

Executive Summary

In Vietnamese provinces with good initial conditions -- such as strong infrastructure, closeness to markets, and ample skilled workers -- private firms have multiplied in number and generally performed well. However, in Vietnam's periphery provinces (ie. those with fewer advantages, and consequently lower levels of economic growth), private firms have made some progress, but continue to lag behind those in the more well-endowed provinces.

This study was undertaken in order to better understand which factors promote and hinder the development of the private sector in Vietnam's periphery provinces. To date, most research on private sector development in Vietnam has focused on the five high performing provinces of Binh Duong, Da Nang, Dong Nai, Ha Noi, and Ho Chi Minh City. Indeed, these five cities and provinces are responsible for most economic activity in Vietnam. Other than these, only the oil rich province of Ba Ria Vung Tau, with substantial foreign investment into the oil industry, has been as successful.

There are four main reasons why such a study, that makes an explicit comparison between the high performing provinces and the provinces farther down the spectrum of economic development, is necessary. First, from a methodological perspective, early efforts at private sector development were limiting, in that they tended only to identify the necessary -- but not the sufficient -- conditions for private sector success. Second, it would be a little shortsighted to believe that best practices in the more successful provinces could be extrapolated nationally, without a greater recognition of the specific differences between provinces. Thus, private sector development programs should be tailored, to some degree at least, to the specific needs of local entrepreneurs in specific locations. Third, studies of periphery provinces in other transition economies have proved highly fruitful in generating policy-pertinent findings. Finally, a few of the periphery provinces in Vietnam have begun to develop quite rapidly, particularly in the wake of the Enterprise Law of 2000. As a result, a systematic study, which compares both successful and unsuccessful provinces, will help us better understand these developments.

As a consequence, MPDF, AusAID, the World Bank, and IFC funded a joint study of eleven provinces, including the 'high performers' and six other medium and low performers (in terms of the size of the private sector relative to total population). This report draws on data collected for that study, and offers a depiction of the environment for private sector development.

Chapter 1 describes the sample selection, the research methodology, and provides an overview of the six periphery provinces selected for this study, comprising: Long An, Hai Phong, Thua Thien Hue (TT Hue), Nam Dinh, Ha Tay and Thanh Hoa. Throughout the study, the private sector environment in these six provinces is compared with the environment in the high performing provinces of Ho Chi Minh City, Ha Noi, Da Nang, Binh Duong and Dong Nai.

Chapter 2 is designed to familiarize the reader with the special economic situations in each of the periphery provinces. Firms in the periphery provinces were established under conditions that were less favorable for their development. As they developed, they were typically burdened by being: farther away from markets, having inferior infrastructure, and being dependent on agriculture and state-owned production. Moreover, existing and potential workers and managers were significantly less well educated and trained than their peers in the high performing provinces. While these conditions were important, they do not necessarily determine success or failure. For example, a province like Binh Duong began with relatively poor conditions, but incorporated appropriate improvements into its development strategy. Conversely, provinces such as Hai Phong and Ha Tay

had relatively decent initial conditions, but failed to develop to the same degree as Binh Duong. Over time, the negative impact of initial conditions in periphery provinces has been reduced by higher costs and diminishing profits incurred in the high performing provinces, and by the positive influence of the Enterprise Law. These critical changes have attracted some domestic and foreign investors away from the more well-established centers of private sector growth, and towards the periphery provinces.

In the second part of Chapter 2, descriptive information is provided on the firms randomly chosen for the survey. This is intended to shed most light on the research findings in the context of the unique factors affecting the private sector in each province. With the exception of Hai Phong, periphery firms tended to be smaller in terms of assets size and number of employees relative to firms in the high performing provinces. With regard to registration of new companies, the high performing provinces recorded a similar pace of registrations both before and after the Enterprise Law was enacted in January 2000, while in the periphery provinces, there was a boom in registrations after the January 2000.

Chapter 3 compares the business performance of periphery firms to the high performers. Periphery firms, while still slightly behind their high performing counterparts, have shown impressive profit, employment, and sales growth. Ha Tay was the periphery province with the highest performing firms, whereas the indicators for firms in Long An were less impressive. These results may reflect a slight shift in the business climate in the northern region of Vietnam. Impressive expansion, however, has pushed firms in Hai Phong, Thanh Hoa, and Ha Tay to their capacity ceilings. The only province where firms appear to be in poor financial health is Thanh Hoa. Here, firms are heavily in debt, probably because impressive returns on investment in the previous year encouraged them to borrow heavily to fund capacity expansion.

Chapter 4 analyzes the market environment of periphery firms, by identifying: the destinations of their sales, the origins of their inputs, and the profile of their competitors. The market environment among periphery provinces is far more constrained than is the case with the high performers. Except for Hai Phong, firms located in these provinces sell very little internationally, and buy even less from overseas. One potential cause of concern was the heavy dependence on state-owned enterprises (SOEs) that appeared to be the case with private firms in a few northern periphery provinces. Chapter 4 also poses the question: is competition among enterprises taking place on a level playing field, or are some firms benefiting from the special support of provincial governments? There was good news on this front. The major source of competition was other small private firms, which suggests a robust and healthy competitive environment.

Chapter 5 contrasts the regulatory and governance environment in the periphery with that of the five high performing provinces. Governance issues 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 various components of the Enterprise Law has generally been very good across the provinces. In fact, problems with licensing are more likely to be found in the high performing provinces. Moreover, delayed development has given periphery provinces an advantage in their ability to allocate land to the private sector, although they need to be diligent in providing firms with secure tenure, by granting them land use rights certificates. A cause of future instability may be the tendency of private firms in some northern periphery provinces to rent land from SOEs, rather than seek land of their own.

One dimension of local governance is transparency. Simply put, are domestic entrepreneurs aware of the activities of their provincial leaders, and are important government documents available to them that might aid business decisions? A composite measure of transparency demonstrated quite

clearly the burden in periphery provinces that is caused by a lack of sufficient clarity in provincial decision-making. On this question, differences were greater on a regional level than they were between specific high performing and periphery provinces.

The study also sought to measure the level of indirect tax placed on firms by government procedures, which then limit productivity. 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 Hue; and 3) waiting periods which held up progress in Hue and Hai Phong. Governance problems in the form of direct payments and "wheel greasing" were evident, but there was not a discernable pattern across provinces. The study also found that in provinces with higher foreign direct investment, "wheel greasing" costs appeared to be higher. This suggests that foreign investment may have raised the cost of unofficial payments.

With regard to contract disputes, settlement mechanisms to resolve them are still in their infancy, and very few firms felt comfortable turning to government institutions for assistance. Only firms in the northern part of the southeast region, near Ho Chi Minh City, felt comfortable using the court system. When probed as to why they did not use formal institutions to resolve conflicts, firms cited fear of damaging business relations and wasting too much time.

Dynamic and pro-active local officials were shown to be a decisive contributor to robust private sector growth, as previous studies have also found. However, this element is poorly understood. Detailed case studies will be necessary to truly understand how this works.

Chapter 6 depicts the means that firms employ to finance their activities, and the constraints that access to financial resources can pose. As in other studies, this survey showed that personal funds and money borrowed from friends and family is the primary source of capital for firms in periphery and high performing provinces alike. Bank financing played only a minor role in the total capital structure, despite the fact that the actual success rate of applications for loans was a quite impressive 60% in the periphery provinces. Applications were few because many periphery firms assumed that their collateral would be too low to obtain a loan, or that the loans would be too small and the interest rate too high to make borrowing worthwhile.

Chapter 7 analyzes the important role played by friends and families in periphery provinces. This role proved substantial in a number of areas, including bargaining with banks, developing good relations with government and promoting sales. The main divide between high performing and periphery provinces on this front seemed to be the special role that family played in supplying business services. Because of the impressive role played by relations, very few firms sought commercial assistance, except with regard to computers. When periphery firms did venture into the private market for business services, they tended to be highly concerned about cost. The difference between periphery and high performing firms, with regard to their willingness to pay for business services, may be the most salient schism in the entire study. It also provides the most potential for corrective efforts on the part of international donors.

Finally, chapter 8 summarizes the study's findings, with individual assessments for each of the periphery provinces. And chapter 9 provides some concluding remarks.

Summary report cards for the periphery provinces

Province	Initial Conditions	Firm Performance	Market Environment	Local Governance	Access to Financing	Business service provision BSP	Corporate governance
Hai Phong	Very good infrastructure and good human capital resources	Low profits, mediocre capacity utilization, good sales and employment growth.	Most internationally oriented periphery province, high dependence on SOEs for sales and inputs, robust private sector competition, and high government support to main competitor.	Minor problems with Enterprise Law, low transparency, high rent-seeking and low response rate of firms to governance questions. Low-medium dynamism levels.	Medium access to private commercial banks and formal lenders, many firms complain a lack of access restrains their activity.	High reliance on family and friends for BSP and market information for sales. Firms are somewhat sensitive to price of service.	Institutional indicators of corporate governance related to type and size of firm, so province has good scores. Mixed scores on non-institutional measures.
Ha Tay	Very good infrastructure and close proximity to market. Low human capital resources.	High profits, high capacity utilization, very low liabilities per firm, very good employment growth, and good sales growth.	Very high SOE dependence for sales and inputs, high competition from state sector and smuggled goods, high government support to main competitors.	Good Enterprise Law implementation, some land issues, good transparency, high number of non-responses, and low dynamism levels.	High success rate for loan applicants, but bank loans a very small portion of total financing, high reliance on friends and family, problematic collateral requirements.	High reliance on family and friends for BSP and market information for sales. Firms are highly sensitive to price and quality of providers.	Institutional indicators of corporate governance related to type and size of firm, so province has medium scores. Good scores on non-institutional measures.
Nam Dinh	Decent infrastructure and low human capital resources	Low profits and return on investment, mediocre capacity utilization, good financial positioning, good employment and sales growth.	Very high SOE dependence for sales and inputs, high competition from state sector, and very high government assistance to main competitors.	Good Enterprise Law implementation, problems with land acquisition, low transparency, high inspections, and low dynamism levels.	Very low access to banks and formal lenders, yet good loan success rate, but few firms applying and biased toward large firms, many firms believe activities restrained by lack of financing.	Very high reliance on family and friends for BSP and high reliance for sales. Firms are somewhat sensitive to price, and very sensitive to quality of providers.	Institutional indicators of corporate governance related to type and size of firm, so province has fair scores. Medium scores on non-institutional measures.
Thanh Hoa	Mediocre infrastructure and low human capital resources	Low profit per employee, but high return on investment, high capacity utilization, high firm liabilities, very good employment and sales growth from a low base.	High dependence on SOE sector and local government for sales, medium dependence on state sector for inputs, robust private sector competition, and very high government support to main competitors.	Very low response rate on governance questions, low transparency, high inspection rates, high rent seeking, and low dynamism levels.	Medium level of bank loans in capital structure, high success rate of loan access, low loan size considered problematic and thereby creating some constraints on activities.	Very high reliance on family and friends for BSP market information for sales, and legal advice. Firms are very sensitive to price and very sensitive to quality of providers.	Very low scores on institutional measures and very high scores on non-institutional measures. Thanh Hoa is a corporate governance puzzle.
TT Hue	Mediocre infrastructure and human capital resources	Mediocre profits and return on investment, mediocre capacity utilization, strong finances, good employment growth, and low sales growth.	Low SOE dependence for sales, but high dependence on local government, very robust private sector competition, and medium government support to competition.	Good Enterprise Law implementation, many firms without formal land rights, low transparency, high transaction costs, and medium dynamism levels.	Medium rate of bank loans in capital structure at start-up and at present, high loan success rate, collateral requirements considered a constraint on activities.	High reliance on friends and families for BSP and sales assistance. Firms are sensitive to experience, price and quality.	Institutional indicators of corporate governance related to type and size of firm, so province has lower scores. Low scores on non-institutional measures.
Long An	Mediocre infrastructure and low human capital resources, but close proximity to markets.	High profit per employee and mediocre return on investment, good capacity utilization, low liabilities, very low employment and sales growth.	Very low SOE dependence for sales or inputs, very robust private sector competition, very low government support to competition.	Good Enterprise Law implementation, high percentage of firms with formal land rights, very high transparency, low transaction costs, and very high dynamism levels.	Medium rate of banks loans in capital structure and as a percentage of loans, low loan success rate and many non-applicants, high bias in favor of large firms, small loan size problematic, but does not constrain activities.	Medium reliance on friends and family for sales assistance and low reliance for, BSP. High number of firms paying for BSP, and only moderately sensitive to price and quality.	Institutional indicators of corporate governance related to type and size of firm, so province has good scores. Low scores on non-institutional measures.

Summary report cards for the high performing provinces

Province	Initial Conditions	Firm Performance	Market Environment	Local Governance	Access to Financing	Business service provision (BSP)	Corporate governance
Binh Duong	Small state sector presence in economy. Had very good infrastructure and good human capital at the time of measurement, but early on in the decade these score would have been much worse.	Medium profits, high return on investment, high capacity utilization, relatively high liabilities, good sales and employment growth.	High international sales, low dependence on SOEs, some credit to customers, medium competition with private sector but high competition with foreign investors, medium government support to main competitors primarily in contracting and finance, low SOE support.	Good Enterprise Law implementation, excellent distribution of land use rights certificates, good transparency level, low transaction costs on waiting periods with pretty high inspections, very high dynamism	Good access to private commercial banks and formal lenders, high loan success rate, many firms complaining about high collateral requirements.	High reliance on family and friends for sales assistance and service provision. Firms are not very sensitive to price of service.	Institutional indicators of corporate governance related to type and size of firm, so province has medium scores. Very few firms have control boards or shareholder meetings. Mixed scores on non-institutional measures.
Dong Nai	Very good infrastructure, proximity to markets, and human capital resources.	Medium profits, highest return on investment in sample, low capacity utilization, low firm liabilities, profit, decrease in employment, satisfactory sales growth.	Medium international sales, low dependence on SOEs, some credit to customers, robust private sector competition, very low support to main competitors and low assistance to SOEs.	Good Enterprise Law implementation, problems with land and foreign exchange acquisition, good distribution of land use rights, extremely transparent, high inspections but low waiting periods, very high dynamism.	Low access to private commercial banks and formal lenders, high reliance on family for capital, many firms complain of high collateral requirements and red tape.	High reliance on family and friends for everything, but especially BSP, sales and market information, firms willing to pay for BSP and primarily worried about reliability.	Institutional indicators of corporate governance related to type and size of firm, so province has low scores. Low scores also on non-institutional measures.
Da Nang	Large state presence in the economy, very good infrastructure, poor proximity to Ha Noi or HCMC, but has its own international port. Among best human capital resources in the sample.	Low profits, mediocre return on investment, strong financial position, low capacity utilization, high employment growth, highest sales growth in sample.	Medium international sales, medium dependence on SOEs, high competition within private sector and with SOEs, medium government assistance to main competitors, but not SOEs.	Good Enterprise Law implementation, big problems with land acquisition and poor distribution of land use rights, good transparency, low inspections and low waiting periods, medium dynamism	Good access to private commercial banks and formal lenders, high loan success rate, many firms complain of high collateral requirements and red tape.	Medium reliance on family and friends for BSP and sales. Firms are somewhat sensitive to price and very sensitive to quality of providers.	Institutional indicators of corporate governance related to type and size of firm, so province has very good scores. Medium scores on non-institutional measures.
Ha Noi	Very good infrastructure, proximity to market, and best human capital resources in the survey.	Medium profits, high returns on investment, strong financial position, high capacity utilization, good employment and sales growth relatively high.	Medium international sales, high dependence on SOEs, high percentage of firms giving credit to customers, robust private sector competition, high government support to main competitors including SOEs.	Problematic implementation of Enterprise Law, problems with land acquisition and only medium distribution of rights, very low transparency, high inspection hours, mixed waiting periods, low dynamism.	Good access to private commercial banks and formal lenders, high success rate at receiving loans, very high use of friends and family, many firms complain of high collateral requirements and bias in favor of SOEs, and red tape.	Very high reliance on family and friends for market information, sales, and accounting advice. Many firms paying for services, but highly interested in reliability.	Institutional indicators of corporate governance related to type and size of firm, so province has mixed scores. There are very few control boards. Good scores on non-institutional measures.
HCM City	Very good infrastructure, proximity to market, but only decent human capital resources relative to high performing peers.	Very high profit per employee, mediocre return on investment, medium capacity utilization, strong financial position, very good employment growth and sales growth.	High international sales, medium dependence on SOEs, some credit to customers, robust competition with private sector and foreign sector, low government support to competition, but some support to SOEs.	Average Enterprise Law implementation, due to problems with land and foreign exchange, high percentage of firms with formal land rights, very good transparency, high inspection hours, mixed waiting periods, medium-high dynamism.	Best access to private commercial banks and formal lenders, low loan success rate, many firms complain of high collateral requirements.	Medium reliance on friends and family for sales assistance, and low reliance on BSP. High number of firms paying for BSP, especially information provision. They are generally not very price sensitive.	Institutional indicators of corporate governance related to type and size of firm, so province has good scores. Medium-low scores on non-institutional measures.