are joint-stock companies, which accounted for 657 billion VND. Of that amount, roughly 40% is produced by joint-stock companies, with some shares held by the state.<sup>31</sup>)

Figure 18: Percentage of firms that applied, but received less than half of their loan requests



A presumption that larger companies have greater success in the periphery would be premature, however, as it neglects the number of firms that self-selected out of the calculation by never applying at all for loans, because they felt they had little chance of receiving bank credit. As table 31 demonstrates, over 55% of the entire sample population had not applied for a loan in the last 5 years. Firms in Nam Dinh and Long An have been particularly shy about formal loan applications at banks.

Province	Mean success rate in applying for loans, among those firms that applied (in %)	Number of firms that did not apply for loans (% of total CEO interviews)
TT Hue	58.3	7(37%)
Hai Phong	NA	NA

<sup>31</sup> General Statistical Office (2002).

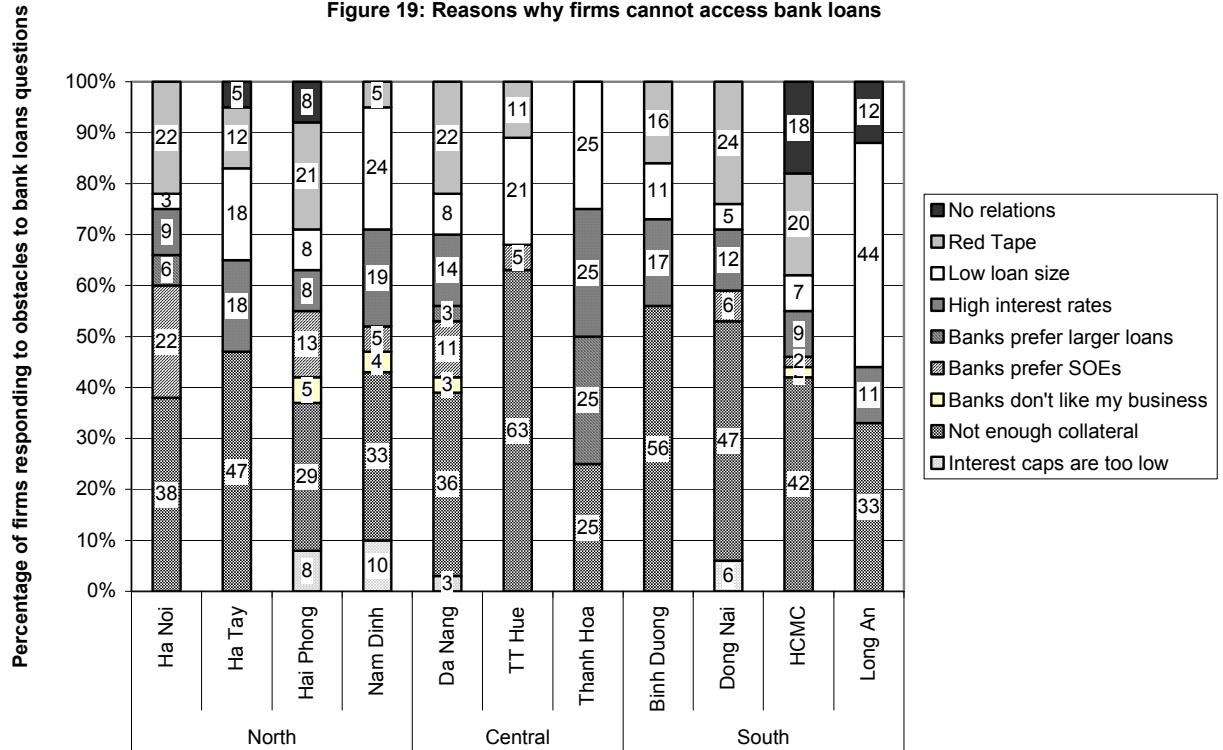
Ha Tay	80.9	4 (27%)
Thanh Hoa	83.3	4 (40%)
Long An	50.0	7 (54%)
Nam Dinh	66.7	10 (56%)
High Performers	64.3	77 (57%)
Total Sample	65.9	123 (55%)

### 6.2.2. Why have firms had trouble receiving bank credit?

A number of theories have been raised about why firms have trouble receiving bank loans, or never apply for loans from banks. All have some validity, as is demonstrated in figure 19. Moreover, these reasons vary across the provinces.

- Not enough collateral: This was the primary reason cited by firms in every province. Two factors are often combined in this issue. First, firms may not have very much collateral at all, and their owners are unwilling to risk their own house. Second, firms may be willing to risk their private holdings, but feel that the banks undervalue their collateral by 30% or more.
- Low loan sizes: Undervalued collateral is compounded when banks offer only small loans, which do not cover business needs. This problem was considered to be of minor importance among the high performers and Hai Phong, but the second leading cause of low bank usage in 5 out of the 6 periphery provinces. Long An firms were most frustrated by the small size of their loans.
- High interest rates: This factor is related to the two above, as it lowers the risk tolerance of firms. Why take a chance when your loan will be minimal and your interest rate expenses will be high? Firms in Thanh Hoa and Hai Phong felt burdened by this factor.
- Red tape: Most periphery provinces did not consider this factor to be a major impediment, but firms in the high performing provinces and Hai Phong ranked it highly.
- Bias in favor of SOEs: Of the non-urban periphery provinces, only Nam Dinh firms cited this issue. Long An firms were extremely unlikely to cite a pro-state bias in financing, confirming interviews with IncomBank officials, who presented data demonstrating a significant decline in the gap between state and private firms. According to data presented by bank officials, state firms in Long An originally received 73% of all loans, with the total non-state sector receiving 27%. The present spread is 53% for the state, 45% for total non-state, and 2% for others. Firms in the high performers and Hai Phong, however, were concerned about bias here. Actually, this result is driven almost entirely by firms from Ha Noi (22%) and Da Nang (11%). In the northern southeast region, firms did not identify this as a major factor.
- Relationships (*quan he*): Firms in Long An, Hai Phong, and Ha Tay felt that they could not access bank loans because "they did not know anyone" connected to the bank who could help them. Interestingly, the high score of the high performing provinces is entirely driven by HCM City (23.5%). No other firm in a high performing province cited this factor.

Figure 19: Reasons why firms cannot access bank loans



### 6.2.3. The constraints imposed by lack of capital access

Thus far we have discussed primarily bank loans, but not other sources of non-bank financing. Figure 20 indicates whether an inability to access non-bank capital causes special problems for firms on the periphery. Firms differed across provinces in what kinds of financing problems they deemed to be the major constraint on their growth and development. Firms in TT Hue and Nam Dinh felt that access to non-bank equity financing was a constraint, whereas firms in Thanh Hoa, Ha Tay, and Hai Phong fretted about the lack of investors and partners. This was also the major dilemma of firms in the high performers. Long An firms felt that the lack of non-bank equity financing was a constraint, but not to the same degree as its peers. On more specialized issues, access to export financing and equipment lease financing did not appear to impact the high performers and periphery provinces differently. Nam Dinh and Thanh Hoa firms felt they were most slowed in their growth by these issues. Long An firms, however, often felt access to most sources of non-bank financing was better than firms in the high performing provinces. This does not necessarily mean that there is better access in Long An, as the result could simply imply that firms in Long An have less need for these types of financing.

**Interview Insights Box 19: Bank loans in Thanh Hoa**

An LLC in Thanh Hoa illustrates that measuring success simply by application success may not be appropriate. This firm had tremendous success in loan applications, receiving loans on all five times that it applied. Four loans were short term, typically around six months, and totaling 50 million VND. A longer-term loan from a German development fund to help repatriates was for five years and was worth 700 million VND. This latter loan was the initial start-up capital for the business, but accessing this loan, where the money was guaranteed due to special circumstances, was very difficult for the small firm. The CEO considered the process to be overly complicated and risky, as he needed to put the land his house sat on as collateral. Despite the extraordinary success of this firm at receiving loans, the CEO considers access to capital to be his biggest challenge. He believes strongly that the loan processes are complex, under-valuation of collateral is common, and the payoff (usually 60% of the collateral) might not be worth the effort.

**Figure 20: Severity of lack of access to non-bank capital on growth**

