

THE INTERNATIONALIZATION OF VIETNAMESE SMEs

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Abstract

Small and medium sized enterprises (SMEs) have been important for Vietnam's rapid economic development. However, the context in which SMEs operate are rapidly changing with the current internationalisation of the Vietnamese economy. The question posed in this paper is "How are Vietnam's SMEs affected by the internationalization process?" This will give an indication of what challenges lie ahead if the plans for further trade liberalization and internationalization are realized. The basis of our analysis is a unique database on the activities of a large sample of Vietnamese SMEs in 1990, 1996, and 2002, with quantitative data about various aspects of company operations, as well as qualitative information about the entrepreneurs' perceptions of the current business environment and expectations about the future.

Keywords: SME; globalization; internationalization; trade; Vietnam

JEL classification codes: O14, O53, F14

Tóm tắt

The internationalization of Vietnamese SMEs - Sự quốc tế hoá của Doanh nghiệp vừa và nhỏ (DNVVN) Việt Nam

DNVVN đóng một vai trò vô cùng quan trọng trong sự phát triển kinh tế của Việt Nam. Tuy nhiên, bối cảnh hoạt động của các DNVVN đang thay đổi một cách nhanh chóng do sự quốc tế hoá của nền kinh tế Việt Nam. Một câu hỏi được đặt ra là “Những DNVVN của Việt Nam sẽ bị ảnh hưởng như thế nào bởi quá trình toàn cầu hoá?”. Nghiên cứu sẽ chỉ ra đâu là những thách thức mà các doanh nghiệp sẽ gặp phải khi các bước tiến về tự do hoá thương mại và quá trình toàn cầu hoá được thực hiện. Những phân tích của báo cáo được dựa trên bộ số liệu của cuộc tổng điều tra doanh nghiệp những năm 1990, 1996 và 2002, với nhiều chỉ số khác nhau về hoạt động của doanh nghiệp. Ngoài ra những nhận định về môi trường kinh doanh và những mong đợi về xu hướng trong tương lai của các nhà quản lý doanh nghiệp cũng đã được sử dụng trong báo cáo này.

1. INTRODUCTION

The degree of internationalization of the Vietnamese economy has accelerated since the mid-1990s, with a normalization of the relations with the US (leading up to a bilateral trade agreement in 2001), membership in ASEAN, large inflows of FDI, rapid increases in international trade, and an application for membership in the WTO (Athukorala, 2004). The major actors in this internationalization process are large firms: in the early 1990s, the economy was heavily dominated by state-owned enterprises (SOEs), but the share of foreign invested enterprises (FIEs) and private firms has increased gradually.

Small and medium sized enterprises (SMEs) have also been important in the country's economic development. In particular, it was clear that the success of the early reforms in the 1980s were largely due to strong supply responses from agricultural households: the dismantling of collective agriculture rapidly turned Vietnam from food shortages to a position as the world's second largest exporter of rice. In recent years, SMEs have again appeared at the center of the development debate. This time, the discussion mainly concerns job creation. Between 1.2 and 1.4 million new workers enter the Vietnamese labor force annually, but only about half as many new jobs are created in the formal sector (Jenkins, 2004). With increasing population density in rural areas, the agricultural sector is no longer able to absorb the new entrants into the labor force. Although the FIE sector has grown rapidly, it is based on relatively capital intensive technologies, and employed less than 700,000 people in 2002 – roughly half of the annual increase of the Vietnamese labor force. SOEs have also focused on heavy and capital intensive industries, and the entire SOE sector only employed about 2.3 million people in 2002, out of a total labor force of nearly 40 million people. The fastest employment growth in recent years has instead been recorded by the private sector. There are no reliable data on employment growth in the smallest enterprise forms, household firms and private firms, but the data on the development of private limited liability and shareholding

firms are impressive. Between the years 2000 and 2002, these enterprise categories nearly doubled their total employment, from around 560,000 to 1,062,000 jobs (GSO 2004). Most of these firms are small and medium sized, with an average of 41 employees.

While Vietnam's private SME sector appears to hold a great potential for employment creation, we know very little about how they are managing the ongoing internationalization process at the enterprise level. This is a cause of some uncertainty regarding future developments, considering that Vietnam is now accelerating its trade liberalization. Although Vietnam's regional trade has been liberalized under the auspices of the AFTA, much of the tariff reductions have been delayed to the period 2003-2005. The bilateral trade agreement with the US that entered into force in 2001 also gave some initial relief for Vietnam, not requiring fundamental reforms until after an adjustment period of several years. If Vietnam's negotiations with the WTO are successful, membership will bring further demands for liberalization and reform.

The question posed in this paper is "To what extent have Vietnam's SMEs already been affected by the internationalization process?" This will give an indication of what challenges lie ahead if the plans for further trade liberalization and internationalization are realized. How severe an adjustment does the SME sector face, and will they be able to maintain the rate of job creation required to avoid widespread unemployment? The basis of our analysis is a unique data base on the activities of a large sample of Vietnamese SMEs in 1990, 1996, and 2002, with quantitative data about various aspects of company operations, as well as qualitative information about the entrepreneurs' perceptions of the current business environment and expectations about the future. The paper is organized as follows: Section 2 provides a brief background on Vietnamese economic reforms, with particular emphasis on internationalization and private enterprise. Section 3 describes the data base and presents some general information about the SME sample in 2002. Section 4 looks at the expectations

of SMEs regarding the effects of further trade liberalization. Section 5 examines to what extent the SMEs have been directly affected by the internationalization process, considering measures such as exposure to import competition, participation in exports, and contacts with foreign firms. Section 6 turns to indirect effects of internationalization, asking to what extent SMEs have been affected by the economic and institutional reforms brought about as a result of Vietnam's internationalization. Section 7 provides some concluding comments. One conclusion is that the great majority of SMEs have not been in any direct contact with the international economy, which suggests that the further liberalization of the Vietnamese market may pose increasingly tough challenges to these firms. At the same time, they have not exploited the opportunities given by internationalization. This suggests that SME policies focusing on competitiveness and export promotion – support for marketing, information services, skill development, and perhaps also trade credits – may have substantial returns.

2. BACKGROUND

Vietnam exhibits an impressive development record for the last two decades (see e.g. Van Arkadie and Mallon, 2003). The gradual shift from traditional central planning to a market oriented economy, which started officially in 1986, has led to dramatic improvements in economic performance and living standards. The GDP growth rate was over 8 percent per year during the period 1990-1995, and has averaged nearly 7 percent since then, in spite of the turbulence in international markets after the Asian crisis, the September 11 event, SARS, and the downturn in the important electronic sector. Domestic savings and investment have increased in absolute amounts as well as in shares of GDP. Exports grew from 25 percent of GDP in 1990 to nearly 50 percent in 2003, with even faster growth for imports. Foreign direct investment has emerged as an increasingly important source of capital and technology, with the aggregate inflow of FDI since 1989 reaching about USD 25 billion (or nearly two-thirds

of 2003 GDP) in 1995. In addition to high growth rates, the reform program has produced macroeconomic stabilization. As a result, real per capita GDP has roughly tripled since 1990 and the share of the population living below the international poverty line has fallen from 58 percent in the early 1990s to 28 percent in 2003 (IMF 2004).

Although the Vietnamese reform program was initially driven by domestic considerations – read a collapse of the command economy – the reforms have subsequently been strongly influenced by Vietnam’s integration with the world economy. The increasing export orientation and the entry of several thousand foreign multinational corporations have created pressures for improvements of the domestic business environment. The normalization of Vietnam’s international relations has added a number of formal reform requirements. For instance, the cooperation with international financial institutions such as the World Bank, the Asian Development Bank, and the International Monetary Fund has contributed both financing and policy advice to the reform process. Similarly, the tens of bilateral donors and major NGOs that are presently active in the country have occasionally been able to influence Vietnamese policies. In some areas, like trade policy, reform has been directly connected to international agreements. So far, the most important of these are Vietnam’s membership in ASEAN’s free trade area (AFTA) since 1995 and the bilateral trade agreement with the US that came into effect in 2001. Vietnam is also negotiating for membership in the WTO, and it is clear that accession would require further changes to the country’s trade policies.

However, the Vietnamese reform process has also faced significant problems. These have in particular been related to the operations of state-owned firms (SOEs). During the first decade of reforms, SOEs accounted for much of the growth in the industrial sector. The extremely limited investment capacity of the Vietnamese private sector in the early reform years was one reason for the dominance of the state sector. Another reason was the skeptical view of the Vietnamese Communist Party regarding domestic private firms: for a long time,

private firms were allowed but not encouraged (Ljunggren, 1997; Kokko and Sjöholm, 2000). Still, the dominant role of SOEs was beginning to become a problem by the mid-1990s, when competition toughened as a result of higher imports, both official and illegal (smuggling). Many SOEs operated in import-substituting industries, and were not able to compete with more efficient foreign producers. The possibility to get direct support from the state budget had disappeared already in the early 1990s, but the larger SOE still had privileged access to credits from state banks to cover their losses. Although data are fragmentary, it is clear that the financial system is still struggling with the overhang of non-performing loans from this period. Other state firms focused on lobbying for continued protection, and the present difficulties to agree about the conditions for WTO accession testify to the continuing strength of these interest groups (see further Kokko, 2004).

The private sector has therefore become the default alternative for further development, and the policies towards private enterprise have undergone significant reform in recent years. Official documents have upgraded the private enterprise sector to one of the cornerstones of the economy, and efforts have been made to reduce some of the privileges of SOEs, to create a level playing field for private firms.¹ For instance, internal discussions in the Communist Party of Vietnam (CPV) apparently concluded in 2000 that a party member can in fact own a private enterprise. The new Enterprise Law, also introduced in 2000, may have simplified the company registration process and enhanced the growth of private enterprise. By the end of September 2003, more than 75,000 new private companies had been registered under the new law, most of them small and medium sized firms. By contrast, the total number of private firms registered during the preceding 10-year period (1990-1999) had not exceeded 45,000. Reports in Vietnamese press indicate that the private sector's share of total investments increased from 20 percent in 2000 to 27 percent in 2003 (to exceed that of the

¹ See for instance the discussions in GoV (2002).

SOE sector), and that private firms created 1.6-2 million new jobs during this period (Saigon Times Weekly, Nov 8, 2003).

The donor community has recently also emphasized the role of SMEs. In tandem with their role in job creation, SMEs are arguably the main vehicle for poverty alleviation, particularly in rural areas. With poverty alleviation as the main development target presently prioritized by the donor community, Vietnam is receiving much encouragement for its policies to promote SME development. This is seen for instance in the more prominent role afforded to the private sector in the “Comprehensive Poverty Reduction and Growth Strategy” designed to fulfill the partnership requirements of the donor community than in the “10-Year Socio-Economic Development Strategy”, which is the main domestic strategy document.

As noted earlier, the ability of the SME sector to fulfill these objectives is partly related to their ability to maintain their growth rate in an environment where the pace of internationalization is likely to accelerate. The remainder of this paper will examine how the internationalization of the Vietnamese economy has impacted the SME sector to date, and what can be expected of the future.

3. DATA: SME SURVEYS

As part of a long-term collaboration project between the Institute of Labor Sciences and Social Affairs (ILSSA) at the Ministry of Labor, Invalids, and Social Affairs, Hanoi, and the Stockholm School of Economics (SSE), the institutions have jointly undertaken three surveys of Vietnamese SMEs since the early 1990s. The first of these surveys, undertaken in cooperation with International Labour Organization (ILO) in 1991 and focusing on SME operations in 1990, covered the operations of about 900 non-agricultural firms in Hanoi, Ho

Chi Minh City, Haiphong, and five rural provinces, including Ha Tay and Long An.² The results of this survey, which provided the first detailed findings about the Vietnamese non-state sector in modern times, were published in Ronnås (1992). In 1997, a new survey was undertaken, covering the three major cities and two of the rural provinces, Ha Tay and Long An. This time, the survey covered about 750 firms, including all the surviving firms from the five provinces. The survival rate between 1990/92 and 1996/97 was only 36 percent, so additional firms were drawn from the relevant populations to create a sufficiently large sample in the new survey. The findings of the second survey are published in Ronnås and Ramamurthy (2001). The third survey, conducted in 2003 with the active participation of the Institute of Economics, Copenhagen University, included the five provinces from 1996/97, as well as two additional rural provinces, Phu Tho and Quang Nam. As in the previous survey, an attempt was made to include all surviving firms: this time, the survival rate was 63 percent. New firms were also added to the sample, bringing the total number of firms in the 2003 survey to about 1,400. The practical selection criterion for identifying SMEs, in all three surveys, has been total employment below 100 jobs. Surviving firms growing above this limit have been re-surveyed, but only included in parts of the analysis, since their presence would distort average values for income, assets, employment, and other variables. More specifically, these firms are mainly retained for analyses focusing on survival and growth patterns.

The basic design of the survey questionnaire has remained roughly unchanged over the three surveys, covering a large number of questions on enterprise characteristics, operations, costs and revenue, employment, linkages, and perceptions about the economic environment. The number of questions included in the survey has, however, increased over time. Moreover, the structure of the sample – in particular, the distribution of firms across different ownership categories – has changed very notably. This is partly a consequence of changes in the

² The province Ha Tay did not exist in 1991, but the firms surveyed in Ha Son Binh were all located in communes that now belong to Ha Tay, which was established as a result of an administrative restructuring in 1994.

Vietnamese economic environment, but also a result of improvements in data availability.

Table 1 summarizes the distribution of firms across different ownership categories. The category for limited liability and shareholding firms was virtually non-existent in 1990, in the sample as well as the underlying population, whereas collectives and cooperatives dominated the non-state manufacturing sector.³ The role and importance of collectives and cooperatives has diminished over time, as conditions for operating purely private firms have improved. The number of limited liability and shareholding firms has undergone a corresponding increase. The increasing share of household firms in 2002 is explained by better data availability and a desire to reflect the distribution of various ownership types in the underlying population. Hence, the 2002 sample provides a reasonable picture of the entire Vietnamese SME sector.

Table 1. Distribution of firms across ownership forms 1990-2002 (percent).

	Household	Private	Collective and partnership	Limited liability and shareholding	Other
1990	38	33	23	0	6
1996	38	27	17	11	0
2002	70	10	8	12	0

Note: About 6 percent of the 1990 sample were SOEs: this category was abandoned later on.

Source: 2003 survey data base.

A word about the distinction between household firms and other ownership types is in order. Household firms are a hybrid form of enterprise between the formal and informal sector. They are not formally registered under the Enterprise Law (but “listed” by the local authorities) and are only able to enter into certain kinds of contracts with suppliers, customers, and creditors.

³ For instance, activities in limited liability and shareholding firms constituted only about one percent of GDP as late as in the mid 1990s (Riedel and Tran, 1997).

While this limits their growth opportunities, they benefit from less stringent regulations when it comes to taxation, accounting requirements, and transparency. Therefore, many entrepreneurs have chosen not to register their companies although the scale of operations is increasing: there is no absolute maximum limit on how large a household enterprise is allowed to be, and there are reports of household firms in Ho Chi Minh City with several hundred employees.

Some new questions have also been included in the surveys. The 2002/03 survey has, in particular, added questions about internationalization. This includes questions about the expected effect of trade liberalization, exposure to foreign firms, competitive pressure from imports, and other similar issues. Although the earlier surveys have not asked questions focusing especially on internationalization, they do include information (e.g. about exports) that can be used to examine changes over time. The focus of this paper will therefore initially be on information from the 2002/03 survey.

Table 2 presents some general firm characteristics for the SME sample in 2002. The most notable observation may be the substantial difference between urban and rural areas. Income, capital intensity, salaries, and average firm size are all distinctly larger in the urban areas. This is partly related to differences in the distribution of the various ownership forms across provinces, but there is also a clear difference between urban and rural firms within each ownership form (not shown). Looking at the different ownership forms, it is clear that the limited liability and shareholding companies stand out from the other categories. They are on average larger (although the difference to collectives and partnerships is not substantial) more capital intensive, and exhibit much higher labor productivity than the other ownership forms. This is likely to reflect the use of more modern and advanced technologies, and also different market niches. Many of the “modern” firms are likely to focus on mass markets with

standardized product characteristics and quality, whereas many household firms and private firms operate in activities where the degree of standardization is lower.

Table 2. Characteristics of SMEs 2002

	Total	Urban	Rural	House- hold	Private	Collective	Limited and shareholding
Income per employee (million VND)	126	146	81	56	89	66	277
Value added per employee (million VND)	18	19	16	13	19	15	29
Assets per employee (million VND)	148	194	72	77	131	102	289
Average wage (million VND)	8.4	9.4	6.8	5.4	9.2	9.0	12.4
Average no. of employees	12	15	10	7	16	27	30

Source: 2003 survey data base.

A further comment on the geographical distribution of the sample is appropriate. Although we will discuss the internationalization of SMEs, it should be noted that the sample was not designed or stratified for this purpose. Instead, the main objectives have been to explore the role of SMEs for employment and income generation, and the sample has been designed to give a reasonable representation for various ownership forms and regions, given the overall resources available for the survey. A survey that wanted to focus specifically on internationalization and trade might wish to take into account the regional patterns of comparative advantages and natural resources. This has not been done in the present survey, which means the conclusions may not apply to those provinces that have the strongest comparative advantages for export production (e.g. the Mekong delta). Some caution in the

interpretation of the results is therefore in order. With this caveat, the following sections will analyze three dimensions of globalization. Firstly, we will examine what SMEs expect from further trade liberalization, and to what extent they are preparing for a continued opening of the Vietnamese market. Secondly, we will look at the direct impact on SMEs from the international economy, focusing on import competition, exports, and linkages with foreign firms. Thirdly, we will explore how SMEs have been affected by the institutional changes precipitated by the internationalization of the Vietnamese economy: How have small firms responded to the policy changes during the past decade? What are the main obstacles to continued growth and development of the SME sector?

4. EXPECTATIONS ABOUT INTERNATIONALIZATION

What do SME expect from increased trade liberalization and internationalization? To what extent are Vietnam's SMEs aware of the opportunities available in the global marketplace? Or is it more appropriate talk about risk and challenges from further liberalization of the Vietnamese market? Table 3 summarizes the responses of the 1369 firms remaining in our data set after cleaning the data. A first point to note is the relatively low frequency of respondents that expect any benefits from the further liberalization of Vietnamese trade policies. Only 12 percent of the SMEs included in the survey report positive expectations, with the limited liability and shareholding firms – the most modern enterprise forms – being the most optimistic. The number of firms expecting losses is also relatively small. Instead, the most common replies are that the SMEs claim not to know what further liberalization will mean, or that they do not expect any notable changes. In particular, rural household firms do not have any clear expectations about the effects of continuing internationalization: over 70 percent reply that they do not know what further liberalization will mean. As we will see below, one reason is likely to be their very limited experience of internationalization: they

have typically not been in formal contact with foreign firms in Vietnam, they do not compete with imports, nor have they been engaged in export.

Table 3. The expected effect of increased globalization 2002 (percent of total firms).

	Total	Urban	Rural	House- hold	Private	Collective	Limited and Shareholding
<i>Expected effect on firm from opening of international trade</i>							
Benefit	12	15	9	8	16	20	36
No change	17	17	17	16	22	17	14
Loss	8	13	3	5	15	18	19
Don't know	63	54	70	71	47	46	32
<i>Does the enterprise take steps to face increased internationalization?</i>							
Yes	18	26	10	9	23	38	44
No	82	74	90	91	77	62	56
<i>If Yes, what type of measure is most important</i>							
Reducing production costs	28	31	19	35	29	29	22
Introducing new technology	41	38	46	36	45	32	47
Training of labor force	7	7	7	3	10	8	8
Identifying new market outlets	19	19	19	20	16	21	18
Other	5	5	7	6	0	11	5

Source: 2003 survey data base.

Consequently, few firms are preparing actively for deeper internationalization. Also this question reveals a clear difference between urban and rural respondents, as well as differences between the different ownership forms. The great majority of household firms and private companies, in particular those located in rural areas, are not undertaking any conscious preparations, whereas nearly half of the modern enterprise forms report that they are preparing

in various ways. The most common type of preparation is the introduction of new technology, although efforts to reduce production costs and to find new market outlets are also common. However, few firms report any efforts to upgrade the capacity of their labor force: in this regard, there are no significant differences between urban and rural firms, nor between the different ownership forms. Overall, these responses suggest that there is cause for concern. Firms have no clear picture of what further internationalization will mean, and are, quite logically, not taking any explicit measures to prepare for it.

5. PRIOR EXPERIENCE OF INTERNATIONALIZATION

One reason for the lack of clear expectations about continuing trade liberalization and globalization is arguably that firms are not much exposed to foreign competition or exporting activities. Without prior experience of these dimensions of globalization, it is understandable that many firms find it hard to respond to relatively abstract questions about further internationalization. Tables 4 and 5 summarize some information about how the surveyed SMEs have been affected by the international economy in the past.

Table 4 examines the perceived competition from different sources. Clearly, neither legal imports, sales by foreign firms operating in Vietnam, nor smuggling are considered to pose much of a threat to Vietnamese SMEs. Not even Vietnamese state-owned firms seem to be in direct competition with the SMEs, with the possible exception for limited liability companies and shareholding companies. Instead, the main competitors are other non-state firms that presumably are similar also when it comes to size, location, and other firm characteristics. This suggests that many of the surveyed firms are operating in market niches that are unattractive for larger and more advanced firms. A feasible hypothesis is that the typical Vietnamese SME is likely to manufacture goods that differ significantly from those of

larger and more modern firms when it comes to standardization, product quality, and complexity.

Table 4. Perceived competition from different sources 2002

	Total	Urban	Rural	House- hold	Private	Collective	Limited and Shareholding
Non-state firms	2.2	2.4	2.1	2.2	2.1	2.3	2.4
State firms	1	1.3	0.6	0.7	1	1.6	1.8
Legal imports / foreign competition	0.7	1	0.4	0.5	0.8	1.3	1.2
Smuggling	0.4	0.6	0.3	0.3	0.5	0.9	0.7
Other sources	0.2	0.2	0.1	0.2	0.1	0.2	0.3

Note: 0 – No competition; 1 – insignificant competition; 2 – moderate competition; 3 – Severe competition.

Source: 2003 survey data base.

Table 5 shows the relative importance of export among Vietnamese SMEs. Export is of relatively little importance as seen from the export ratio of 16 percent. The importance differs between firms, with relatively higher export ratios in the modern enterprise forms in the urban areas – Hanoi, Haiphong, and Ho Chi Minh City. Moreover, exporters are not equally distributed over size categories but tend to be larger than the average SME. Only about three percent of the firms participate in export, substantially less than the weighted export share of output. Hence, a vast majority of the firms are producing only for the domestic market.

Table 5. Export in Vietnamese SMEs (%).

	Total	Urban	Rural	House- hold	Private	Collective	Limited and Shareholding
Export as a share of output	16	22	5	14	4	16	20
Share of firms with positive export	3	4	1	1	1	4	15

Source: 2003 survey data base.

One might wonder what firms that contribute to the strong export growth in Vietnam over the last decade, considering the low export from SMEs?⁴ The most important Vietnamese exporters are FIEs: export from foreign owned firms constituted more than one third of total export and almost 60 percent of manufacturing export in 2000. There is little information on the exact distribution of exports from domestically owned Vietnamese firms, but it seems to be dominated by SOEs and large privately owned firms.

The importance of large firms in export is confirmed when we look at previous SMEs that have grown in size over the years. Twenty-two of the firms surveyed in 1997 had outgrown the 100-employee limit by 2002 and are therefore no included in table 5. Five of these (more than one-fifth) were exporters, which is a significantly higher ratio than that for the overall sample. Hence, exporters tend to be large in size and SMEs tend to produce for the domestic market. It is likely that the most successful exporters will expand their operations, so that they fall outside the SME population, i.e. firms with at most 100 employees.

⁴ Vietnam had the highest export growth in the world in the 1990's, and even exceeding China's performance in the 1980's (Thoburn, 2004; World Bank, 2000).

Table 6. Main customers of Vietnamese SMEs 1990-2002 (unweighted averages, percent of total sales).

	Total			Urban			Rural		
	1990	1996	2002	1990	1996	2002	1990	1996	2002
Individuals	44	42	65	34	36	57	58	56	72
Non-state firms	27	31	20	24	36	22	34	33	18
SOEs	18	15	9	24	21	15	6	5	4
State trading companies	7	1	1	11	1	1	2	4	1
Local authorities	1	0	2	1	0	1	1	1	2
Tourists	.	0	0	.	0	1	.	0	0
Export	2	3	1	4	5	2	1	1	0
Foreign owned firms	.	.	1	.	.	1	.	.	0
Other	.	0	1	.	1	1	.	1	1

Note: The alternative "Foreign owned firms" was not included in the 1990 and 1996 surveys, and the alternatives "Tourist" and "Other" were not included in 1990.

Source: 1991, 1997, and 2003 survey data bases.

One possibility is that the figures in table 5 underestimate the degree of internationalization of SMEs if they are involved in indirect exports, as suppliers and subcontractors to other (presumably larger) firms that are in charge of the direct exports. Table 6 shows the main customers for Vietnamese SMEs in 1990, 1996 and 2002. Looking at the other customer categories, it may first be noted that state trading agencies are not important in this context. However, over half of the cooperatives, collectives, and limited liability and shareholding firms have other state or non-state firms as their main customers. It is reasonable to expect that some of the SME products will find their way to the world market through these firms. It is impossible to make a precise assessment of the importance of indirect exports, but an upper limit may arguably be given by the presence of formalized long-

term relations with other firms. Those SMEs that participate in export production networks are likely to have a formal position in a subcontracting chain. Table 7 shows that 14 percent of all firms (and about one-fourth of the modern enterprise types) had such subcontracting relationships in 2002. Even if all of these relationships were oriented towards export markets (which is unlikely), the average export share would still be quite low. The data suggest that at most 17 percent of all SMEs in the sample have any direct or indirect relations with export markets. However, the share differs between firm types and is substantially higher for the modern firms: about 28 percent of them have subcontracting arrangements (not shown), which suggest that as much as 43 percent might have direct or indirect export. For rural areas and simpler enterprise forms (household and private firms) the numbers are much lower.

Table 7. Subcontracting agreements 2002 (percent)

	Total	Urban	Rural	House- hold	Private	Collective	Limited & Shareholding
<i>Did the enterprise produce as a subcontractor?</i>							
Yes	14	18	10	10	19	23	28
No	86	82	90	90	81	77	72

Source: 2003 survey data base.

A final explanation to the low export in SMEs could be the rapid development of Vietnam's domestic market. With an average annual growth rate of over 7 percent during the past decade, it is safe to say that domestic market opportunities have been expanding. This means that only few SMEs have been forced to search for export market opportunities because of weak domestic demand. Given the high fixed cost of acquiring the necessary information about foreign markets, it is not surprising that few SMEs are export oriented. In fact, it appears that the export intensity of the SME sample is in fact diminishing. Table 6 shows that

more firms had export as the main market in both 1990 and 1996 than in 2002. This can partly be explained by changes in the sample structure, with a significantly higher share of household firms and private firms in 2002. However, the underlying data for Table 6 also show that the importance of export has fallen for each of our four enterprise categories. It is hard to explain this observation without referring to the improved opportunities in the domestic market.

5.1 Exporting firms

Given the low export orientation of the SME sample, it may be interesting to explore some of the characteristics of the firms that are actually exporting. A first question concerns what products Vietnamese SMEs export. Table 8 outlines the industry structure of the SME sample and the group of firms reporting that they engaged in direct export activities in 2002. It can be seen that the exporters are mainly found in food products (SITC 0), non-metallic manufactures (SITC 6) and other manufacturing (SITC 8).

In other manufacturing, the main products are furniture, garments, and handicrafts. These product categories also figure prominently in Vietnam's overall exports (see e.g. Hill, 2000). A few of the other leading Vietnamese export items are conspicuously absent from the sample of SME exports. In food products, two of the main items at the aggregate level are rice and frozen seafood, together accounting for some 17 percent of total exports: none of these appear in the present sample. Moreover, around 20 percent of Vietnam's total exports in 2002 were made up of crude oil, and another 11 percent were made up of footwear, both of which are missing from the SME sample. A more detailed comparison of SME exports and aggregate exports is unfortunately not possible, since Vietnam does not publish detailed SITC trade statistics. It is, however, reasonable to conclude that the SME exports largely fall within the broad areas of Vietnam's comparative advantages, but with heavier emphasis on more

labor-intensive products in the food and other manufacturing categories. Instead of rice, frozen seafood and footwear, the focus among SMEs is on rice crackers, furniture, garments, and handicrafts.

Table 8. Industry distribution of all SMEs and exporting SMEs 2002 (percent)

Sector	SITC	Share of all SMEs	Share of exporting SMEs
Food	0	19	16
Crude Materials	2	6	2
Mineral Fuels	3	1	0
Chemicals	5	7	5
Non-metal manufactures	6	26	20
Machinery	7	17	9
Other manufacturing	8	19	43
<i>Building materials</i>	81	7	0
<i>Furniture</i>	82	2	11
<i>Travel goods</i>	83	0	0
<i>Clothes</i>	84	5	14
<i>Footwear</i>	85	1	0
<i>Professional goods</i>	87	0	2
<i>Optical goods</i>	88	0	0
<i>Miscellaneous</i>	89	4	16
Other		6	5

Source: 2003 survey data base.

Looking at the distribution of exporting firms across ownership forms, Table 9 shows that limited liability and shareholding companies are dominant. However, there are exporting firms from all enterprise categories, including household firms. The table also shows that the

exporting SMEs are not evenly distributed across the seven provinces included in the survey. More than half of the exporters are based in Ho Chi Minh City. Hanoi accounts for about one-fifth of exporters, and Ha Tay and Long An have about one-tenth each. Haiphong, Phu Tho, and Quang Nam have very few exporters.

Table 9. Distribution of exporting SMEs across ownership types and provinces 2002 (percent).

Ownership form	Household	Private	Partnership	Limited and shareholding				
% of exporters	19	3	13	61				
Location	Hanoi	HCM	Hai Phong	Ha Tay	Long An	Phu Tho	Quang Nam	
% of exporters	19	55	3	10	10	3	0	

Source: 2003 survey data base.

Figure 1 provides a picture of how the characteristics of exporters compare with the average enterprise in our survey. The scale is normalized, so that a score equal to one corresponds to the average for all firms, while a score above one means that the exporters record a higher than average value for the relevant firm characteristic. Hence, the first column indicates that the average value added per employee in exporting firms was nearly twice as high as that for the entire sample, the second column compares exporting urban firms with all urban firms, and so forth. There are three major observations from the figure. First, although the labor productivity of the average exporting enterprise is nearly twice as high as that of the average SME, this is entirely due to high productivity in exporting limited liability and shareholding

firms. Neither the exporting household firms nor the exporting partnerships and collectives record any remarkably high labor productivity.⁵

Insert Figure 1 here: Characteristics of exporting SMEs 2002

Second, the capital intensity of exporting firms (measured as assets per employee) is lower than that for all firms, regardless of ownership category. The values for total, urban, and rural exceed one, but this is only because the share of the modern enterprise forms is high among exporters. This suggests that comparative advantages – related to cheap labor and raw materials – are important also at this very disaggregated level.

Third, the exporting SMEs tend to be larger than the average firm in each enterprise category. This observation supports our earlier statement that successful exporting firms are likely to graduate from SME status as they grow larger thanks to their export success. It may also illustrate the importance of scale economies for export success. There are significant fixed costs connected to exporting, mainly related to marketing and information about foreign markets: the smallest firms are unlikely to invest the necessary resources in these activities.

It is tempting to conclude that exporting firms are better informed than non-exporters. Whether this is indeed the case is hard to discern from the available data. However, going back to the questions posed in Table 3, it is possible to look for differences regarding expectation and preparations between exporters and non-exporters. Table 10 below presents the results of such a comparison. A clear pattern emerges. The expectations of exporters are consistently more positive, with 53 percent of exporters expecting benefits, compared to only 12 percent of non-exporters. It is also significant that only 25 percent of exporters reply that they do not know what to expect from further liberalization: the corresponding figure for non-

⁵ The number of exporting private firms is too low for a separate category.

exporters is 63 percent. The exporters are also getting ready for further internationalization. Two-thirds of the exporters report that they are preparing for trade liberalization, while only 16 percent of non-exporters do the same. Table 10 does not report data for the different ownership forms, but a similar pattern, with a larger share of exporters expecting positive effects and making preparations for increased trade openness, applies for all ownership forms.

Table 10. Expected effect of increased globalization among exporting and non-exporting SMEs 2002.

	Total		Urban		Rural	
	Exporter	Non-exporter	Exporter	Non-exporter	Exporter	Non-exporter
<i>Expected effect of further trade liberalization?</i>						
Benefit	53	12	50	14	63	9
No change	12	17	12	17	12	18
Loss	9	8	12	13	0	3
Don't know	25	63	25	55	25	70
<i>Does the enterprise prepare for further trade liberalization?</i>						
Yes	66	16	71	24	50	9
No	34	84	29	76	50	91

There are too few exporters among private firms for a comparison.

Source: 2003 survey data base.

We have also asked the surveyed firms about their knowledge of some of the recent institutional reforms in Vietnam. As noted earlier, the 2000 Enterprise Law has been a very important step in promoting the Vietnamese private sector. In addition, the past few years have seen revisions of several different laws, including the Tax Law, Customs Law, Land Law and others. To what extent do exporting and non-exporting firms have different

perceptions of these laws? Table 11 summarizes the responses of exporters and non-exporters to questions about how familiar they are with seven different laws that can be expected to have an impact on business activities. On a scale from 1 to 4, where 1 indicates good knowledge of the law in question and 4 indicates no knowledge, most of the laws fall in the medium category, with average scores between 2 and 3.⁶ Urban firms seem better informed than rural firms. On average, firms seem to know most about the Tax Law and be most ignorant about Customs Law, which is not surprising against the backdrop of the results we have already presented. While virtually all firms will be affected by tax regulations, very few have any direct contacts with the customs administration. There is also a clear difference between exporting and non-exporting firms. On average, exporters appear to be better informed about all laws, with a particular information advantage regarding the Customs Law. However, the differences between exporting and non-exporting firms in the modern ownership categories (collectives and partnerships, and limited liability and shareholding companies) are small. Non-exporting firms in these categories actually give a more positive assessment of their own knowledge about most laws, except the Customs Law.

⁶ The difference between scores 2 and 3 can be illustrated drawing on some additional information about the Enterprise Law. We asked firms to assess how this law had affected their operations, with the answer “Don’t know about the law” as one of the response alternatives. This alternative was chosen by 28 percent of the exporting firms, at the same time as their average score regarding knowledge of the Enterprise Law was 2.2. Non-exporters recorded a corresponding average score of 2.9, while 54 percent of them responded that they had no knowledge of the law. In other words, a score below 2 suggests that few firms are unaware of the law, whereas a score above 3 implies that more than half of the firms do not know about the law.

Table 11. Knowledge of laws among exporting and non-exporting SMEs 2002.

	Total		Urban		Rural		Household		Collective		Limited and shareholding	
	Non-Exp	Non-exp	Non-Exp	Non-exp	Non-Exp	Non-exp	Non-Exp	Non-exp	Non-Exp	Non-exp	Non-Exp	Non-exp
<i>How would you characterize your knowledge of:</i>												
Enterprise law	2.2	2.9	2.0	2.5	2.5	3.2	2.9	3.2	3.0	1.9	1.8	1.7
Labor code	2.2	2.9	2.0	2.6	2.6	3.2	3.0	3.2	2.3	2.1	2.0	1.9
Customs law	2.3	3.6	2.1	3.4	3.0	3.7	3.0	3.7	2.3	3.3	2.2	2.8
Insurance law	2.6	3.4	2.5	3.2	3.0	3.6	3.3	3.6	2.5	2.8	2.6	2.5
Tax law	1.8	2.5	1.7	2.1	2.4	2.9	2.4	2.8	2.0	1.7	1.7	1.4
Environmental law	2.9	3.1	2.9	2.9	3.0	3.4	3.1	3.3	3.0	2.4	2.9	2.4
Land law	2.7	2.9	2.6	2.7	3.0	3.0	3.3	3.0	2.5	2.3	2.7	2.3

Note: Responses range from 1 (good) to 4 (no knowledge). The number of exporting private firms is too small for a comparison.

Source: 2003 survey data base.

One cautious conclusion is that exporting firms in the rural areas are better informed than non-exporters. This information advantage coincides with a size advantage, and may have been an important determinant of their ability to enter into export activities. Urban exporters also appear to have a somewhat stronger knowledge base than other urban firms, although the differences become smaller the larger the firms get. However, they are not more capital intensive than other firms: on the contrary, for all enterprise types, exporting firms exhibit a lower ratio of assets to labor than non-exporters. Yet, the most notable feature of the SME exporters is their small number. The notable observations are perhaps that the average SME only exports 16 percent of its output, and that only three percent of the firms are involved in any direct exports.

6. EFFECTS OF INSTITUTIONAL REFORMS

We have noted above that the increasing internationalization of the Vietnamese economy has necessitated various economic and institutional reforms. Trade regulations have been liberalized, tax laws have been reformed, the financial system has been encouraged to work with the private sector, the administrative requirements on private firms have been eased, and so forth. Even if the direct effects on SMEs of internationalization appear to be limited – few firms seem to compete with imports, and few firms are engaged in exports – it is possible that the reforms brought about by the internationalization process have had a more thorough impact. The changes in the Vietnamese business environment may simply have affected the conduct and performance of SMEs (as well as other firms).

One notable change over time is related to hazard rates. While only 36 percent of the firms surveyed in 1990 survived until 1996, 470 of the 750 firms covered in 1996 were still active in 2002, yielding a survival rate of 63 percent. It appears feasible to interpret this as an improvement in the business climate, following from the various reforms that have been undertaken during the past decade.

A similar conclusion can be reached by comparing transition matrices for the period 1990-1996 and 1996-2002. These matrices trace the movement of firms across different size categories over time. The matrix for 1990-1996 (Table 12) suggest at very dynamic and changing business environment. The first row of the matrix shows that 53 percent of the companies belonging to the first quintile (in terms of employment) in 1990 were still in the first quintile in 1996. However, 33 percent of the companies had grown to reach the second quintile, and 7 percent had managed to grow so rapidly that they belonged to the highest quintile in 1996. Similarly, the last column shows that 6 percent of the firms belonging to the highest quintile in 1990 had slipped to the lowest quintile by 1996: only 44 percent of the firms that had belonged to highest quintile in 1990 were still in the same position six years

later. Overall, it appears that the changes in enterprise development were often dramatic during this period, with marginally higher odds for growth than decline, given that the firm did not belong to the large majority that vanished altogether.

Table 12. Transition matrix 1990-1996.

Employment	1. Quintile 1996	2. Quintile 1996	3. Quintile 1996	4. Quintile 1996	5. Quintile 1996
1. Quintile 1990	53%	33%	7%	0%	7%
2. Quintile 1990	21%	31%	21%	15%	13%
3. Quintile 1990	19%	13%	23%	23%	23%
4. Quintile 1990	3%	10%	19%	29%	39%
5. Quintile 1990	6%	9%	15%	27%	44%

Source: Rand et al. (2004).

The transition matrix for the period 1996-2002 (Table 13) suggests a less turbulent business environment. In particular, the majority of firms can be found in the diagonal of Table 13, which suggests that they kept their relative position in the employment ranking. No firm starting out in the two lowest quintiles was able to reach the highest quintile, but there were also very few of the firms belonging to the highest quintiles that declined to the lowest quintiles during this period. Moreover, as noted earlier, the odds for survival increased from 36 percent in 1990-1996 to 63 percent in 1996-2002. Overall, it appears reasonable to characterize this development as positive, in particular as it seems that the higher stability has

not been related to lower competitive pressure or explicit public interventions that would allow unhealthy private companies to survive in spite of weak profitability and efficiency.

Table 13. Transition matrix 1996-2002.

Employment	1. Quintile 2002	2. Quintile 2002	3. Quintile 2002	4. Quintile 2002	5. Quintile 2002
1. Quintile 1996	51%	44%	5%	0%	0%
2. Quintile 1996	15%	63%	15%	7%	0%
3. Quintile 1996	6%	25%	44%	18%	7%
4. Quintile 1996	1%	5%	22%	49%	22%
5. Quintile 1996	1%	1%	7%	23%	68%

Source: Rand et al. (2004).

Turning to enterprise perceptions about constraints to growth, Figures 2 and 3 summarize some of the survey findings in this area. Figure 2 refers to enterprise assessments of which are the main constraints to their continuing growth (firms were allowed to report at most three constraints). The main problem, throughout the study period, appears to be the shortage of investment capital, mentioned by between 50 and 60 percent of firms. Market-related problems, expressed either as limited demand or excessive competition, were also common. The most significant changes over time have been related to lack of modern technology and uncertainty regarding government policies. The frequency of complaints about these issues was nearly halved between 1990 and 2002, and it is notable that government policy is not

perceived as a constraint for SME development anymore. Moreover, the number of companies claiming that they do not see any major constraints to growth has increased over time, particularly in South. Less than 5 percent of firms in Ho Chi Minh City and Long An claimed that there were no constraints to growth in 1996; by 2002, this view was shared by about 17 percent of firms in these two provinces.

Insert Figure 2 here: Main constraints to growth 1990-2002

Figure 3 reports responses to questions about the kind of government assistance desired by the firms. While improved infrastructure was the main category in 1990, access to credits has since become the major kind of support requested by the SMEs. This is interesting in view of the strong growth of credit available for the private sector in Vietnam. For instance, bank lending to private firms in Vietnam has increased from ten percent of total lending in 1990 to almost 60 percent in 2001 (Van Arkadie and Mallon, 2003, p. 100). A plausible reason is that the increased availability of credit has primarily benefited large privately owned firms (Tenev et al, 2003). Two other developments are notable. Firstly, marketing was rarely mentioned as a desired support area in 1990, but has emerged as one of the major issues in 2002. This is notable, because it indicates an increased awareness of what is needed for commercial success in an economy that can no longer be characterized as a shortage economy. Secondly, policy-related requests are rapidly disappearing. About one-quarter of companies wanted clarifications about the long-term policies of government or improvements in the macro environment in 1990, but only 10-15 percent of firms had similar requests in 2002.⁷

⁷ Another notable observation concerns the number of firms reporting that they do not want any support from government. In 1996, some two-thirds of firms responded that they did not desire any assistance, but only 19 percent of firms gave the same answer in 2002. This is an interesting development, which may either mean that firms feel an increasing need to seek assistance, or that they feel more comfortable in their relations with the government. Informal interviews with Vietnamese SMEs suggest that the latter alternative is closer to the truth.

Insert Figure 3 here: Government assistance desired 1990-2002

Summarizing the results from these subjective assessments of the business environment in Vietnam, it appears that credits and tough competition remain the main problems faced by Vietnamese SMEs, and that the institutional reforms implemented during the past years have not had any major impact on the companies' assessments of their own situation. Before concluding that the reforms have had no effects, however, it is appropriate to note that similar complaints are likely to persist in most economies. Capital is a scarce asset, and the information asymmetry between creditors and SMEs will often result in a situation where the firms feel that they need more funds. Similarly, competition is one of the driving forces of the market economy, and competitive pressure should be perceived as a constraint by every individual enterprise in a functioning market. Hence, there may be reason to put more emphasis on some of the other responses from the survey. The decrease in the number of complaints about uncertain government policy – and the related reduction in calls for clarification and improvement of policies – is a very positive development that arguably reflects real improvements in the Vietnamese business climate. On the basis of these observations, it seems reasonable to conclude that the economic and institutional reforms connected to internationalization have had an impact on Vietnamese SMEs, and that the impact has largely been positive.

7. CONCLUDING REMARKS

In this paper, we have attempted to examine the degree of internationalization of Vietnamese SMEs, exploring micro data from three surveys of SME covering information for 1990, 1996, and 2002. The findings indicate that very few SMEs have been directly influenced by the country's internationalization, through import competition, direct contacts with foreign firms,

or direct exports. The central observation may be that only three percent of the SMEs surveyed in 2002/03 participated in direct export activities. Due to their limited exposure to internationalization, they have very unclear expectations of what further internationalization may mean and are, consequently, not preparing in any explicit manner for the opening of the Vietnamese market.

The exceptions from these statements are mainly found among the modern enterprise forms, the limited liability and shareholding firms, that may be said to be in transition to non-SME status. The conditions for private enterprise have improved gradually over the past few years, and successful SMEs that are able to source capital (e.g. shareholding firms) and participate in the international market are likely to grow out of the SME category in a relatively short period of time.

But what about the remaining majority of Vietnamese SMEs? Will they be able to continue growing, creating employment, and alleviating poverty at the rates required to maintain a healthy development of the Vietnamese market? The results of our survey suggest that substantial challenges lie ahead. To maintain the growth rates of the past few years in the face of increasing international competition in the Vietnamese market will require substantial efforts to upgrade capacity. This does not only apply to investments in machinery and technology, but also to investments in human capital and skills. At the same time, it is essential to note the opportunities provided by the international market. The relative diversity of the exporters in the present SME sample – and in particular the observation that many do not belong to the most advanced and capital intensive among the SME group – hints at the opportunities available to Vietnamese SMEs. What is lacking is largely information about foreign market opportunities and export infrastructure. Both of these require substantial initial investment, and are to some extent public goods: once the knowledge or infrastructure is in place, it can be used by many firms. This may provide good opportunities for public

investment or ODA investments, given that the social return to well-designed projects is likely to be high. Export success also requires active investments by the SMEs to exploit the opportunities that are available. However, it appears that few firms are considering investments in human capital, although lack of knowledge – in particular related to marketing – appears to be a major obstacle for many firms.

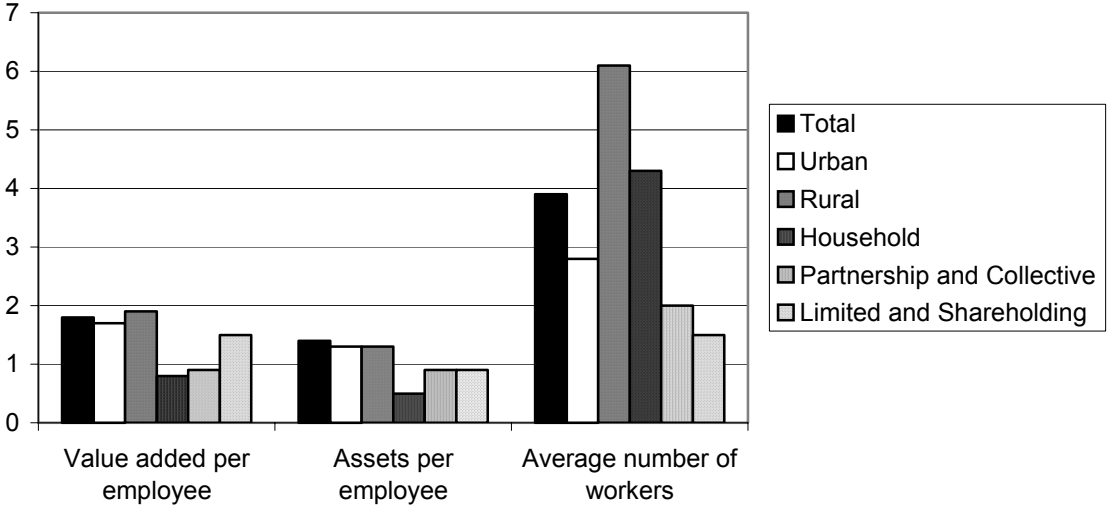
Another obstacle for further development is access to credits. Household firms and private firms are particularly credit constrained and have also exhibited much slower growth than the more modern enterprise types. Given the structure of the Vietnamese financial system (and the generic problems related to financing of SMEs) it probably not realistic to expect substantial improvements in credit flows to the smallest enterprise types. The feasible alternative may instead be to promote those enterprise forms that exhibit strong growth potential and are able to attract capital from other sources than the formal banking system. Shareholding and limited liability companies are the prime examples of these kinds of firms. The new Enterprise Law from 2000 has already reduced the administrative requirements for starting new firms. The future reform needs in this area are closely related to the main overall development challenges for Vietnamese economy. Without continued reforms of the SOE sector, to reduce the privileges enjoyed by the leading state firms, and without thorough reform of the financial system, to raise the share of long-term credits going to the private sector, it will be very difficult for Vietnam's dynamic SMEs to fulfill their potential and graduate to the L category.

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Figure 1. Characteristics of exporting SMEs 2002



Note: The index value 1 denotes the average for the relevant category. There are too few exporting private firms for a comparison.

Source: 2003 survey data base.

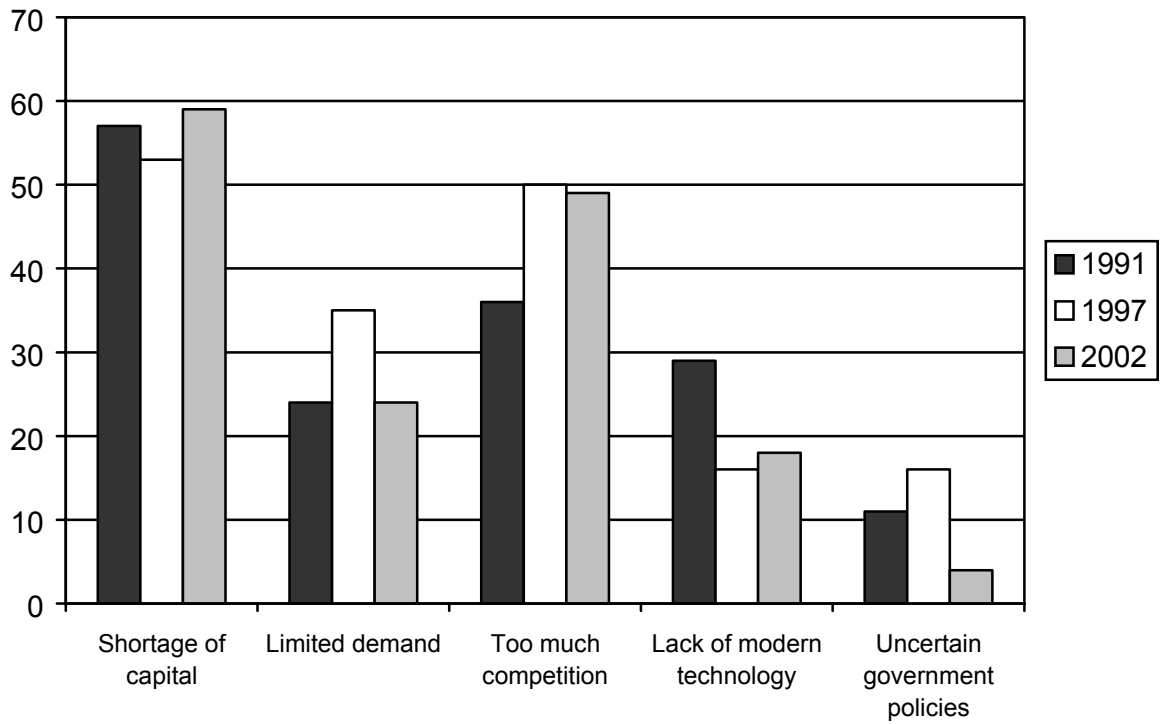
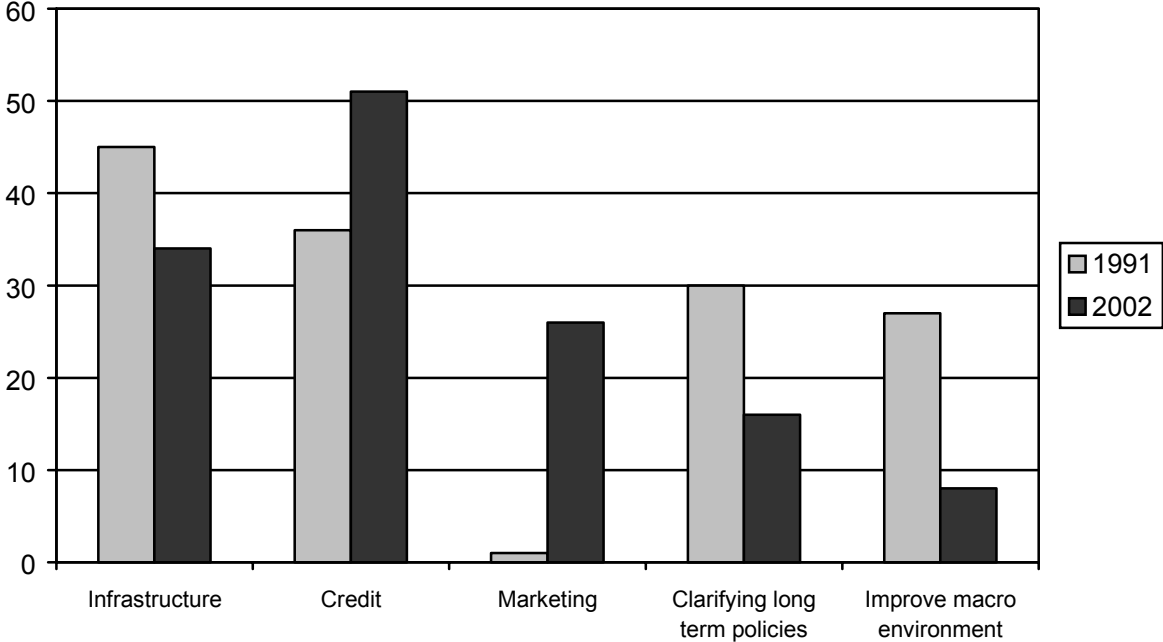


Figure 2. Main constraints to growth 1990-2002

Note: Firms were allowed to name at most three major constraints.

Source: 1991, 1997, and 2003 survey data bases.

Figure 3. Government assistance desired 1990-2002



Note: Firms were allowed to state at most three types of assistance desired.

Source: 1991 and 2003 survey databases.