

## Chapter 9: Conclusions

### 9.1. General Conclusions

This study has provided a profile of the business environment in the periphery provinces, from which it is now possible to highlight some general trends and patterns. Firms in the periphery provinces began with less favorable initial conditions for development. As they commenced their development process, they were burdened by being farther from markets, possessing inferior infrastructure, and being dependent on agriculture and state-owned production. While these conditions were important, they did not necessarily determine outcomes. For instance, a province like Binh Duong began with challenging conditions, but incorporated improvements into its development strategy. Conversely, provinces like Hai Phong, and Ha Tay had decent initial conditions, but still have not seen their private sector grow and prosper at the rate of the high performing provinces.

Over time, despite initial negative conditions, periphery provinces have begun to seem more attractive to investors, partly because of higher costs and diminishing marginal returns in the high performing provinces. The implementation of the Enterprise Law has also aided development in periphery provinces. Due to these critical changes, domestic as well as foreign investors have been attracted away from the provinces that have been the main engines of Vietnam's growth. Improvements in the legal rights of private business have led to some impressive gains in periphery provinces since 2000. While still slightly behind their high performing counterparts, periphery firms have shown impressive profit, employment and sales growth. Such expansion, however, has pushed firms in Hai Phong, Thanh Hoa, and Ha Tay to the limits of their capacity. The only province where firms are in poor financial health is Thanh Hoa, but high liabilities there may be the result of the impressive return on investment in that province during the previous year. Expecting high returns, firms may have been motivated to borrow heavily in order to expand.

The market environment among periphery provinces is far more constrained than high performing provinces. Except in Hai Phong, firms sell very little internationally, and buy even less from overseas. One cause of concern in a few northern periphery provinces is the heavy dependence many private firms have on both purchases and sales to SOEs. This may be one of the reasons why firms in these provinces are more likely to grant credit to customers. The news on competition in the periphery was mixed. The major source of competition was other small private firms, which signals a robust and healthy competitive environment that should benefit consumers through innovation and reasonable prices. On the other hand, firms in periphery provinces were more likely to feel disadvantaged due to the perception that government favors their competitors. The most likely forms of government support to competitors were in the areas of financial assistance and in the awarding of contracts. When the study focused on competition with SOEs, the legacy of initial conditions appeared to be quite strong.

Issues of governance drew a visible dividing line between high performers and the periphery, but not in the sense that is usually discussed by analysts of Vietnam. Implementation of components of the Enterprise Law has been very good across the provinces. In fact, problems with licensing are more likely to be found in the high performing provinces. Moreover, delays in development have given a number of the periphery provinces advantages in their ability to allocate land to the private sector, although they must be more diligent in formalizing unofficial ownership by obtaining land use rights certificates. A cause of future concern may be the tendency of some companies in northern

periphery provinces to rent land from SOEs, rather than seek land of their own. Using a variety of ways to seek information about transparency proved more reliable than directly asking about this, and the results demonstrate the lack of transparency in provincial decision-making has a negative impact in the periphery provinces. On this question, differences were greater from one peripheral region to another than was the case between the high performing and peripheral provinces. Speculation regarding these differences varies from attributing them to differences in culture, to the fact that southern provinces have a longer history of free enterprise and are therefore better able to understand the mechanisms of a market economy.

Analysis of transaction costs yielded three different types: 1) customs regulations faced solely by the high performers and Hai Phong; 2) inspections that were a source of trouble in Nam Dinh and TT Hue; and 3) the waiting period, which held up progress in Hue and Hai Phong. It appeared that some provinces may have tacitly adopted a local compromise – that of inspecting more diligently (and collecting more fees in the process) in order to make up for the shorter waiting periods, as required by the Enterprise Law. Governance problems in the form of direct requests for payments and the need to pay for "wheel greasing" were evident, but did not yield an observable pattern among provinces. This may result from the hesitancy of firms to report such costs, and the impact that FDI has on this element of governance. When firms did get into contract disputes, settlement mechanisms to resolve them were still in their infancy. Very few firms felt comfortable turning to government institutions for assistance. Only firms in the region near HCM City felt comfortable using the court system. When probed about why there was fear of using the courts, firms cited damaged business relations and the time likely to be lost.

Dynamism and pro-activity on the part of local officials, proved to be an important factor in predicting the size of the active private sector, especially when size of the provincial market is taken into consideration.

Surveying financial status showed that personal funds and money borrowed from friends and family (with an obligation to return the funds or without) are the primary sources of capital for periphery firms, as well as firms in the high performing provinces. Hai Phong firms were able to obtain capital from input suppliers, and Thanh Hoa firms were likely to turn to informal moneylenders, but these numbers were still relatively small. Bank financing played only a small role in the total capital structure, despite the fact that the actual success rate of applications for loans in the periphery provinces was a staggering 60%. Such a high percentage was probably the result of a number of large firms receiving bank loans, and the selection effect of smaller firms not applying at all for loans, because they felt they had little chance of success. Applications were also low because many periphery firms feared that their collateral was too low to compensate for the small loans they would receive and the high interest rates they would have to pay. Some provinces had firms fretting over red tape, biases toward SOEs and a feeling that they lacked the relationships necessary to help them obtain bank financing.

This led to a brief study of the role of friends and family in periphery business development. This role was quite substantial in a number of areas, including bargaining with banks, relations with government and sales promotion. The main difference between high performing and periphery provinces on this front seemed to be the special role that the family played in supplying business services. As a consequence of the impressive role played by relations, very few firms sought commercial assistance with business services, except when related to computers. When periphery firms did venture into the private market for business services, they tended to be highly price sensitive. Differences in the willingness

of firms in periphery and in the high performing provinces to pay for business services may be the greatest difference in the entire study. It also provides the most potential for corrective efforts on the part of international donors.

## 9.2. Suggestions for further research:

This report has been drawn primarily from surveys of enterprise directors and interviews with local officials. These are useful techniques, but they have arguably raised more questions than answers about comparative provincial business environments. A few questions raised over the course of this study, and which deserve further in-depth analysis, include the following:

- The topics discussed in this report are only the proximate cause for provincial private sector development. More research is necessary to understand the ultimate causes underlying the private sector environment. In essence, what cultural, historical, geographical, and economic forces have led to the different economic environments we see today?
- More thorough case study work is necessary to understand the subtle differences in provincial governance and provincial relations with the central government, especially as they apply to dynamism. We have little understanding of the difference in capacity of provincial governments. More importantly, we have little knowledge of why some provincial governments have the policy space to be innovative, while others feel more constrained.<sup>32</sup>
- A new GSO survey is needed to account for active enterprises. First, it will help researchers understand whether the components discussed in this report have any impact on growth in the private sector over time. Second, it will allow for a thorough test of the relationship between registration and firm activity over time. How much of the present boom in registrations is sustainable, and what accounts for that sustainability?
- A smaller study would be useful to better understanding the reasons for variance in post-Enterprise Law registrations. What accounts for the boom in Hai Phong and Ha Noi? Conversely, why has growth in Long An, Dong Nai, and Da Nang been more limited? Are these registrations due to proactive work on the part of economic officials, or can they be explained by changing conditions in the business environment?
- The World Bank and IFC/MPDF survey should be expanded to other provinces. Vietnam has over 60 provinces and cities, creating a wealth of variation for hypothesis testing. The results of this report can only be considered conjectural, because there was a limited number of provinces, and too few respondents in each province. Expanding the survey, and creating a more scientific PSE index for the new sample, that integrates subjective survey measures with objective economic and political indicators from the provinces, would be an interesting research tool. Ideally, the study should also be repeated over time, in a bid to capture dynamic

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<sup>32</sup> Presently, The Asia Foundation and the Vietnam Chamber of Commerce and Industry are conducting research that involves a review of provincial planning documents and situational case studies, in a bid to better understand provincial dynamic behavior.

improvements. A study five years after the Enterprise Law would be a great opportunity to record changes among the provinces.