



VIETNAM PRIVATE SECTOR

Productivity and Prosperity

Ha Noi, 2018



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Le Duy Binh

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ACRONYMS

| | |
|----------------|--|
| ADB | Asian Development Bank |
| AEC | ASEAN Economic Community |
| ASEAN | Association of South East Asian Nations |
| BA | Business Association |
| BDS | Business Development Service |
| CIEM | Central Institute for Economic Management |
| CPTTP | Comprehensive and Progress Agreement for Trans-Pacific Partnership |
| EVFTA | European Union (EU) Viet Nam Free Trade Agreement |
| EU | European Union |
| FDI | Foreign Direct Investment |
| FIE | Foreign Invested Enterprises |
| GC | General Corporations |
| GDP | Gross Domestic Product |
| GDT | General Department of Tax |
| GSO | General Statistical Office |
| HAWASME | Hanoi Women Business Association |
| HAWEE | Ho Chi Minh City Women Business Association |
| HHB | Household Business |
| ICOR | Incremental capital-output ratio |
| IFRS | International Financial Reporting Standards |
| JETRO | Japan External Trade Organization |
| MBI | Mekong Business Initiative |
| MOF | Ministry of Finance |
| MOLISA | Ministry of Labor Invalids and Social Affairs |
| MOST | Ministry of Science and Technology |
| MPI | Ministry for Planning and Investment |
| OECD | Organization for Economic Cooperation and Development |
| PCI | Provincial Competitiveness Index |
| PLC | Public Listed Company |
| PRC | People's Republic of China |
| PSD | Private Sector Development |
| ROE | Return on Equity |
| SBV | State Bank of Viet Nam |
| SEG | State Economic Group |

| | |
|--------------|---|
| SME | Small and Medium-Sized Enterprises |
| SOE | State-Owned Enterprises |
| STEM | Science, Technology, Engineering and Mathematics |
| TFP | Total Factor Productivity |
| CPTPP | Comprehensive and Progressive Agreement for Trans-Pacific Partnership |
| VAS | Viet Nam Accounting Standard |
| VCCI | Viet Nam Chamber of Commerce and Industry |
| VELP | Viet Nam Executive Leadership Program |
| VNPI | Viet Nam Productivity Institute |
| VSI | Viet Nam Social Insurance |
| US | United States |
| VWEC | Viet Nam Women Entrepreneur Council |
| WEF | World Economic Forum |
| WOB | Women-Owned Business |
| WTO | World Trade Organization |

Exchange rate used for reference purpose:

US\$ 1 = VND 23,220.2 (June 2018)

In this report, "\$" refers to US dollars, and "VND" or "D" refers to Vietnamese dong.

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EXECUTIVE SUMMARY

In 2017, the Resolution of the 5th plenum of the 12th Party Central Committee was issued, affirming the need to promote the private sector to be the driving force of Viet Nam's socialist-oriented market economy. This is an important milestone given that the private businesses experienced volatile growth in Viet Nam in the past. During the command and planning economy, private businesses was not officially recognized. However, private sector entrepreneurs still existed, filling the vacuum that was not covered by the government. In 1986 the Doi Moi "Renovation" policy was launched at 6th Party Congress. Under the Doi Moi policy, the private sector was officially recognized as part of the development of socialist-oriented market economy and of a multisector economy. Gradually, Viet Nam's private sector broadened. The Enterprise Law introduced in 1999 triggered a boom in the development of the domestic private sector enterprises in Viet Nam, and the policy and legal framework for private sector continuously improved since then.

The number of registered businesses has dramatically increased, reflecting both the formalization of existing household businesses as well as the creation of new firms. However, the gap between the number of registered enterprises and those who are actually active is widening. Besides domestic private companies, household businesses (HHBs), foreign investment enterprises (FIEs) are becoming integral components of the private sector in Viet Nam. The expansion of the private sector is coupled with the reduction in the number of state-owned enterprises (SOEs) and with the slow growth of cooperatives (the collective economy). The rise in the number of private enterprises has resulted in a dramatic growth in capital stock of private sector enterprises. The private sector has contributed enormously to the formation of fixed assets and to long-term investment of the business sector and of the entire economy.

The private sector has been a key contributor to Viet Nam's economic growth in recent years. In 2016, the domestic private sector accounted for 38.6% of gross domestic product ([GDP] of the percentage, formally registered enterprises accounted for 8.2%, household business sector for 30.43%). Foreign private sector (FDI enterprises) accounted for 18.95% of GDP. The private sector is the main contributor to job creation, poverty reduction, improved living conditions, and inclusive and sustainable growth in Viet Nam. Excluding HHBs, domestic private enterprises and FIEs created 3.35 million new jobs between 2010–2015, or 557,000 new jobs on average per year. Private sector enterprises overtake SOEs in terms of income generation for employees and workers. Employment generated by the private sector enterprises have helped millions of workers to shift away from lower-

paid jobs in the farm sector to jobs in more productive ones and which are higher paid. Furthermore, private sector businesses contribute significantly to the expansion of the social security coverage. Enterprises contributed about US\$39 billion to the state budget in 2016, accounting for 79.8% of the total revenue. The share of contribution by domestic private enterprises in the total internal revenue of the state budget has increased from 11.9% in 2010 to 14.3% in 2016. In absolute terms, the contribution increased from US\$3 billion in 2010 to US\$7 billion 2016.

Private sector development has contributed significantly to women economic empowerment, especially through job opportunity and income generation. In 2015, 46% of the employment in the whole formal enterprise sector were women. Some estimates indicate that 25% of enterprises in Viet Nam are owned or led by women as compared with the average of 8% in South Asia. About 5% of CEO of companies listed on the national stock exchange are women. The rising trend of women leadership in the private sector has driven up the emergence of an increasing number of women business associations.

However, the quality of growth of the private sector is a concern. Productivity gain in the private sector is still far from satisfactory. Increased productivity will be required to sustain and increase growth to meet Viet Nam's medium-term targets. The private sector, as an important engine of growth as the Resolution V resolves, needs to play an important role in propelling productivity gain in the coming decades. Low productivity growth in the economy is associated with the large number of micro- and small enterprises. The "missing middle", i.e., the absence of medium-sized enterprise, is another concern. The pace of capital accumulation by internal sources is slow in domestic private enterprises.

However, large and better governed private enterprises in Viet Nam are experiencing an upward productivity trend and efficiency. It is important that Viet Nam policies emphasize having more large and well-governed companies rather than many small enterprises. In addition to boosting productivity, large enterprises can play the role of "lead firms," which can drive the growth of a sector or a business cluster.

ICOR statistics show that private sector enterprises in Viet Nam have been far more efficient than SOEs in using capital and investment. Despite the better performance of the private sector in ICOR, much of the capital and resources in the national economy have not been reallocated to this sector. Within the private sector, there is a good chance to improve productivity by reallocating resources from the quasi-formal HNB sector to the formal one.

Sectorwide financial performance indicators of private sector enterprises are worrisome. The rise in absolute number of revenue and profit of domestic private enterprises do not escape the fact that their profitability is much lower than that of SOEs and FIEs. In 2014, 45.5% of domestic enterprises and 47.3% of FIEs reported losses, and this trend has been picking up sharply in recent years. The fact that 176,500 domestic private enterprises were running at loss in 2014 is worrying. The financial losses affect adversely the accumulation of capital by internal sources, and the growth in size of private sector enterprises.

Interlinkages between subsets of the private business sector is an important issue. The share of domestic private sector enterprises in total export has been plummeting in the last few years and the economy depends heavily on export by foreign private sector. Within the private sector, the linkage between domestic private and foreign invested enterprises is weak. The phenomenon of *three economies in an economy* is detrimental to the growth of both the entire economy and the private sector. The government is yet to have concrete policies or measures to support the linkage between FIEs, domestic enterprises, and SOEs.

The private sector is facing a decline in a once-abundant resource that it used to benefit from to grow. Viet Nam is becoming less competitive in terms of labor costs as the worker wages increase in recent years. Furthermore, the demographic dividend that the private sector in Viet Nam has been benefiting significantly from has been nearly spent. In fact, in recent decades the domestic sector enterprises and household business has relied much on the demographic dividend and on lower labor costs to grow and to produce a combined 38.64% of GDP (in 2016). However, domestic private sector enterprises have been slow in responding to the decline of this once-abundant and cheap resource.

The private sector is characterized by high level of informality and quasi-formality. This is an important challenge. Excessive regulations, ineffective enforcement, high compliance costs are the key reasons for high level of informality or quasi-formality. HHBs continued to be a preferred form to start up a business, especially for those who do it out of necessity, to subsist and to earn a living. HHB sector's contribution to the state budget and to social security coverage is extremely limited, despite accounting for one-third of the GDP. Many HHBs benefit from the ambiguity that is granted to the HHB sector, resulting in complaints from the formally registered businesses about the unfair practices and competition from the informal private sector. Productivity in HHBs is generally lower than that of formal domestic enterprises. Improving the performance and efficiency of HHBs is highly important as the sector accounts for 30.4% of GDP.

The business environment has significant room for improvement. There is still a lot of work to be done to level the playing field between private enterprises and SOEs, and between domestic private enterprises and FIEs. Unfair access to resources is also reflected for firms with and without “close connections” with authorities. Access to finance is a major constraint for private sector enterprises. Interest rates charged on loans by banks are generally higher than the rate of return of private enterprises.

Viet Nam is far from an innovation-led and technology-driven economy. Its performance in terms of innovation is unsatisfactory, and the private sector needs to be encouraged to play a stronger role. There is a limited number of private sector research and development institutions in Viet Nam. According to the Ministry of Science and Technology, there are only about 300 companies accredited as science and technology enterprises. Infrastructure and funding for research and development is generally of poor quality. STEM and innovation curriculums remain underdeveloped. Access to advanced technologies, including information and communication technology, in agribusiness, manufacturing and services are yet to be fully exploited. The enforcement of intellectual property laws and regulations is ineffective, resulting in rampant violation of intellectual properties, trademark, and copy rights. This dampens the interest and the desire of the people in general and of private sector businesses in particular, to innovate.

However, the outlook for private sector development is bright. Strong economic growth, continuous efforts of the government in structural and institutional reforms create an enabling environment for the private sector to thrive. The political determination in and commitment to private sector development has been repeatedly reaffirmed. The government has been increasingly adept in playing the “facilitating and enabling” role to create a business environment in which the domestic private sector can start up, grow, and prosper. Viet Nam’s geographic position and membership of regional and international trade agreements provide precious opportunities for its private sector.

Foreign direct investment remains high and there is a stronger awareness on the urgency and benefits of stronger linkage between domestic enterprises and FIEs. Stepped-up efforts by the government to divest from SOEs and to reform the SOE sector is also an opportunity for the private sector. Private sector enterprises also see important opportunities when important public works and infrastructure projects, which used to be reserved for SOEs are now offered to the private sector. Entrepreneurship among the Vietnamese is improving dramatically and is continuously supported by the improving business environment and by public information programs.

1. Improving the competitiveness of enterprises and private sector are the key components of Viet Nam competitiveness. Continued efforts to improve the business environment should be one of the highest priorities for Viet Nam. The government should shift the focus to the quality of growth of private sector enterprises. Instead of aiming at hundreds of thousand enterprises being set up in the coming decades, policy focus should be laid more on quality indicators, e.g., productivity at firm level, size of business, level of technology, innovation, financial performance, level of integration into the regional and international supply chains, and competitiveness.

There should be a clear policy statement on domestic formal private sector enterprises being the pillar of the national economy and of national competitiveness. Within the business sector, there should be measures to facilitate the reallocation of resources to enterprises that use resources (capital, labor, land) more efficiently. Policy measures to strengthen the linkage between domestic private enterprises with FDI enterprises and with SOEs need to be introduced. The “missing middle” phenomenon should be addressed, and should be supported by explicit policy statements and policy measures to support capital accumulation and the growth in size of domestic private sector enterprises.

Policies should prioritize increasing the capacity of private sector enterprise to adopt technologies. Technologies can be adopted from abroad or from FIEs or from other countries. Strategic, continuous, persistent, and smart technology adoption will lead to accumulation of know-how, technology, and knowledge and eventually to innovation and invention. The STEM curriculum needs to be constantly updated and reformed. In line with the Industry 4.0, it is important that the private sector growth need to be driven by technology, led by innovation, geared toward higher productivity and competitiveness in the coming decades. It is imperative that the private sector get prepared for the rising wage and the “population dividends” being spent off in a near future.



CHAPTER I

PRIVATE SECTOR IN VIETNAM: LOOKING BACK AND CURRENT STRUCTURE

I. PRIVATE SECTOR DEVELOPMENT IN VIET NAM – IMPORTANT MILESTONES

1. **Private businesses experienced bumpy growth.** During the command and planning economy, private businesses was not officially recognized. However, private sector entrepreneurs still existed, filling the vacuum that was not covered by the government. According to the General Statistics Office (GSO), in 1975 when the country was unified, the private sector and small-scale industry production still accounted for 8.3% of total GDP of the north.¹ In 1986, before the *Doi Moi* (the Reform) was launched, private sector industrial production units employed 23.2% of the total labor and produced 15.3% of total industrial output of the industry sector in Viet Nam.²

2. **The year 1986 was an important milestone for the development of the private sector.** In 1986 the *Doi Moi* policy was launched at 6th Party Congress. Under the *Doi Moi* policy, the private sector was officially recognized as part of the development of socialist-oriented market economy and of a multisector economy. The most immediate impact of the official recognition of the private sector as a sector of the economy was the robust growth of the household businesses. This is the form of private sector business that flourished before the formal introduction of the Sole Proprietorship Law and the Company Law in 1990.³ In 1989, before these two laws were introduced, there were 333,300 household businesses that were registered across the country.

3. **The private sector broadened gradually.** The private sector in Viet Nam was expanded with the participation of foreign private sector businesses when the first Law on Foreign Investment was adopted in 1987. In 1990, private sector companies and enterprises were recognized for the first time with the introduction of the Company Law and the Sole Proprietorship Law.⁴ The two laws provided the much-needed legal foundation for the establishment of first-ever private businesses in Viet Nam. However, the market entry requirements under the two laws remained prohibitively costly and cumbersome.

1 General Statistic Year Book 1983 (GSO).

2 General Statistic Year Book 1988 (GSO).

3 The Sole Proprietorship Law 1990 is often literally translated as Private Company Law 1990, and sole proprietorship company/ enterprise have been literally named and translated as *private enterprises*, even in the prevailing Enterprise Law 2015. This has created a lot of confusion and a lot of difficulty in getting the public to understand correctly and accurately this important legal form of business in Viet Nam.

4 Law No. 47-LCT/HDNN8 on Company dated 21 December 1990 by the National Assembly and Law No. 48-LCT/HDNN8 on Sole Proprietorship dated 21 December 1990 by the National Assembly.

4. **The Enterprise Law introduced in 1999 triggered a boom in the development of the formal domestic private sector enterprises.** The law liberalized the freedom to do business of the Vietnamese citizens and provided a formal protection of private businesses and of private ownership of businesses. The law introduced unprecedented business environment reforms, tremendous improvements in business start-up procedures, removed myriad barriers to business entry, and prompted a change in the mindset of government institutions, ministries, local authorities toward private sector enterprises. As soon as the law was introduced, the number of annually registered enterprises increased dramatically. Billions of US dollars have been invested by Vietnamese business people into the economy through enterprises registered under the Enterprise Law.

Figure 1: Private Sector Development in Viet Nam – Important Milestones

1986

Introduction of *Doi Moi* (the Reform)

- 1986: Recognition of the multisector economy in the Congress VI of the Party
- 1987: First-ever law on Foreign Direct Investment in Viet Nam

1990

Company Law and Sole Proprietorship Law

- 1990: The Company Law and Sole Proprietorship Law were promulgated
- 1991: Private sector officially adopted and encouraged by the Party in the Party Congress and was recognized as an integral sector of the economy
- 1995: Viet Nam becomes a member of Association of Southeast Asian Nations

1999

Breakthrough Enterprise Law enacted

- 1999: The breakthrough Enterprise Law was introduced, liberalizing the freedom to do business of the people
- 2011: The Viet Nam – United States Bilateral Trade Agreement was signed

2004

Unified Enterprise Law and Investment Law

- 2004: The Enterprise Law and Investment Law were revised, creating the same legal framework for private, state-owned and foreign enterprises.
- 2007: Viet Nam joins WTO

2014

Enterprise Law further reformed

- 2014: The Enterprise Law and Investment Law were further reformed

2017

Resolution 5 of the Congress XII of the Party

- 2017: The private sector is officially recognized as the driving force and a key pillar of the national economy by the Resolution No. 5 of the Congress XII of the Party. Large-scale private sector enterprises are encouraged.

5. **Since 1999, the legal framework for private sector has been continuously improved.** The Enterprise Law and the Investment Law were revised in 2004 by combining the different laws applicable to domestic, foreign and state-owned investors and entrepreneurs. A common legal framework applicable to all investors, regardless of their ownership, became a reality in 2005. This is part of Viet Nam's preparation for the accession to the World Trade Organization (WTO) in 2007. In 2014, the Enterprise Law and Investment Law were further revised with new reforms being introduced.

6. **In 2017, the Resolution of the 5th plenum of the 12th Party Central Committee was issued, affirming the need to promote the private sector to be the driving force of the socialist-oriented market economy.** In the last few decades, the change in the mindset of the Party, as reflected in multiple resolution and strategic papers, plays an important role in the development of the private sector. The changes in policy and thoughts of the Party have been translated into different policies, laws, regulations, and measures by the government to develop the private sector in general and private sector enterprises in Viet Nam.⁵ The Resolution of the 5th plenum of the 12th Party Central Committee aims to sustainably develop the private sector, with strong focus on the development quality, efficiency, and performance of the private sector business. The resolution aims at 1 million active private sector enterprises in 2020, and 2 million in 2030. It also aims at the target that the private sector contributing 50% of GDP in 2020, 55% in 2025, and 60-65% in 2030. Furthermore, the resolution supports the formalization of household business. It also encourages the formation and emergence of multi-owner and large private sector conglomerates, and the investment by big private conglomerates into SOEs, making it possible to link up with the regional and global supply chains.

7. **Private sector development has been accompanied by SOE reforms by the government.** The government has shown determination in reforming the SOE sector to make it more efficient. The government however continued to maintain its high expectation of the SOE sector as an engine of growth, thereby implementing policies to support and protect it. Early on in its Doi Moi reform process, the government recognized the importance of transforming the role of SOEs as critical to reducing the dominance of inefficient state production, promoting private sector development, job creation,

5 Two years after the Doi Moi was launched, according to Resolution 16 of the Politbureau, Tenure VI (1988) and the Resolution of the Central Committee, the Communist Party of Viet Nam articulated that the private sector can develop without any limit in terms of geographic location, scale, and in all sectors not prohibited by laws. In 2002, the Resolution of the Central Committee V, Tenure IX reaffirmed that the private sector is an essential integral part of the national economy, and that developing the private sector is a strategic issue in the development of a multisector socialist-oriented economy. At the Party Congress X (4-2006), the private sector is formally recognized as a sector of the national economy. The private sector is considered an important engine of the economy. This position is again reiterated in the Party Congress XI (1-2011) that "the private sector is one of the important engines of the economy."

and economic growth. As early as 1992, the focus of initial reform efforts was placed on SOE *equitization*—a process of converting SOEs into joint-stock companies or liability limited companies. However most of the SOEs equitized through this process were small unprofitable enterprises, with the larger SOEs occupying the majority of economic activity and employment remaining intact (CIEM 2010). The government equitized fully or partially 3,759 SOEs between 1999 and 2013 and 445 more between 2014 and 2016 (CIEM, 2017).

8. Private sector development and SOE reforms have reciprocal impacts. Evidence show that while SOEs tended to absorb a very large share of aggregate investment, their contribution to real GDP and aggregate employment was disappointing and low compared with that of the private enterprises. When SOEs compete with private sector companies, they also often doing so on a favored basis—making it difficult for private sector competitors to invest and grow (ADB, 2012). In addition to receiving preferential access to capital, land and public procurement opportunities, SOEs were able to use their advantages to navigate Viet Nam’s complex regulatory environment to gain advantage. In many cases this has come at the disadvantage of private sector small and medium enterprises (SMEs), The government is currently pursuing plans to equitize most of the SOE and to reduce the number of SOEs to 103 by 2020.⁶

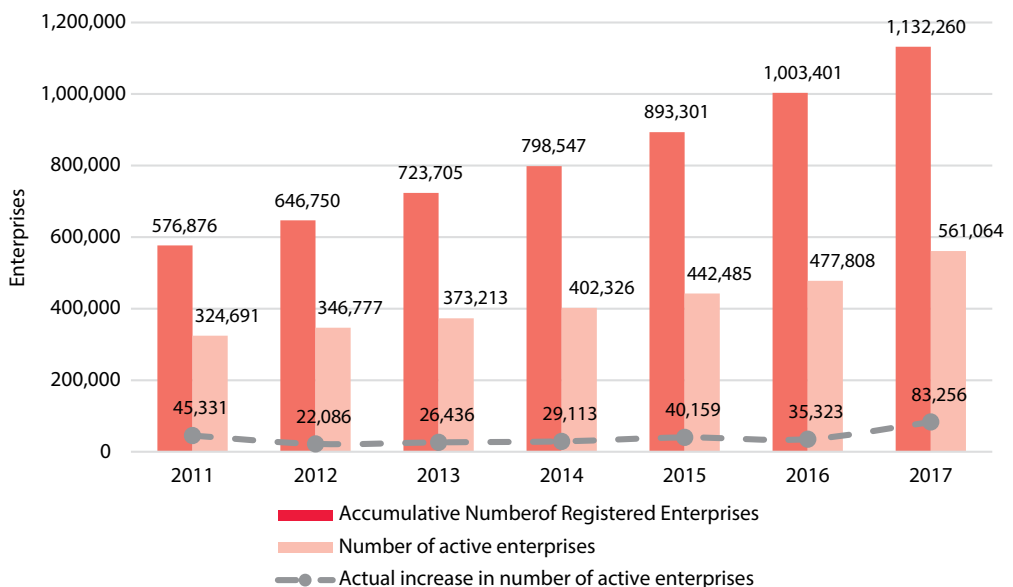
⁶ Decision No. 707/QĐ-TTg which approves the Proposal on SOE reform between 2016-2020.

II. AN OVERVIEW OF THE PRIVATE SECTOR IN VIET NAM

1. Massive growth in quantity of the private sector

9. **The number of registered businesses has dramatically increased, reflecting both the formalization of existing household businesses as well as the creation of new firms.** Formally registered enterprises were non-existent before 1990 as the laws simply did not allow the establishment of private sector enterprises. The first private enterprises were established in 1991 after the Sole Proprietorship Law and Company Law were promulgated in 1990. But establishing a private company was both complicated and prohibitively costly during the time. Within 9 years after the laws were introduced until 1999, only 14,500 private enterprises were established. The Enterprise Law adopted in 2000 triggered a rapid growth in the number and size of private enterprises. It eased restrictions and conditions in market entry. Since then, the number of enterprises has increased at an amazing rate. By the end 2017, more than 1 million private enterprises have been registered. In 2016 alone, 110,000 private enterprises were registered, and this figure increased to 126,800 in 2017. The incidence of number of enterprises over 1,000 population increased slightly to 10 enterprises per 1,000 population in 2017. The entrepreneurship of Vietnamese people has been unleashed by the law.

Figure 2: Cumulative number of registered enterprises, active enterprises, and actual annual increase of active enterprises

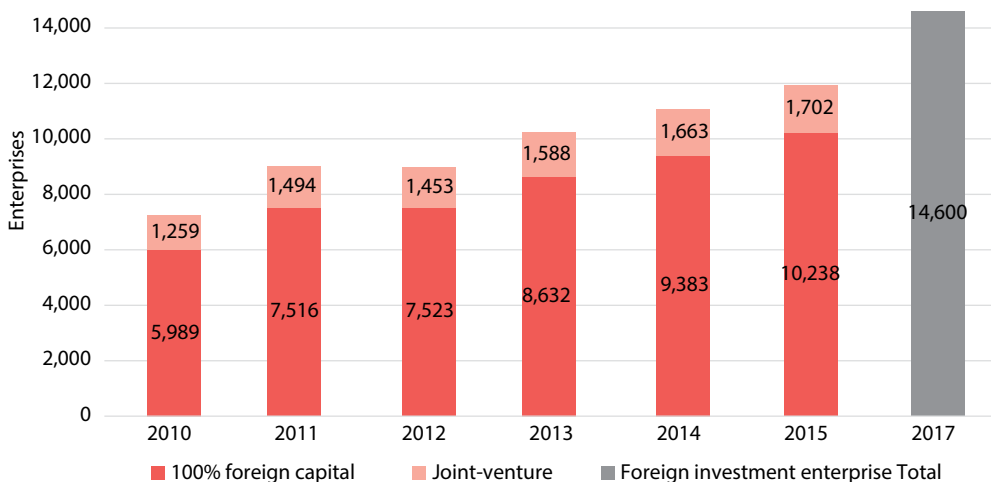


Source: General Statistics Office (2017), Ministry of Planning and Investment (2018)

10. **However, the gap between the number of registered enterprises and those that are actually active (or alive) is widening.** This indicates a challenging business environment for most of the private enterprises in Viet Nam. According to GSO, only 427,000 private enterprises were active in 2015. This represented only 49.5 % of the total number of enterprises which had been registered until 2015. Figure 2 also shows a widening gap between the number of the enterprises that are registered and the actual increase in number of active enterprises in a year. It is worrying that this gap has been widening in recent years. Between 2010–2016, the increase in the number of active enterprises varied between 22,000–40,000 enterprises per year. But 2017 witnessed the increase of 134,000 active enterprise in 1 year. This helps to bring the percentage of active enterprises out of registered ones to 54% in 2017.

11. **Foreign investment is becoming an important component of the private sector.** Besides the robust growth of the domestic private sector, FDI enterprises are flourishing in Viet Nam. The country has become increasingly accessible to foreign investments. After the US-Viet Nam Bilateral Trade Agreement and the milestone adhesion to WTO, Viet Nam signed a free trade agreement with the EU (EVFTA) in 2016. Viet Nam continues to diversify its economic partners, such as through increased ASEAN integration, the proposed Regional Comprehensive Economic Partnership, covering 3.4 billion people and most recently through the Comprehensive and Progress Agreement for Trans-Pacific Partnership (CPTTP). FDI inflows in to Viet Nam have been steady and strong. Total FDI inflow reached US\$24.4 in 2016 and US\$35 billion in 2017. Between 1998–2016, US\$336.7 billion have been registered to be invested into Viet Nam by foreign investors from 112 countries and territories. Of the amount, US\$154.5 billion or 45.9% of the total have been disbursed.

Figure 3: Number of active foreign invested enterprises

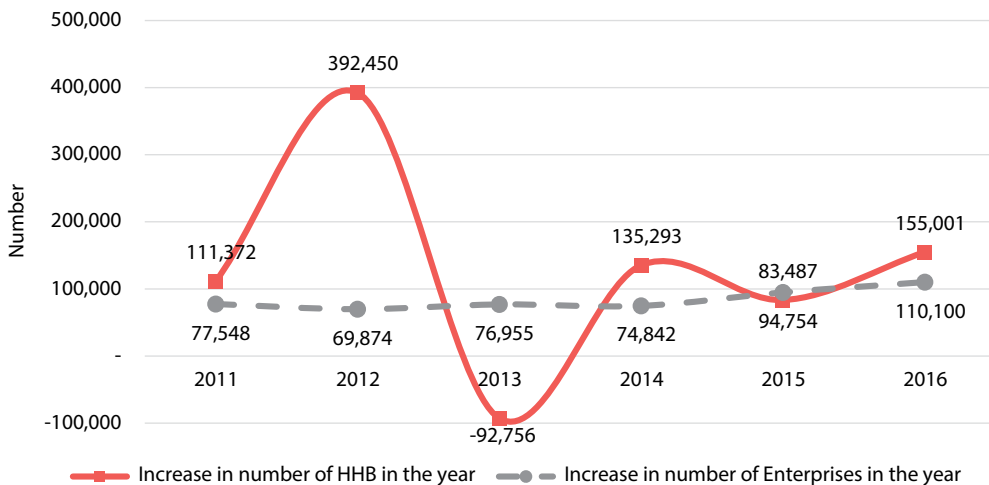


Source: General Statistics Office (2017), Ministry of Planning and Investment (2018)

12. The amount of capital invested by private foreign investment increased exponentially between 2010–2015 though the number of FIEs increased by only 4,700 in the same period. FIEs are much larger in size as compared with domestic enterprises. FDI inflow into Viet Nam, in terms of registered capital, currently stands at more than US\$20 billion a year—a significant increase from the early 2000s when FDI totaled just a few billions. Services and manufacturing have been the most prominent economic sectors for FDI into Viet Nam over the past 3 decades. A majority of the more recent investors have taken advantage of the country’s relatively inexpensive land, labor resources, and generous incentives offered by the government to undertake processing production using imported materials.

13. Household business (HHB) sector is an important pillar of the private sector with its share of GDP being three times larger than that the formally registered enterprises. HHBs have a longer history of development as compared with formally registered enterprises and FIEs.⁷ Household businesses constitute a peculiar and unique form of business in Viet Nam and were accepted as a form of private initiative during the planned economy times. Before 1986, household businesses existed in the form of microscale goods production units that includes artisans, farmers, and small service providers that did business after being licensed by the government. This is the only form of private sector business, though tiny, that were allowed to exist during that time besides the dominating role of the state sector in the economy. According to GSO, in 1975, the microscale private sector producers of this sort only account for 8.3% of the GDP (Statistics Year Book 1983). In 1986, microscale nonfarm household businesses employed 23.2% of the total workforce and created 15.3% of total industrial outputs (Statistics Year Book 1988). By the end of 1989, the whole country counted 333,300 registered HHBs besides 3,020 SOEs, 21,901 cooperatives, and 1,284 private businesses. Before 1990 when the two laws on private companies and on sole proprietorships were introduced, HHBs were officially recognized by the government by the Decision No.27/HDBT, which recognized the status of individual business units and private business units in the form of HHBs and small-scale industrial HHBs.

7 HHBs were allowed before private sector enterprises were officially allowed in 1990 (marked by the promulgation of the Sole Proprietorship Law and the Company Law). HHBs could still be registered with local authority at commune level and pay license tax (*thuế môn bài*). In 1988, HHBs were further recognized and could take the form of individual HHB (*hộ cá thể*) and small industry HHB (*hộ tiểu công nghiệp*) according to the Decree No.27-HDBT dated 9 March 1988 by the Minister Council (now the government).

Figure 4: Annual increase in number of nonfarm household businesses

Source: General Statistics Office (2016)

14. **Private sector existed during the command economy.** The private sector did exist even during the planned economy and despite the unfavorable policies and regulatory environment under which they operated. Entrepreneurship runs deep among Vietnamese people. Private sector business entities were smouldering under the surface despite the official unrecognition of the sector by the government. This strong entrepreneurship and private sector economic activities were preconditions for the boom of private sector enterprises when the law officially allowed it in 1990 and then liberalized it in a decade later in 1999.

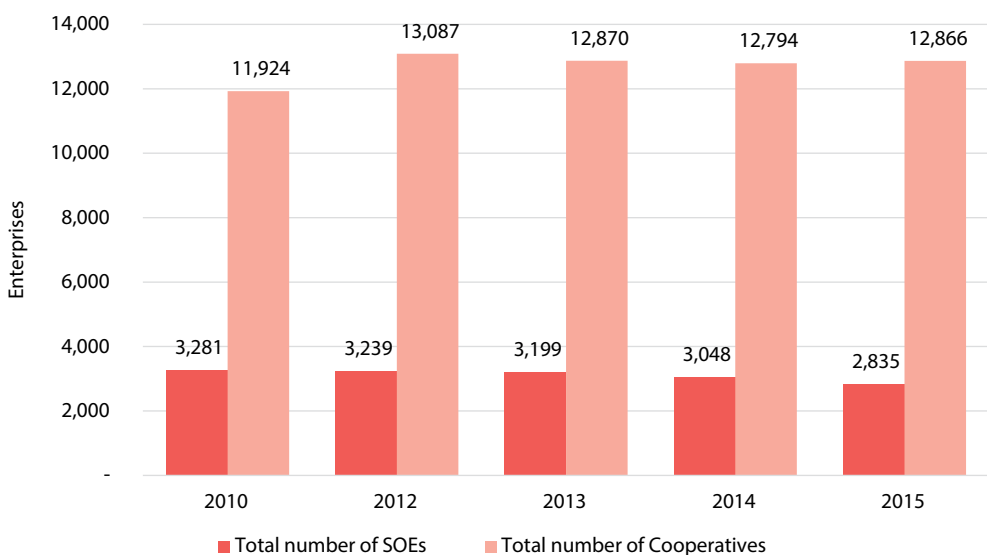
15. **After the Doi Moi was launched, HHBs flourished and were chosen to be the favorable business form by millions of entrepreneurs to start their business.** To date, HHBs are still the preferable form for people to start a business. HHBs now constitute an important pillar of Vietnamese economy. HHB sector plays an extremely important role in ensuring the resilience of the economy especially at times of external shocks. Approximately 8 million workers are employed by HHBs. The sector creates about 30.4% of GDP though contributing merely 1.56% to government budget annually (General Department of Tax, 2018). HHBs provide services or products in areas and industries underserved by enterprises. HHBs are defined in regulatory documents (Law 68/2014/QH13 “Law on Enterprises” and its Decree 78/2015/ND-CP “Enterprise Registration”). HHBs follow a regulatory regime that in real terms is much lighter than that applicable to enterprises in terms of registration, bookkeeping, tax report and payment, and social security obligations. However, they are subject to limitations in the scope of doing

business. They are also prone to more interaction with authorities, which often induce harassment and informal payments.

16. Though many HHBs are registered with district government authorities, HHBs are considered part of the informal economy. HHBs have just recently caught the spotlight of public policies and government support programs. But HHBs are convenient and easy ways to start a business in Viet Nam. HHBs are preferred than some of the legal forms stipulated the Enterprise Law for a person to start a business. For example, in 2016 there were 110,000 enterprises being registered in the legal form as stipulated under the Enterprise Law. However, 155,000 people chose to start their business in the form of HHB in the same year. The vigorous vitality of HHBs and the choice of HHB as the preferred way to start a business should be a critical point for policy makers and regulators to consider in the upcoming reforms of business laws and regulations in Viet Nam. The Theme Chapter of this report discusses further the issues related to HHBs.

17. The expansion of the private sector is accompanied by the reduction in the number of SOEs and with the slow growth of cooperatives (the collective economy). In terms of SOE reform, government policy has centered on equitization of small to medium-sized SOEs, while concurrently consolidating other large SOEs as part of its industrial policy strategy. During the 1990s and the early 2000s, Viet Nam equitized thousands of SOEs. The number of SOE have been declining dramatically. The government's plan is to further equitize SOEs and reduce the number of SOE to 103 by 2020.

Figure 5: Number of active SOEs and cooperatives



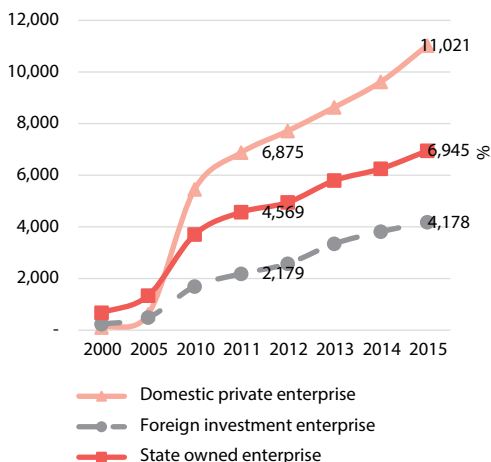
SOE = state-owned enterprise

Source: General Statistics Office (2017)

18. The importance of SOEs in the economy has steadily decreased but they remain dominant in many sectors. In 2000, SOEs accounted for nearly 68% of capital, 55% of fixed assets (such as land), 45% of bank credit, and 59% of the jobs in the enterprise sector. By 2010, private sector growth meant the share of SOEs in capital, fixed assets, bank credit, and employment in the enterprise sector had fallen to about 39%, 45%, 27%, and 19%, respectively. Notwithstanding shrinking state ownership, the state still controls all the critical areas (e.g., electricity, water supply, chemicals, etc.), but also has considerable presence in less important economic sectors and in various commercial activities like cement, textiles, etc. (ADB, 2016).

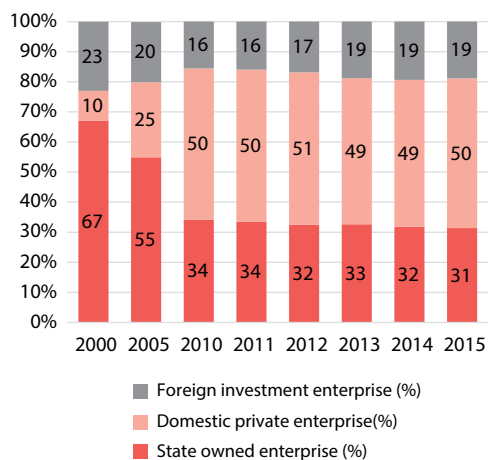
19. The rise in the number of private enterprises has resulted in a dramatic growth in capital stock of private sector enterprises. The contribution by domestic private business sector to total capital stock of the corporate sector increased from a meager 9.85% in 2000 to 49.77% in 2015. If the FDI sector is combined, the total share of capital stock contributed by the private business sector (domestic and foreign) are of 32.9% and 68.6%, respectively. Total capital stock of domestic private enterprises increased from D98.3 trillion in 2000 to 11,020.9 trillion in 2015. In other words, about US\$ 546 billion have been mobilized by Vietnamese entrepreneurs and put into the economy within 15 years, or US\$36.4 billion a year on average. This amount far exceeds the amount of FDI inflow and official development assistance disbursed in Viet Nam during this period. Private sector enterprises have been contributing tremendously to the overall efforts of unleashing the huge amount of funds and capital, including those in the form of gold and foreign currency, into effective use. While still growing in absolute number, the share of SOE in the total capital stock of the corporate sector has declined from 67.1% to 31.4% in 2015, mostly as a result of the impressive growth in the share of the private sector.

Figure 6: Capital stock of enterprises (D trillion)



Source: General Statistics Office (2017)

Figure 7: Capital stock of enterprises by sectors (%)



Source: General Statistics Office (2017)

Private sector has contributed enormously to the formation of fixed assets and to long-term investment of the business sector and of the entire economy as a whole.

Fixed assets and long-term investment are important indicators of how much of the new value-added in the economy is invested rather than consumed. These also measure the value of acquisitions of new or existing fixed assets and of long-term investment by the business sector. Fixed asset and long-term investment of domestic private sector enterprises skyrocketed by 114 times between 2000 and 2015—a growth rates much faster than that of the SOE and FDI. The share of domestic private sector in total fixed asset and long-term investment of the corporate sector increase dramatically from 8.24% in 2000 to 36.9% in 2015.

20. Strong growth in capital stock and accelerated rate of fixed asset formation and sharp rise in long-term investment by the private sector has helped to fuel the economic growth. Strong and sustainable growth of in these indicators by the domestic private sector will be important for Viet Nam to become a strong economy—one that relies strongly on internal and domestic resources and not overdependent on FDI.

Figure 8: Fixed asset by business sector (D trillion)

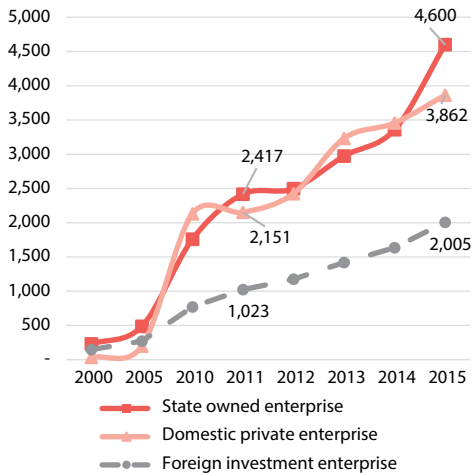
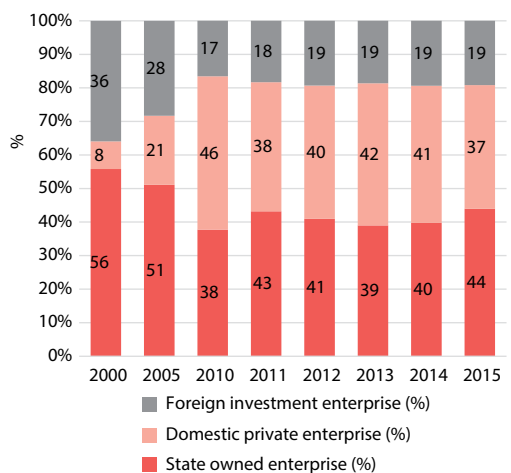


Figure 9: Fixed asset by business sector (%)



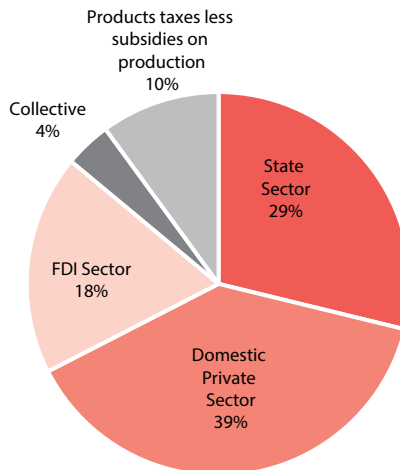
Source: General Statistics Office (2017)

2. Contribution to economic growth and social progresses

21. The private sector has been a key contributor to economic growth in recent years. Between 1986–1990, the economy was growing at 4.5%. The growth rate reached

8.2% between 1991–1995 and 7.6% between 1997–1999. The growth rate was slower in recent years but was maintained at 7.34% between 2001–2005, and 6.32% between 2006–2010. The growth rate has been on the upswing in recent years, hovering around 7%. The size of the economy has tripled within 3 decades, enabling the country to emerge from being one of the poorest Asian countries to become a lower middle-income economy by 2010. Poverty rates declined rapidly from over 50% in the early 1990s to just 8.4% in 2016 (IMF 2004, ADB 2016). The domestic private sector accounted for 38.6% of GDP in 2016 (of the percentage, formally registered enterprises account for 8.2%, household business sector for 30.43%). Foreign private sector (FDI) accounted for 18.95% of GDP. Obviously, the private sector has become the major driver of Viet Nam’s strong economic performance.

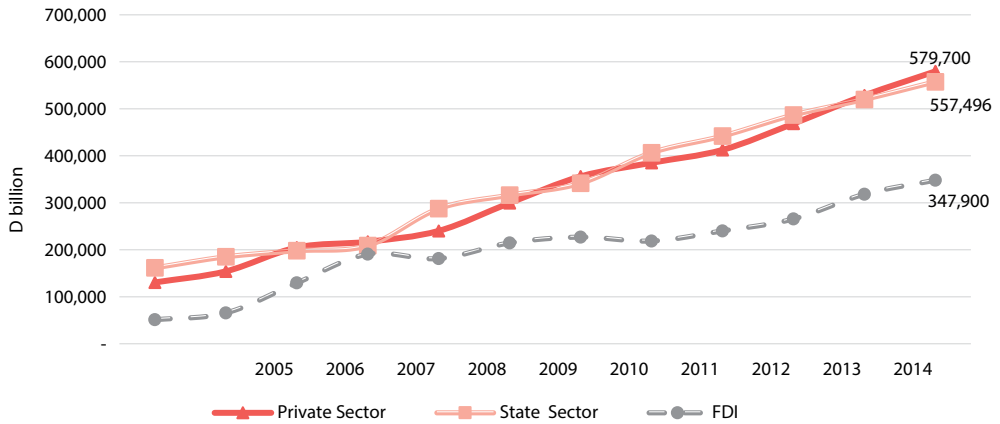
Figure 9: GDP structure in 2016



GDP = Gross domestic product

Source: General Statistics Office (2017)

22. Improving the performance of the private sector is important to gain higher productivity. In stark contrast with the central planning period when economy consisted of mostly SOEs and cooperatives, the formal private sector (both foreign and domestic-owned) accounted for 61.12% of the GDP in 2016. Improvement in the performance of the private sector coupled with structural transformation by moving resources and employment from sectors, which are less effective in using resources to others, especially the domestic and foreign private sector enterprises, can help to reverse the diminishing productivity trends of Viet Nam’s economy.

Figure 10: Total capital invested into the economy

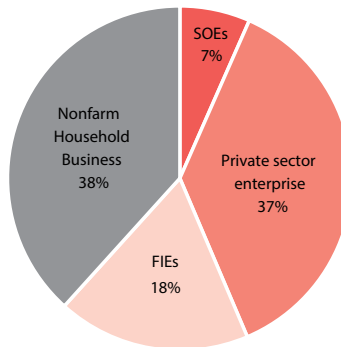
Source: General Statistics Office (2017)

23. The private sector contributed significantly to the total capital investment in the economy. Within a decade, total investment by the domestic private sector quadrupled from D130,398 billion in 2005 to D579,700 billion (\$25.8 billion) in 2016, accounting for 39% of total investment into the economy. If FDI is combined, the private sector contributed 62.4% of total investment capital in 2016, compared with 52.9% as in 2005. The expanded investment by the private sector was in line with the declining share of state investment from 47.1% in 2005 to 37.6% in 2016. The growth and expansion of private sector has contributed tremendously to the economic achievements in Viet Nam in the last decades.

24. The private sector is the main contributor to job creation, poverty reduction, improved living conditions, and inclusive and sustainable growth. Viet Nam has been successful in lifting out millions of people out of poverty, reducing poverty rate to 7%, maintaining a low unemployment rate of 2.28% in 2016 in 2017 (MOLISA and GSO, 2017). This is credited to millions of jobs that were created by the private sector. The domestic private sector enterprises created 5.98 million jobs in 2010 and the figure soared to 7.7 million in 2015. In a similar pattern, jobs created by FDI enterprises rose from 2.1 million in 2010 to 3.77 million in 2015. Employment in the household business sector also increased from 7.4 million to 7.89 million in 2015. In total, 19.47 million workers were working in the private business sector in 2015.

25. **If HHBs are not included, domestic private enterprises and FIEs created 3.35 million new jobs between 2010–2015, or 557,000 new jobs per year on average.** Of this figure, private domestic enterprises created the larger share of about 288,000 new jobs each year. The employment created by the private sector plays an important role in absorbing the workers that enter the new labor market each year. This is even more important given the fact that SOEs are employing less and less. The number of workers in SOEs declined sharply between 2010–2015. Undoubtedly, without the jobs created by these private sector enterprises in this period, 3.35 million people either could have been unemployed or could have worked in the less productive and lower-paid jobs in the farm sector.

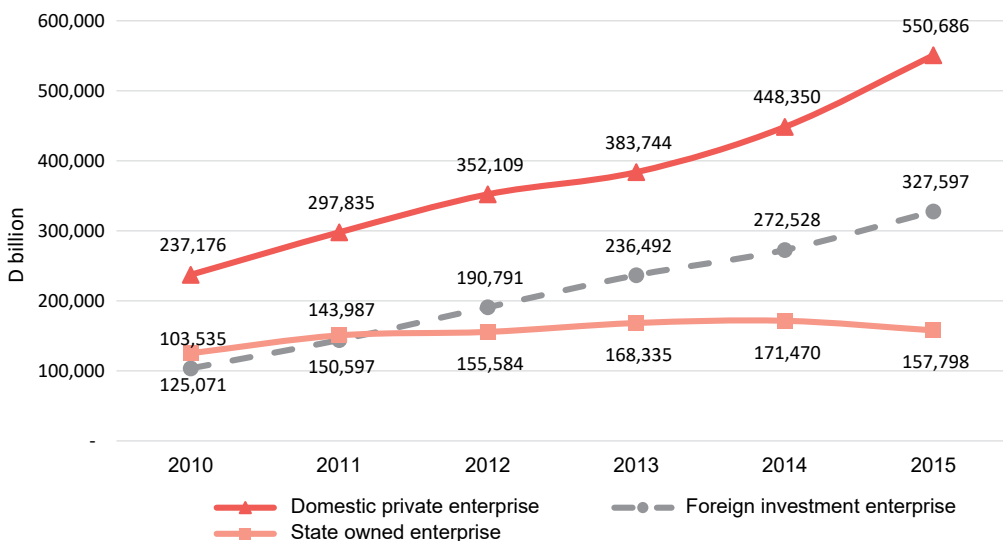
Figure 12: Employment by business sector 2015



FIE = foreign investment enterprise
SOE = state-owned enterprise.

Source: General Statistics Office (2017)

Figure 13: Total income of employee and workers in the corporate sector

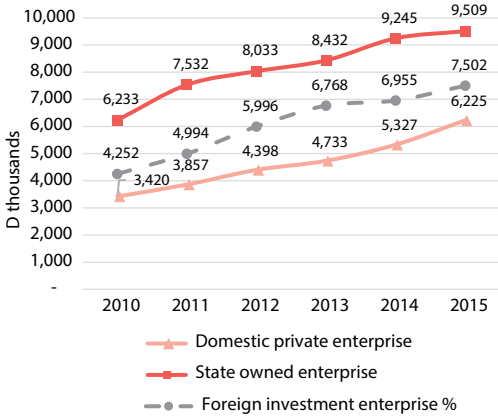


Source: General Statistics Office (2017)

26. Private sector enterprises have overtaken SOEs in terms of income generation for employees and workers and the gap has been widening. Domestic private enterprises have paid a total income of D550.7 trillion (\$24.5 billion) to its employees and workers in 2015. If the FDI sector is combined, total income paid to workers by the two sectors reached D878.3 trillion in 2015 (\$39.03 billion). The amount was equivalent to 19.1% of the country's GDP in 2015. This is very meaningful as the SOEs have become a much less important income generator for workers in the economy. In 2010, the share of worker income generated by SOEs was 26.85%. But this figure has quickly declined to only 15.23% and this declining trend has continued sharply in recent years. Contrary to this trend, the share of income paid to workers by private sector enterprises keep rising steadily over the years, solidifying the role of the private sector as the main generator of jobs and income in the decades to come. The increase in total disposable income of private sector enterprises workers on its turn has helped to fuel the economy, especially by way of increasing domestic consumption.

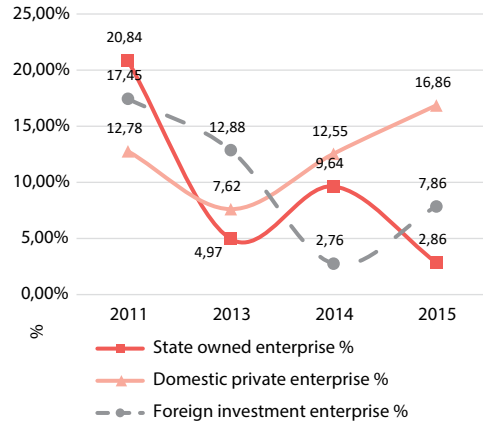
27. Employment generated by the private sector enterprises have helped millions of workers to shift away from lower-paid jobs in the farm sector to jobs in more productive ones and those that are higher paying. On average in 2015, a worker in domestic private enterprise was paid D 6.2 million (\$276) per month while the counterpart in an FIE was paid D 7.5 million (\$333.4). Interestingly, the growth rate in average monthly income in the domestic private sector has been higher than those in the FDI and SOE sector in recent years, helping to narrow the average monthly income gaps between these sectors. More importantly, the average monthly income in private enterprises has been much higher than that of a farmer—a job that a private sector enterprise worker would have to worked on if such a job had not been created by the private sector enterprises. In 2015, a worker in domestic private enterprises earned 2.6 times higher than an average farmer. This ratio is 3.1 in the case of those working in FIEs. Between 2010–2015, private sector enterprises have helped to triple the total income of 3.35 million workers who would otherwise have had to toil on the fields with much lower income or had been underemployed or unemployed.

Figure 14: Average worker monthly income by business sector



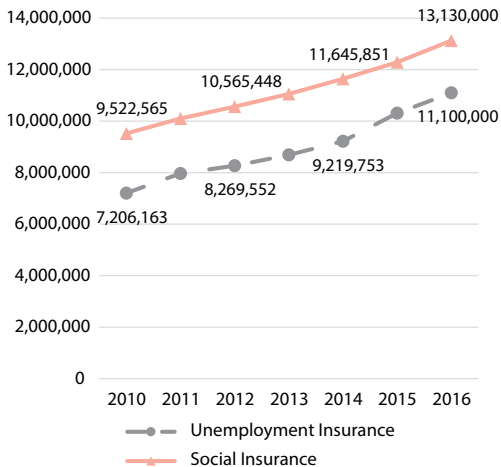
Source: General Statistics Office (2017)

Figure 15: Average worker monthly income growth by business sector



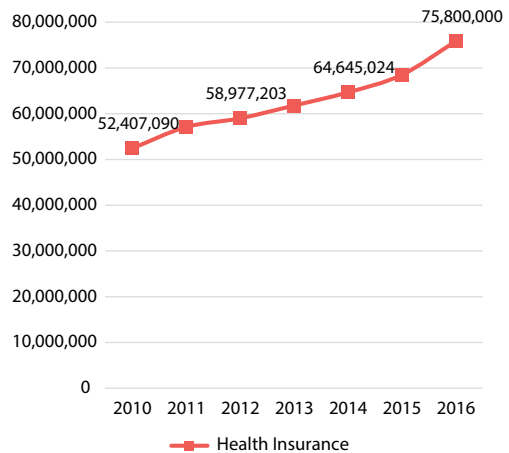
Source: General Statistics Office (2017)

Figure 16: Social insurance and unemployment insurance coverage (number of people)



Source: Viet Nam Social Insurance (2017)

Figure 17: Healthcare insurance coverage (number of people)



Source: Viet Nam Social Insurance (2017)

28. Private sector businesses contribute significantly to the expansion of the social security coverage. With the total number of workers in SOEs declining and the number of workers in the public sector remaining stable between 2010–2015, private sector enterprises have been playing the key role in increasing the number of people being covered by social insurance from 9.2 million in 2010 to 13.13 million in 2016. On average,

each year social insurance coverage is expanded to cover 650,000 new workers, and the majority of these are working in private sector enterprises (VSI, 2017). With the ongoing efforts in SOE reform and the reforming of the public sector, it is not exaggerating to say that private sector is wholly responsible for the official target of 50% of the labor force being covered by social insurance 2020 (as compared with a modest 24% as in 2017).

Figure 18: State Budget contribution by business sectors (D billion)

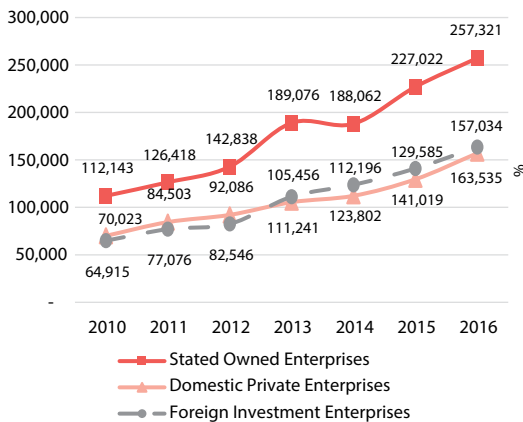
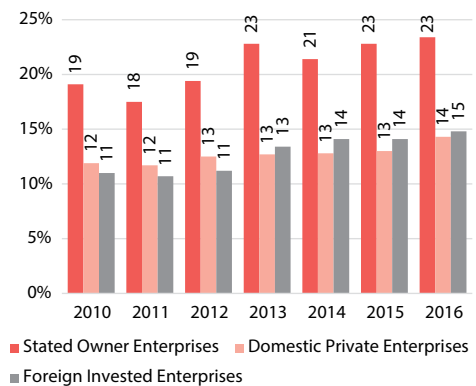


Figure 19: State Budget contribution by business sectors (%)



Source: General Statistics Office (2017), Ministry of Finance (2017).

* Percentage as of total revenue of State Budget

29. Private sector enterprises are important contributors to the state budget. While Viet Nam is becoming more active in international trade liberalization and adhering to an increasing number of international and free trade agreements, both on multilateral and bilateral basis, budget revenue from custom duties is bound to decline in the years to come. In addition, as the economic restructuring is being stepped up, budget revenue from oil revenue and natural resources royalty will decrease. Revenue from grants and official development assistance will continue to drop as Viet Nam is being recognized as a lower middle-income country. The corporate sector, especially private sector enterprises, will become the main source of revenue for the state budget in the coming decades. Increase in contribution to state budget by private sector enterprises will also help to contribute to the soundness and sustainability of public finance in Viet Nam.

30. Enterprises contribute about \$39 billion to the state budget in 2016, accounting for 79.8% of the total revenue. The share of contribution by domestic private enterprises in the total internal revenue of the state budget has increased from 11.9% in 2010 to 14.3% in 2016. In absolute terms, the contribution increased from about \$3 billion to \$7 billion during this period. Combined with the foreign enterprise sector, the share of all

private enterprises in total government budget revenue jumped from 22.9% in 2010 to 29.1% in 2016. Of the top 1,000 enterprises with highest payment of corporate income tax to the state budget in 2017 as announced by the Ministry of Finance, domestic private sector enterprises account for 45.8% in terms of number of enterprises and 34.1% in terms of the amount paid, foreign private sector enterprises (FDI enterprises) account for 40.4% in terms of number of enterprises and 36.7% in terms of the amount paid. SOEs account for 11.7% in terms of number of enterprises and 27.7% in terms of the amount paid (MOF, 2018)⁸. This trend of tax revenue from the private sector enterprises keeps increasing upward, helping to compensate for the drop in oil revenue and for the decline in customs duties. Economic restructuring needs the helping hand of a growing and expanding private sector enterprise, including domestic and foreign ones.

31. The HHB sector, which accounts for 30.4% of the country's GDP only contributes to 1.56% of the state budget revenue (excluding revenue from oil). The majority of HHBs are micro and small, and are mostly run out of necessity and should be subject to much less stringent regulations for them to survive. However, hundreds of thousands of HHB should be subject to more stringent tax regulations and tax payment obligations. According to the General Department of Tax, there are 102,095 HHBs with regular sale and revenue volume of more than D1 billion/ year in 2017. Many HHBs even have sales of few hundreds of billion Vietnamese dong per year (GDT, 2018). There are numerous cases of HHBs that operate in business lines that are not relevant to HHB business form like trading in chemicals, health care equipment, construction equipment, natural resources, etc. HHBs operating in these business sectors are not subject to the standards that are required for these conditional lines and benefit from lumpsum tax payment method. This has created an *unfair practice from the informal sector* from the perspective of the formally registered enterprises. These HHBs, which are in the upper tier of the HHB pyramid,⁹ have been making all possible efforts to evade from being formalized and to become more transparent. This is mostly for the motivation of capitalizing on the easy and loose tax regime, the social security regulations which are currently applicable to HHBs. In addition to the unfair practice for formally registered businesses, this results in a loss for the state budget. The elusion from transparency, from compliance with tax and social security obligations by these large HHBs is obviously not a good business culture. It will prevent these large-scale HHBs to grow sustainably, to become better governed, to be more productive, and can become more competitive nationally and internationally with their services and products.

⁸ Total amount of corporate income tax paid by the 1,000 enterprises in the list reached D 110,027 billion (approximately \$47.8 billion, accounting for 62.59% of the total corporate income tax revenue of the state budget in 2017 [MOF, 2018]).

⁹ Please refer to the Theme Chapter for the Household Business Pyramid in Viet Nam.

3. Gender and women advancement

32. Private sector development has contributed significantly to women economic empowerment, especially through job opportunity and income sources. Jobs play an important role for women to improve women's status in the family and in the community. It also helps women to strengthen their autonomy in decision making and in having their voice heard. In 2015, 46% of the employment in the whole formal enterprise sector were women. The share of female workers in domestic private and FDI enterprises were at 37.7% and 67.9% respectively, as compared with 32.6% in SOEs. Overall, the female workforce participation is 79% (GSO, 2017). Private sector enterprises are playing an increasingly more important role in job creation for women.

Figure 20: Number of female employees by business sector

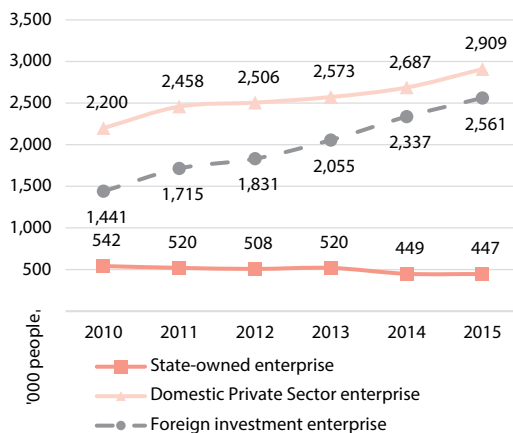
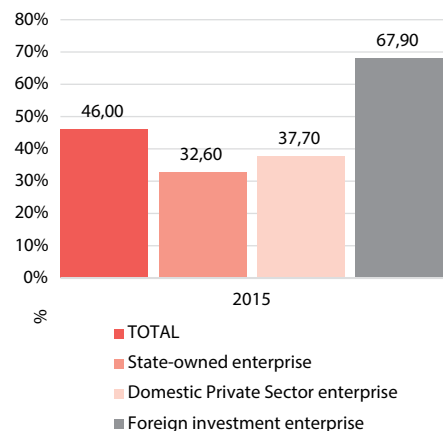


Figure 21: Female employee percentage by business sector (%)



Source: General Statistics Office (2017)

33. According to ADB and Hanoi Women's Association of SMEs (HAWASME), 25% of enterprises in Viet Nam are owned or led by women as compared with the average of 8% in South Asia.¹⁰ About 5% of CEO of companies listed on the national stock exchanges are women. These numbers are encouraging. Women have taken a stronger role in leadership and management in companies.¹¹ Viet Nam has been witnessing the rise of a prominent and influential business women CEO, managers and business owners, for example the presidents or CEOs of VietjetAir, Vinamilk, TH True Milk, Kova Paint,

¹⁰ Women-owned and Medium Sized Enterprises in Viet Nam: Situation Analysis and Policy Recommendations, ADB/HAWASME (2016).

¹¹ For example, women leaders in FPTSoft account for 31% of total leadership in the company (FPTSoft, 2018).

Nutifood, HD Banks, VN Direct, HD Bank, PNJ, REE etc. These business women are no less influential and inspiring than their male counterparts in the country.

34. The rising trend of women leadership in the private sector has led to an emergence of an increasing number of women business association, e.g. Viet Nam Women Association for Women Entrepreneurs, Viet Nam Women Entrepreneur Council (VWEC), Hanoi Women Business Association (HAWASME), Ho Chi Minh City Women Business Association (HAWEE), Viet Nam Business Coalition for Women's Economic Empowerment etc. to advocate for their role. Most recently, the definition of women-owned or women-led enterprises have been introduced in the SME Support Law and women-owned enterprise have become a development target. This has demonstrated the success in advocacy work of the women entrepreneurs and women business associations and the of the government's uncontestable support of women businesses and women entrepreneurs.



02

CHAPTER II

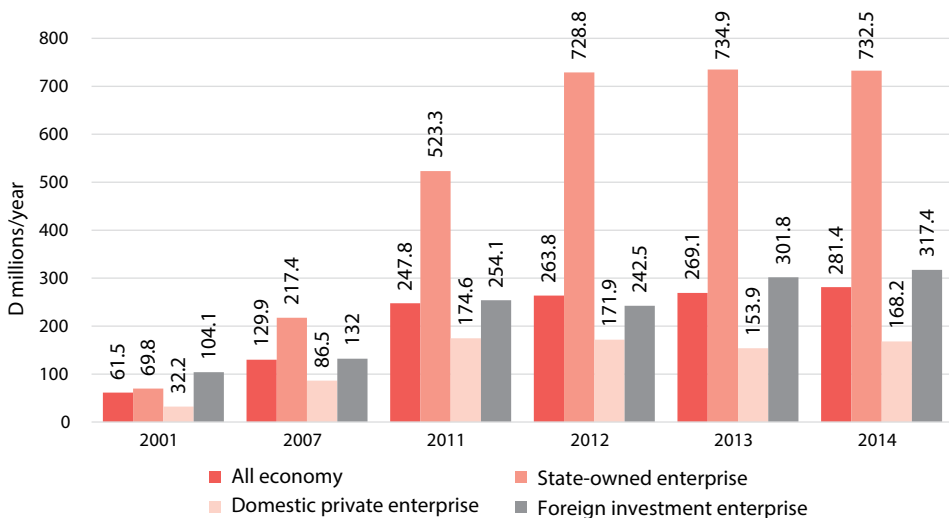
CONSTRAINTS AND CHALLENGES FACING THE PRIVATE SECTOR

I. QUALITY OF GROWTH AND ISSUES INHERENT TO THE PRIVATE SECTOR

1. Productivity and efficiency in allocation and use of resources

35. **Increased productivity will be required to sustain economic growth to meet Viet Nam's medium-term targets.**¹² The *Viet Nam Firm-level Labor Productivity* report published by GSO in 2016 shows that the Viet Nam's firm-level labor productivity has stagnated or even decreased slightly in recent years. The firm-level labor productivity of the domestic private enterprise has fallen significantly between 2011–2014 (Figure 22). Statistics also show that the total factor productivity growth in Viet Nam has dropped since 2001. Recent growth stems largely from structural transformation as workers move from the less productive agricultural sector to the more productive manufacturing and services sectors. The growth returns to this structural transformation are both diminishing and finite, although with agriculture still accounting for almost half the labor force. The policy document entitled *Viet Nam 2035 Report: Towards Prosperity, Creativity, Equity and Democracy* (the Viet Nam 2035 Report) sets out the vision for strong and stable GDP growth above 6% per annum. To maintain strong growth as set out in Viet Nam 2035, the diminishing productivity trends must be reversed (World Bank and MPI, 2016).

Figure 22: Viet Nam firm-level labor productivity between 2001–2014
(D million/year)



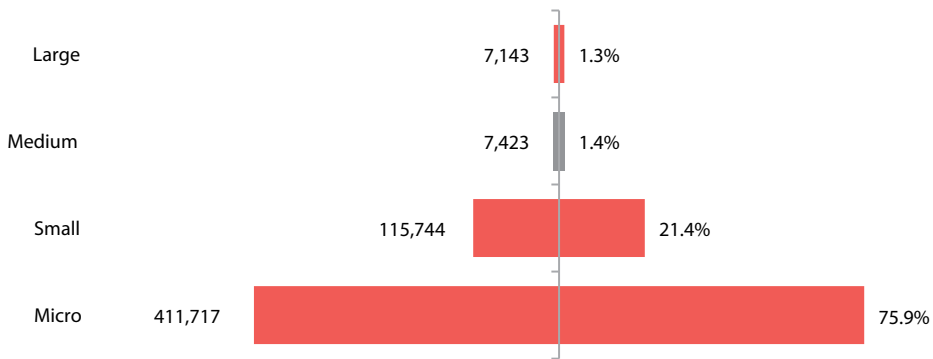
Source: Viet Nam Firm-level Labor Productivity, General Statistics Office (2016)

12 As stated Viet Nam Social Economic Development Strategy until 2020 and in the Viet Nam 2035 Report.

36. **The private sector, an important engine of growth as resolved by the Resolution V, needs to play an important role in propelling productivity gains in the coming decades.** To achieve this, important issues inherent to the private sector need to be addressed. However, the domestic private enterprises "...have been marked by worsening productivity since early 2000s" [Viet Nam 2035 Report, p.128].

37. **Low productivity growth in the economy is associated with the large number of micro and small enterprises.** Small size and informality deter the ability of the domestic business sector to take advantage of the economies of scale, specialization, improving business sophistication, increasing investment into R&D, technology and innovation—all factors that are critical to productivity gains. The domestic enterprise sector in Viet Nam is dominated by micro and small enterprises. If nearly 4 million HHBs are included, the picture is even more worrying as all of the HHBs are micro and small in size. Microenterprises and HHBs are important for Viet Nam economy as they generate one-third of the country's GDP, produce millions of much-needed jobs, and provide livelihood for millions of people across the country. However, if the business environment is not enabling enough to support these microenterprises to grow further in size, to improve its business sophistication, and to become formalized, Viet Nam will not be able to expand the potential productivity gains.

Figure 23: The “missing middle” – Viet Nam’s enterprises structure by size in 2017*



Source: General Statistics Office (2018).

* In number of enterprises and by percentage of the total enterprises

38. **The “missing middle”, i.e., the lack and absence of medium-sized enterprises, is another concern.** Of the domestic private sector enterprises and in 2017, 97.3% of them were micro and small. Large enterprises accounted for only 1.3 % of the total. Notably, medium-sized enterprises accounted for only 1.4%, resulting in an “unusual” structure of enterprise when compared with those in other economies like Japan; Taipei, China; and the Republic of Korea. The “missing middle” is also a proxy indicating that

there have been few small enterprises that graduated into medium-sized ones due to the weak performance of small enterprises and to the external business environment. Small enterprises have neither the capacity nor the motivation and ambition to grow in size. The “missing middle” also indicates that there will not be many “medium-sized enterprises” to become large in the medium term. This “missing middle” issue needs to be addressed given the general rule of thumb that larger firms can capitalize on economies of scale to operate more efficiently and productively and thus yielding higher productivity gain for the economy. Figure 23 shows that there were only 7,422 medium-sized enterprises in the entire country in 2017, which could potentially graduate into large size in the coming years, assuming that these companies perform well. This number is modest given that more than 110,000 enterprises are registered annually, and that more than 550,000 enterprises are currently in operation.

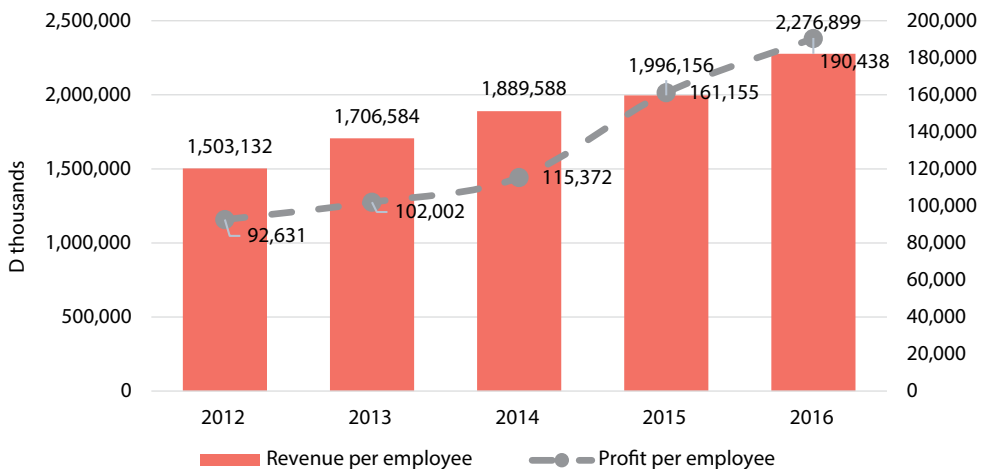
39. **Viet Nam’s “missing middle” is caused by many reasons.** While in recent years, more than 100,000 enterprises are registered annually (about 120,000 in 2017), about 60,000 also exited from the market. The majority of enterprises registered are small in size (at D8 billion on average, according to MPI). Most of the registered enterprises are in low-value added and have low productivity production technology. The enterprises mostly operate locally, supplying to the local market, with limited linkage with the global supply chain. They have limited access to modern technology and business know-how and opt to build their advantages on low costs, connections, rather than on knowledge, technology, innovation, and competitiveness. Nearly half of these enterprises are operating at loss, thus hampering the capacity to accumulate capital. Consequently, very few of micro and small enterprises ever graduate to medium size, resulting in the missing middle in the overall picture of domestic private firms in the country. “...The lack of medium enterprises has proven challenging in the efforts of private enterprises to bridge the missing middle and grow into larger corporations or create international brands...” (Light Manufacturing in Viet Nam, Hinh T. Dinh, World Bank, 2013).

40. The **pace of capital accumulation by internal sources is slow in domestic private enterprises.** The slow pace of capital accumulation also hinders the growth in size of private enterprises, constraining the emergence of middle-sized companies, aggravating further the phenomenon of the “missing middle.” Many reasons cause the slow pace of capital accumulation. Low profitability and financial losses, lack of policies to support capital accumulation, inappropriate tax regulations, lack of a long-term business vision, and high cost of the business environment are the major constraints (Le Duy Binh, 2017). “The lack of capital accumulation has clearly hindered the capability [of Vietnamese private sector companies] to contribute to the move from factor-driven to efficiency-driven, or from labor-intensive to capital-driven economic models. Lack of adequate capital has also prevented private companies from investing in and upgrading their technology” (CIEM and NUS, 2010). This, on its turn will affect badly the firm level

productivity and the sophistication of companies – an important element of national competitiveness.¹³

41. Evidence show that larger and better governed private enterprises in Viet Nam are experiencing an upward productivity trend and efficiency. This is in total contrast to the declining trend in productivity gains of the private domestic business sector observed in recent years. Economies of scale in general allow larger firms to operate more productively. This general rule is also confirmed in the context of Viet Nam. In addition to economy of scale, large companies also excel because of better corporate governance (thus better access to finance and human resources), higher level technology, more research and development, and more innovation—factors that are prerequisites for a company to be productive. These factors are generally only possible when a company reaches a certain size. Consolidated data from 100 top private companies that are listed on the stock market in Viet Nam show that *revenue per labor unit* and *profit per labor unit* of the top 100 private listed enterprises grew steadily between 2012–2016. Revenue per labor unit of these top 100 enterprises rose from 1.5 billion in 2012 to 2.27 billion in 2016 and profit per labor unit also increased two-fold from 92.6 million in 2012 to 190.4 million in 2016. This steady growth trend in productivity of large enterprises is in stark contrast to the declining trend of the firm-level labor productivity of the whole domestic private enterprise sector, which micro and small enterprises dominate.

Figure 24: Productivity of top 100 private enterprises listed on Viet Nam stock markets

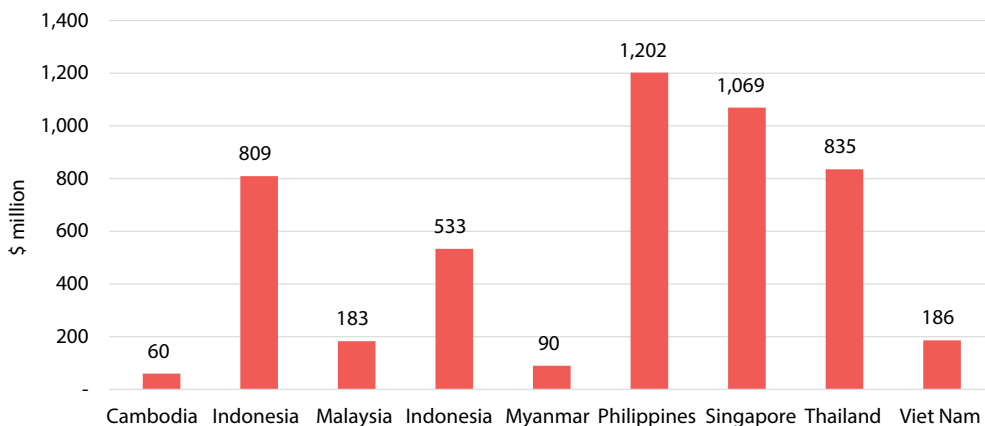


Source: Productivity of Top 100 Performing Private Sector Companies, Economica Viet Nam (2017)

13 Viet Nam Competitiveness Report, CIEM and NUS (2011)

42. Viet Nam should emphasize having large and well-governed companies rather than having many small enterprises. Not only will large firms have a better chance of gaining higher productivity, they can also become lead firms that drive the growth of a whole sector, a whole value chain, or a whole business cluster. Large firms will be the nucleus that links many smaller enterprises and become the driving force for the growth of a sector or a cluster. The number of large-sized enterprises in Viet Nam is low with 7,143 enterprises classified as of large as of the end of 2017. Though classified as large, the average size of large companies in Viet Nam is smaller than that of its peers in the region. For example, statistics of publicly listed companies (PLCs), the most relevant representative for large-sized private sector companies in Viet Nam, show that the average capitalization of PLC in the Vietnamese stock market is \$186 million per company as of end of April 2018. The average capitalization per PLC in Viet Nam is therefore much lower than that in the Philippines (\$1.2 billion per company), Singapore (\$1.07 billion per company), Thailand (\$835 million per company), Indonesia (\$809 million per company), and in Malaysia (\$553 million per company) as of end of April 2018.¹⁴ The government therefore should encourage micro and small enterprises to grow into medium-sized enterprises, and medium-sized enterprises to large enterprises, instead of emphasizing the creation of many small enterprises that may go out business after a few years. The priority of private sector enterprise development policy should be focused on quality rather than only on the number of enterprises being created every year. Quality of growth does matter.

Figure 25: Average capitalization per public listed companies in the stock markets of ASEAN countries as of end of April 2018 (\$ million)



Source: “Corporate Governance Frameworks in Cambodia, Lao PDR, Myanmar and Viet Nam”, (OECD, 2018) and “Overview of Corporate Governance in ASEAN”, (Economica Viet Nam, 2018).

¹⁴ *Corporate Governance Frameworks in Cambodia, Lao PDR, Myanmar and Viet Nam*, OECD (2018); and *Overview of Corporate Governance in ASEAN*, Economica Viet Nam (2018)

43. In addition to helping to boost productivity gain, large enterprises play the role of “lead firms,” which lead or drive the growth of a sector or a business cluster.

Driven by market rules, and motivated by efficient use of resources (and by corporate social responsibility and social commitments), large firms do not work in isolation. Rather, large firms often choose to link with other businesses, either by supply chain approach (with enterprise in the same supply chain) or by cluster approach (with related enterprises and business geographically located in the same region). Large enterprises can therefore lead or drive the growth of a sector or a region. Examples in Viet Nam include Vingroup, THACO, TH True Milk, Hoa Phat, etc. Thousands of smaller businesses and household businesses in the same sectors or in the same clusters have benefited from the business linkage with such lead firms. In addition to benefits in economic terms, such linkages will boost the productivity of both the lead firms and the small businesses that work together in the same supply chain or cluster. It is also beneficial for raising the productivity of the whole sector or of the whole geographic region where the enterprises, large and small, are clustered.

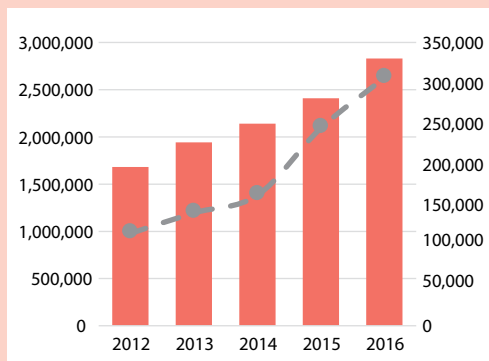
Large Domestic Enterprises Keep Improving their Productivity – A Snapshot of 100 Private Large Enterprises

A composition of 100 large domestic private companies¹⁵ that are listed in Ho Chi Minh Stock Exchange are chosen for analyzing the productivity of large private companies in recent years. The companies are selected by the following criteria: (i) domestic private ownership, (ii) size of capitalization, and (iii) volume of sale in the sector. In terms of sector, the sample includes 50 firms in manufacturing and construction, 30 in trade and service, 20 in agriculture and fishery. Examples of the firms included in the list include: Masan, Vinamilk, Kinh Do, Cottecons, Hoa Binh, and Vicostone. The purpose of this quick analysis is to verify the productivity of large domestic private sector enterprise in recent years.

Two indicators, including revenue per labor unit and net income per labor unit, are used to observe how these large enterprises have performed in the last few years. The composite indicators of all 100 enterprises as seen in the figures show that large enterprises did improve their productivity in the last 5 years, which is in reverse direction with the declining trend of the entire enterprise sector as observed in the *Viet Nam 2035: Toward Prosperity, Creativity, Equity, and Democracy (MPI and WB, 2017)*.

Manufacturing and Construction

Unit: D thousands



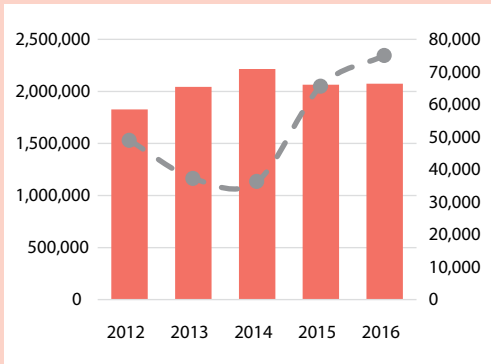
¹⁵ The full list of the 100 enterprises and detailed data used for analysis can be found at www.economica.vn

Further analysis show that the improved productivity trend takes place in large enterprises in all sectors, including manufacturing and construction, trade, service, and agriculture and fishery. Large enterprises in these sectors saw their revenue per labor unit increase steadily between 2012–2016. Meanwhile during this period, the net income per labor unit increased in both the manufacturing and construction and in the trade and service sectors.

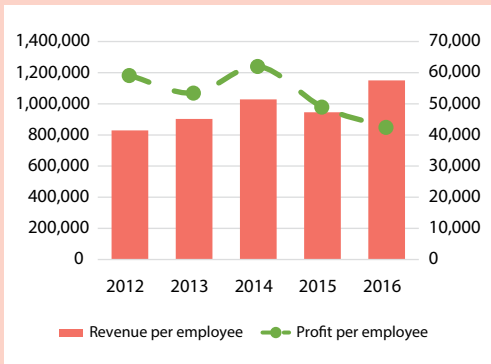
The upward improvement trend of large private enterprises confirms the generally expected assumption that large companies can capitalize on economies of scale. Large capital and resources also allow these large companies to have a higher level of business sophistication, making better use of technology, spending more on management, research and development, and innovation. They also have stronger link with international market and global supply chain. Most of these companies have been able to develop their own brand rather than working on subcontracts or providing goods and services only to local market as the case often seen in most of the micro and small enterprises.

In addition, larger domestic companies have better corporate governance and are subject to more transparency requirements. This enables them to access better to financial resources and human resources. This, in its turn, contributes the improvement in performance and productivity of the enterprises.

Trade and Service



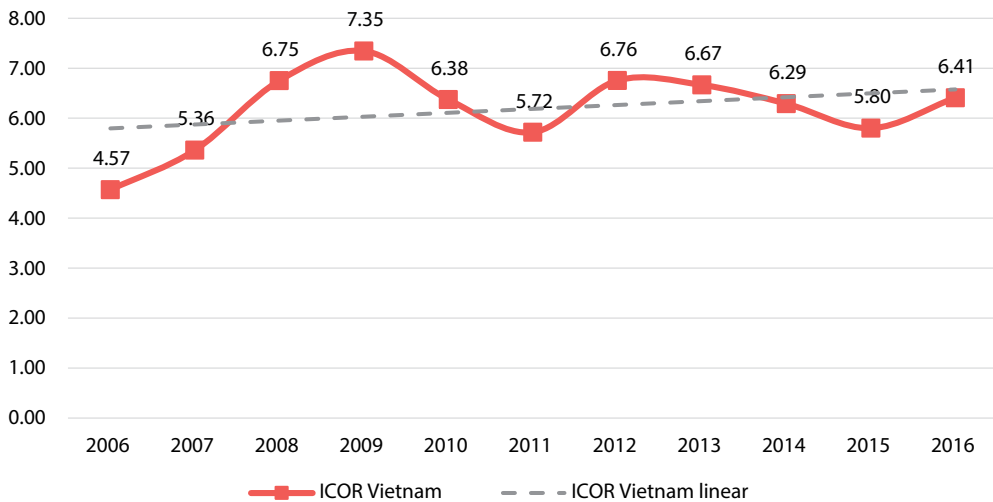
Agriculture and Fishery



44. Accumulation of capital is an important precondition for growth but what matters more is the efficient use of the capital that have been stocked and accumulated. In recent years, the growth of the Viet Nam economy has relied more on capital inputs rather than on the efficient use of capital. Total factor productivity

accounted for 44% of Viet Nam's GDP growth in the 1990s, but the share then declined to 26% in 2000–2008, and then picked up slightly to 31.1% in 2010–2016. During the same period, the contribution of capital increased from 35% to 54.1% (VNPI, 2016). This concern is also demonstrated by the rising ICOR of Viet Nam. According to GSO, the ICOR of Viet Nam climbed from 4.01 in 2005 to 6.4 in 2016, demonstrating that the economy has been less efficient in the use of capital and investment to produce output and growth.

Figure 26: Viet Nam ICOR 2006 - 2016



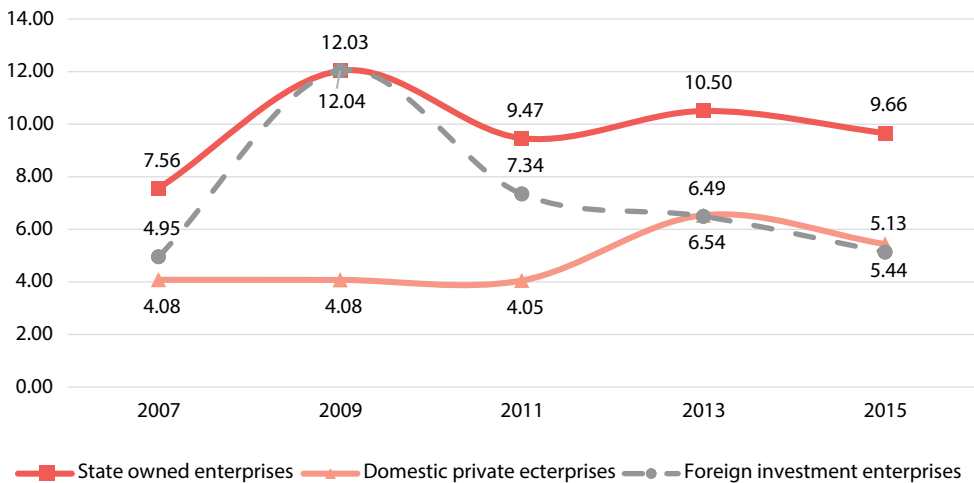
Source: General Statistics Office

45. ICOR statistics show that private sector enterprises have been far more efficient than SOEs in using capital and investment. In general, private sector enterprises have been nearly twice efficient than SOEs from ICOR perspective. In 2015, the ICOR of private sector enterprises was 5.13 while that of SOEs was 9.66.

46. Though private sector performs better in terms of ICOR, much of the capital and resources needed have not been reallocated to this sector. This has adversely affected the productivity gains of the whole economy. Figures and data from the previous chapters show that resources have not been allocated to its best use and there is still a lot to do for the market to perform fully according to its principles. As indicated in the previous sections, even though the capital stock of the private sector increased dramatically between 2010–2015 in absolute terms, the proportion of capital stock of enterprises by economic sector remained almost unchanged over this long period. After much of the fanfare about the divestiture from SOEs, the share of capital stock of SOE out

of total decreased only slightly from 34.1% to 31.3% between 2010–2015. Despite the impressive increase in absolute number of new enterprises, the share of capital stock of domestic private enterprise decreased from 50.3% to 49.8% in the period.

Figure 27: ICOR by enterprise sectors



Source: General Statistics Office

47. Within the private sector, productivity could be improved by reallocating resources from the informal or quasi-formal HHB sector to the formal one. The informal business sector and HHBs also accumulated a significant amount of capital during in the last few decades and are using a significant share of resources of the economy. Total capital stock of the HHBs by the end of 2015 reached D716.13 trillion, equivalent to 6.5% of the total capital stock of the domestic private enterprise in the year. The HHB sector are now employing more than 8 million employees, with the revenue per labor unit of merely D280 million per labor unit in 2015. This shows that within the private sector itself, a significant amount of labor resources are locked in the subsector where they are less efficiently used. Given that Viet Nam has almost spent its demographic dividend, the labor costs are rising and that the proportion of working-age population has been declining since 2013, labor is becoming increasingly scarce in Viet Nam. Had this scarce labor resource in the HHB sector been shifted to formal domestic private sector or to the FDI sector, the productivity of the whole private sector in Viet Nam could have been significantly improved. The Theme Chapter of this report discusses some measures to reform the HHB sector, thus improving the formality of the economy and the shift of resources from the informal or quasi-formal sectors to the formal ones.

48. The same holds true when looking from the perspective of GDP structure.

The state sector and HHB sector still account for 28.8% and 30.4% of GDP respectively. Meanwhile the contribution by domestic private sector enterprises and foreign invested enterprise just increased slightly between 2010–2016. As such, the country's GDP depends on the two sectors whose ICOR and productivity are much lower than those in the formal private sector. This is one of the factors that drags down the overall productivity of the economy. This calls for policies and imperative actions to accelerate the shift of resources, including capital and human, from the SOE and household business to the formal private sector where resources are generally of better use. According to GSO (2017), investment by private sector in the total investment of the economy has been picking up for the last 3 years, from 38.7% in 2015 to 40.6% in 2017. This trend should be sustained and accelerated in the coming decades.

2. Financial performance of private sector enterprises

49. Total revenue of the enterprises sector doubled between 2010 and 2015. The growth is mostly attributable to the revenue growth of the domestic private enterprises and by FIEs. During this period, domestic private sector enterprises doubled the revenue. The revenue generated by FDI sector also increased by almost threefold. However, the growth in revenue of SOE sector slowed down and even decreased in 2015 as compared with the preceding year. Private sector enterprises therefore have been playing an increasingly important role in producing goods and services for the economy, both for domestic consumption and for exports.

50. In absolute number, the profit of domestic private sector enterprises keeps rising between 2010 and 2015, from D 115.6 trillion to 150.5 trillion in 2015. Over the period, the growth is slower than that observed in the SOE and of FIE sectors. It should also be noted that the growth rate in total profit of domestic private enterprises have been stable while that of the SOEs and FIEs have been stalled or even declined in recent years.

51. The rise in absolute number of revenue and profit of domestic private enterprises cannot eclipse the fact that their profitability is much lower than that of SOEs and FIEs. While the return on revenue of SOEs and FIEs were constantly more than 5% between 2010–2015, the rate varied between 1.1%–2.7% in the case of private sector enterprises. Domestic private sector enterprises operate in much less favorable conditions than SOEs and face numerous disadvantages. SOEs tend to work in sectors at which the rent is higher, e.g. electricity, telecoms, mining, etc. and tend to have better and cheaper access to resources like land, credit, and business opportunities. Similarly,

FIEs also have better and cheaper access to land, incentives, and credit in addition to their absolute advantages in terms of technology, capital, market linkage, etc. FIEs are entitled to more incentives in terms of tax, access to land, land rental rates, etc. as compared with domestic enterprises. Less advantageous conditions combined with the internal weaknesses and constraints of private sector in capital, technology, corporate governance, business savvy, management, production methods, etc. explain the fact that the domestic private sector enterprises have to work harder, with higher volume of sale only to find themselves earning a much less amount of profit.

Figure 28: Yearly revenue generated by business sectors

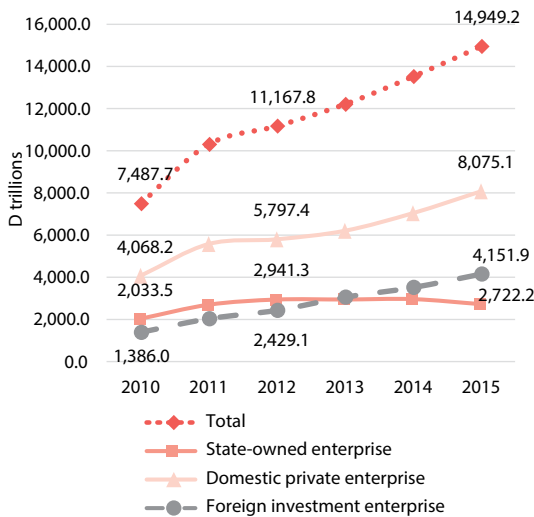
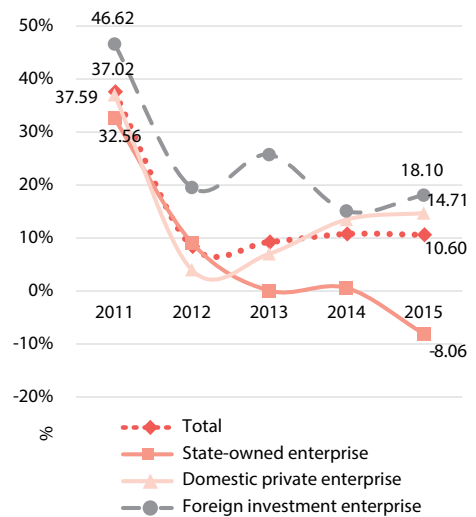
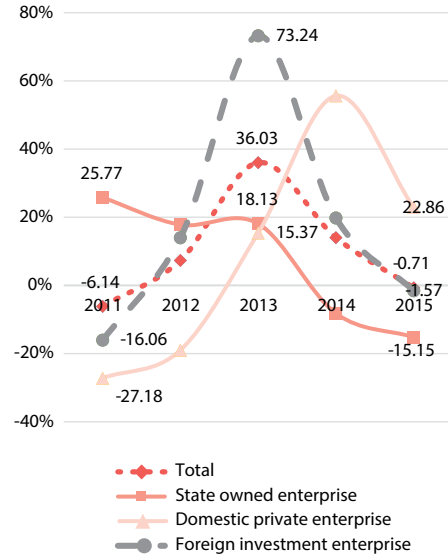
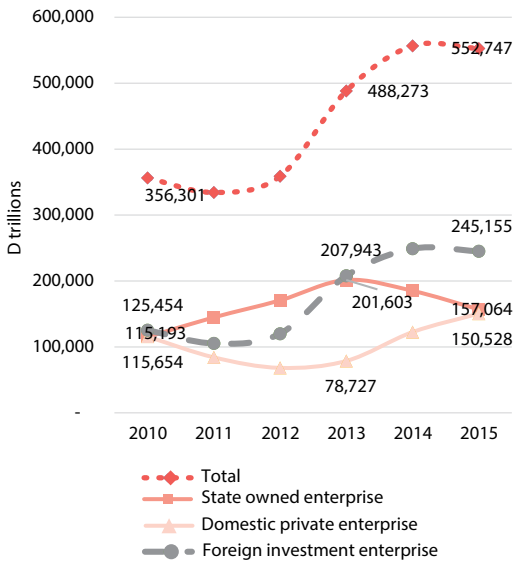


Figure 29: Yearly revenue growth rate by business sectors



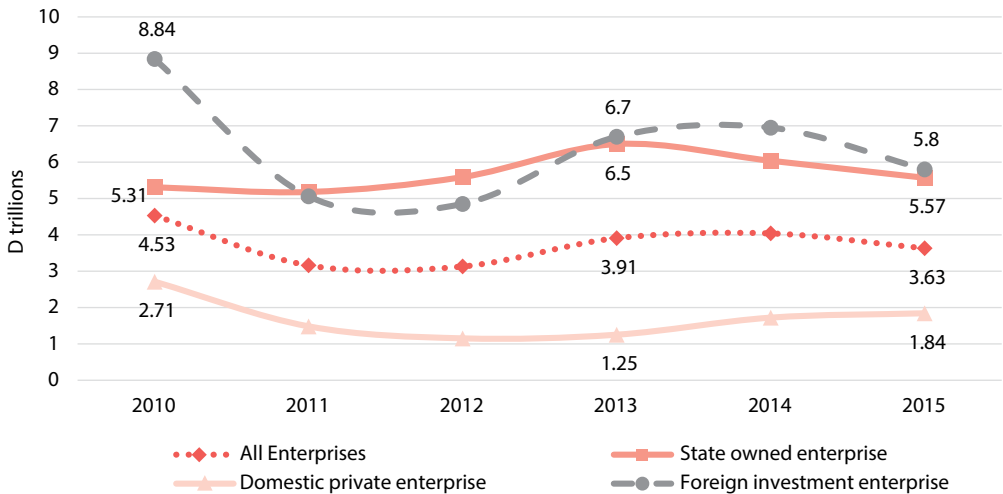
Source: General Statistics Office (2016)

Figure 30: Aggregate profit by business sector **Figure 31: Aggregate profit growth rate by business sector**



Source: General Statistics Office (2016)

52. The rate of return of domestic private enterprises has been much lower than the average bank loan interests. The low rate of return creates more problem for private sector enterprises and for potential investors considering investment into domestic private enterprises (either as a new enterprise or into an existing one). While domestic private enterprises could only borrow from domestic banks that charge interest at 8%–10% per annum (SBV 2016, 2017), FIEs could borrow loans from foreign sources or from banks at their home countries at much lower rates. For example, Japanese FIEs borrowed at 3.3% per year, while FIEs from Taipei, China and the Republic of Korea borrowed at 2.9% and 4.7% per year during 2006–2016. With rates of return being lower than bank lending rates, investors are not encouraged to invest into domestic private sector enterprises.

Figure 32: Return on revenue by enterprise sectors

Source: General Statistics Office (2016)

53. In 2014, 45.5% of domestic private enterprises reported losses. In other words, more than 176,500 private enterprises lose money every year, a staggering figure that demonstrate the hardship of businesses in Viet Nam. The number of enterprises that have been losing money also explains the increasing number of businesses that have reported exiting from the market or stopping operation. According to the Ministry of Planning and Investment, 60,553 private sector enterprises closed their business or temporarily ceased operation in 2017, slightly lower than the figure of 60,670 in 2016. This jeopardizes the target of 1 million active enterprises by 2020 set by the government.

54. Financial losses adversely affect the accumulation of capital by internal sources, and the growth in size of private sector enterprises. The amount of aggregate losses of domestic private sector enterprise rose from about \$260 million in 2000 to \$1.8 billion in 2010 and then to \$3.96 billion in 2014. Not only did the financial losses push many of the enterprises out of the market, the loss and the extremely low profit of many private sector enterprises have adversely affected the accumulation of capital by internal sources by private sector enterprises, hindering the growth in size of the enterprises.

Figure 33: Percentage of enterprise at loss

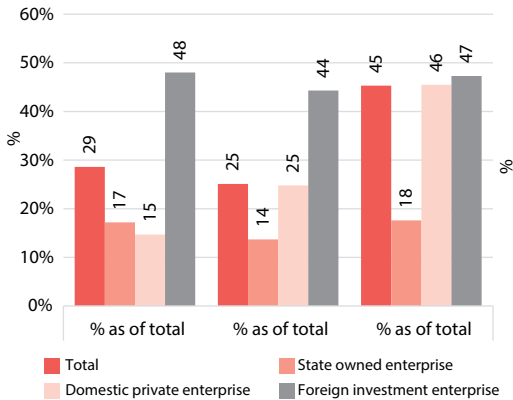
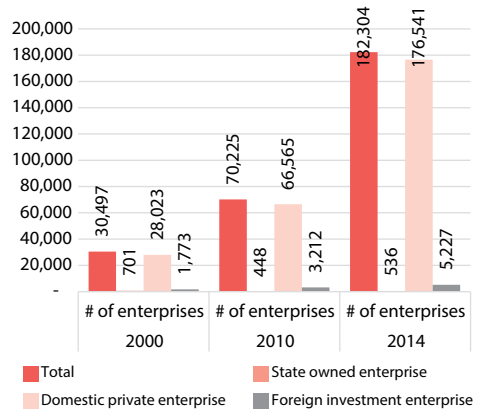


Figure 34: Number of enterprise at loss



Source: General Statistics Office (2015)

55. Weak business planning, management, as well as low corporate governance standards constrain the growth of domestic private sector enterprises. Many private business owners are confused between corporate governance and operational management. Improper management practices and a lack of effective corporate governance hinder Vietnamese firms' competitiveness, making them slow to respond to changes in the business environment. Furthermore, financial reporting of SMEs is unreliable and reporting standards for SMEs are lacking. Information transparency in business is limited. According to a survey by VCCI, only 40% of respondents disclosed their financial statements and merely 6.5% released annual reports. Thirty percent of them made no public reports at all.¹⁶

56. Weak accounting, financial reporting, and monitoring is another hindrance to the growth of the private sector enterprises. All listed and unlisted domestic companies are required to use the Vietnamese Accounting Standards (VAS). According to the International Financial Reporting Standards (IFRS), Viet Nam has not adopted IFRS standards and the IFRS for SMEs standards. Neither has it made a public commitment to move toward a single set of high-quality global accounting standards. SMEs in Viet Nam use an accounting regime for SMEs developed by the Ministry of Finance, which is simplified compared to the VAS (IFRS, 2016). Dual bookkeeping system, one used internally for owners and managers, and one for tax purpose, is a popular practice among Vietnamese private enterprises. Maintaining dual bookkeeping reflect the fact that the

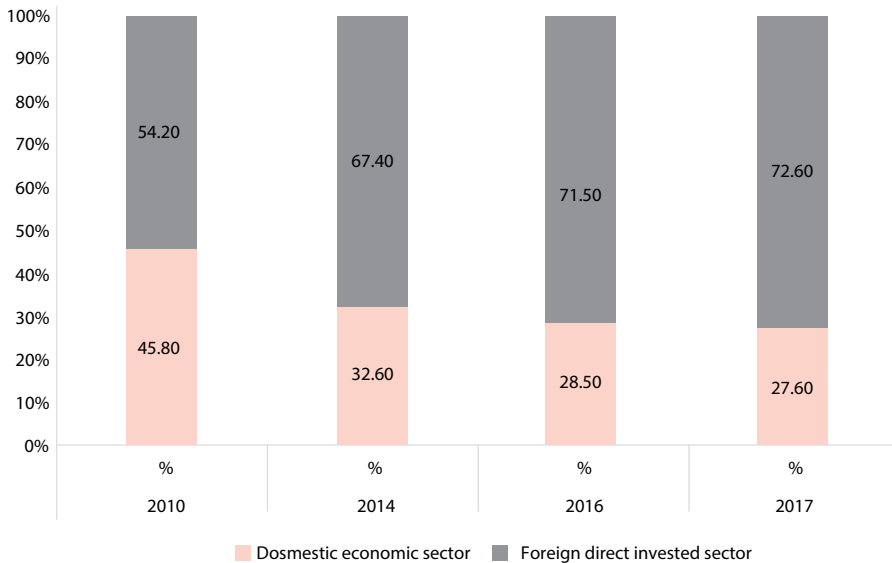
¹⁶ VCCI, 2016. "VCCI Business Annual Report 2015: Corporate Governance".

business owners and managers are not willing to be subject to sound business practices, thus weakening the morale needed for the business to grow. Furthermore, these issues hinder access to capital, international market, global supply chain, and eventually deter the growth of private sector enterprises.

3. Interlinkages between subsets of the private business sector

57. Domestic private sector enterprises' share of export has been plummeting in the last few years and the economy heavily depends on exports by the foreign private sector. Statistics show that the private sector in Viet Nam dominates the share in exports, a key driver of growth in Viet Nam in the last few decades. However, the share of domestic private companies in total export is decreasing fast. This is a concern as domestic private companies are weak when it comes to international trade and therefore fail to reap the benefits brought about by international trade agreements, which Viet Nam has adhered to. According to GSO, the total share of export by domestic enterprises (including private and SOEs) have declined rapidly from 45.8% in 2010 to 28.5% in 2016. Of the total export of \$213.7 billion in 2017, FDI enterprises exported \$155.24 billion, accounting for 72.6%. Domestic enterprises share of export in 2017 is only 27.4%, a further decline as compared with that in 2016. If export by SOEs is excluded, the share of export by domestic private companies will be far lower than this 27.6% figure. The small and declining contribution of domestic private enterprises to total export should be addressed for the domestic private sector in Viet Nam to become a pillar of the national economy, and for domestic companies to benefit more from the international and global integration process.

Figure 35: Share of exports by domestic and foreign invested enterprises in Viet Nam



Source: GSO, Viet Nam Customs (2017)

58. Within the private sector, the linkage between domestic private and foreign invested enterprises is generally weak. According to a JETRO survey,¹⁷ Japanese firms, one of the largest foreign investors in Viet Nam, sourced 32.4% of inputs from local suppliers in 2016. This is much lower than their peers in neighboring countries, e.g., People's Republic of China (PRC) (67.8%), Thailand (57.1%), and Indonesia (40.5%). It should also be highlighted that of the firms that supplied to Japanese FDI companies in Viet Nam, 58.9% are FDI companies that are based in Viet Nam. Only 13% of local inputs were supplied by Vietnamese-owned firms. Or in the case of Samsung in Viet Nam, though the company boasted that the localization rate of Samsung mobile is 57%, only 29 Vietnamese-owned companies were supplying directly to Samsung by the end of 2016.¹⁸ Most of the localized inputs sourced locally as disclosed by Samsung are from other foreign investment companies (most of them Korean-invested companies). In a similar pattern, the linkage between Vietnamese domestic firms and SOE, small firms and large companies are insignificant. For example, in the automobile industry where 20 large automobile assemblers are operating, there are only 81 tier-1 suppliers and 145 tier-2 and tier three suppliers. Meanwhile in Thailand, there are 16 large automobile

¹⁷ JETRO (2016). *Survey on Business Conditions of Japanese Companies in Asia and Oceania*.

¹⁸ Bang Hyun Woo, Workshop on Linkage for Development of Electronics Industry in Viet Nam, 29 Nov 2017.

assemblers but the country has 690 tier-1 suppliers and 1700 tier-2 and tier-3 suppliers.¹⁹ Vietnamese private companies are operating in isolation, engaging in production of unsophisticated goods and services. Besides, the scarcity of joint ventures has also prevented cross-collaboration and innovation (WB, 2016).

59. The phenomenon of *three economies in an economy* is both detrimental to the growth of the entire economy and of the private sector. The phenomenon is used to describe the isolation, fragmentation, and lack of interaction between the state-owned, domestic, private, and foreign-owned sector. There is limited purchase and procurement by large enterprises, SOEs, and FIEs from small enterprises. SOEs and larger enterprises fail to provide the high-quality raw materials and machinery that small enterprises need to produce for their products (especially in higher valued added areas, e.g. production of mold, spare parts, etc.). Technology transfer between FIEs and domestic enterprises is insignificant. The fragmentation and lack of interaction are problematic because they limit the ability to source inputs, new technologies, expertise, and so on domestically, preventing the economy from becoming more productive (Hinh T Dinh, 2011).

60. The government is yet to have concrete policies or measures to support the linkage between domestic enterprises, FIEs, and SOEs. In this respect, it is important to look back to the experience of Japan and the Republic of Korea. For example, in the Republic of Korea, the need for an effective vertical relationship between large firms and SMEs was raised during the 1960s. In 1975, the Promotion of Alliance with SMEs Act was introduced with the expectation that an operational vertical structure in each industry of the economy is achieved. After the 1970s, the economic development of the Republic of Korea was accelerated thanks to the successful industrial policy driven by the government. To take a balanced approach to the industrial plans and policies, the “10-year Plan for the SMEs Growth” was introduced in 1981 and the “Act on Facilitation of Purchase of SMEs-Manufactured Products” was passed. During the 1980s, the world economy—high oil price, high interest rate, and high US dollar value—did not help the heavy chemical industry drive. The policy on the heavy chemical drive was set back and the policy on the balanced industrial development was getting support. The Republic of Korea enacted two laws during this period: the Fair Transactions in Subcontracting Act of 1984 and the Support for SME Establishment Act of 1986. These policies and actions by the Government of Korea help to strength the linkage between small enterprises and larger ones. This is a good experience that Viet Nam should consider.

19 Institute of Industry Policy and Strategy (IPSI) (2018). *Supporting Industry in 4.0. Era Workshop*.

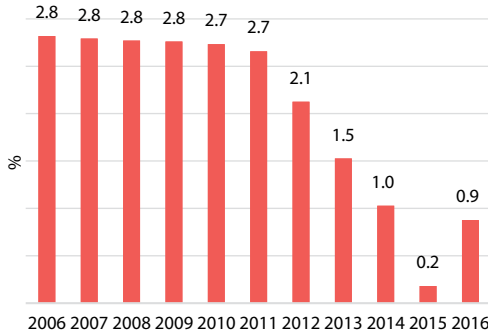
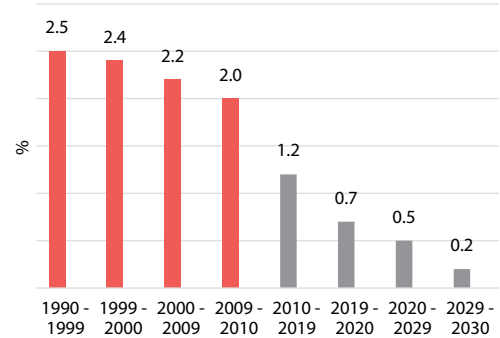
4. Slow response to the decline in once-abundant resources

61. Viet Nam is becoming less competitive in terms of labor cost as the worker wages keep increasing in recent years. Between 2007 and 2015, Viet Nam experienced double-digit annual rates in minimum wage. As a result, the average wage increased 1.5-fold during this period.²⁰ Private sector enterprises therefore cannot rely on abundant and cheap labor as one of the major competitive advantages in their medium and long-term strategy.

62. Furthermore, the demographic dividend that the private sector in Viet Nam has been benefiting significantly from has already been spent. The proportion of the working-age population has been declining since 2013. According to GSO, the growth rate of the working-age population (from 15 and above) have been in decline since 2012. Between 2001–2011, the growth rate of the working-age population was stable at 2.6%–2.9%. The rate declined to 2.1% in 2012 and then 1.5% in 2013. This trend is also observed in the case of the total labor force. The growth rate of labor force was in decline at the rates of 1.8%, 1.7% and 1.1% respectively in 2012, 2013, and the first 9 months of 2014. According to the UN, the demographic phenomenon known as the “golden population”²¹ of Viet Nam lasts for about 50 years, from 1970–2020. The working-age population (15–64) was 50.7% in 1970 and peaked 79% in 2015. This proportion will be maintained at 70% between 2015–2025 and then declined further. The decrease in growth rate of population in the working age and then the labor force will affect the growth of the business sector as a whole and of the private enterprises in particularly if they fail to make a strategic shift away from labor-intensive industries to ones which are built more on knowledge, technology, innovation, capital, and productivity.

²⁰ VERP (2017). *Labor Productivity and Wage Growth in Viet Nam*.

²¹ Golden population is defined as when the number of working-aged people outnumbered dependents.

Figure 36: The labor force growth rate**Figure 37: Growth rate of population in working age (15-64)**

Source: General Statistics Office (2016) & UN Population (2012)

63. The domestic private sector enterprises and household businesses have been relying much on the demographic dividend and on the low labor cost to grow and to produce a combined 38.64% of GDP (in 2016). Domestic private enterprises and HHBs employ 15.7 million people. The rising labor cost, demographic changes, and the aging population are posing important challenges and will hit these two labor-intensive business sectors the hardest in the near future. These are posing significant challenges to private sector enterprises in Viet Nam. The challenges are more severe for domestic private enterprises and HHBs. Though it is also a challenge for FIEs, they are affected on a lesser scale and level because of their higher level of capital intensity and technology application.

64. Domestic private sector enterprises have been slow in responding to the decline of the once-abundant and cheap resources. With the demographic dividend being gradually spent off and natural resources becoming increasingly scarce and expensive, private sector enterprises are yet to have a clear vision and strategy on how to become less factor-driven and become technologically advanced, and more capital intensive. According to a survey by GSO on 7,450 private sector enterprises in 2014, the number of enterprises that used high-technology remained almost unchanged at 17% between 2010–2014. The survey also revealed that only 6.23% enterprises were implementing R&D, and only 5.15% invested in renovating and upgrading technology, machinery, and equipment in 2014. Eighty-three percent of the enterprises surveyed did not have any plan to work on R&D or in upgrading technology, machinery, and equipment. More worryingly, these facts showed a worsening trend as compared with 2010 when the same survey was conducted.

5. High level of informality and quasi-informality

65. **The private sector is characterized by high level of informality and quasi-formality and this is another important challenge.** According to GSO, the total number of HHBs in Viet Nam reached 4.6 million in 2016 and many of them are unregistered. The number of HHBs that are registered with the tax agency is 1.6 million. HHBs do register with district authorities and do fulfill tax obligations like annual license fee and other taxes (mostly lumpsum taxes). Though registered with district authorities, HHBs are considered informal. HHBs that are not registered are also under the radar of the district and local governments. The government does know about the existence and the operation of HHBs and they often pay duties. This is different from the general concept about informality that reflects the government's lack of knowledge about businesses. As such, quasi-formality is a better word to reflect the status of HHBs in Viet Nam. HHBs and their quasi-formality is a peculiar issue in the country, reflecting an issue to be addressed to make the whole business sector more transparent and productive.

66. **Excessive regulations, ineffective enforcement, high compliance costs are the key reasons for high level of informality or quasi-formality.** HHBs are reluctant to graduate into enterprises because of the required changes in the accounting system, in proper bookkeeping, in complying with more stringent social security and labor regulations, and higher tax reporting requirements, etc. When registered as a company, an HHB has to be subject to more rigorous and transparent regulatory system than staying as household businesses. Household businesses do not want to formalize as registered enterprises to avoid more stringent administrative procedures and higher cost of complying with regulations. According to an analysis by *Economica Viet Nam*, a ten-employee HHB after converting into an enterprise will immediately incur an increase in regulatory compliance costs by 181.2 million per year.²² Regulatory reforms and reduction of compliance costs are needed to promote the formalization of HHB.

67. **HHBs exist out of necessity, for subsistence, and for earning a living.** A total of 135,000 people in 2014 and 155,000 people in 2016 chose HHB as a way to start up their business. The figures speak volumes about the vitality and relevance of HHB as an easy and convenient way to start up a business in Viet Nam, especially for those who wish to find a decent way to do business for livelihood. The figures carry an important message and implications and are very meaningful for the work of formulating policy and support measures to the HHB sector and to the private sector development.

22 *Viet Nam Legal Journal*, (36)163/9 - 2017. Formalization of HHBs into Enterprise: Legal Compliance Cost Barriers", Le Duy Binh and Pham Tien Dung.

68. **Many HHB benefit from the ambiguity that is granted to HHB sectors.** According to the General Department of Tax, there are 102,095 HHBs with regular sale and revenue of more than D1 billion per year in 2017. Many HHBs even have sales of few hundreds of billion dong per year (GDT, 2018).²³ However, many of them resist registration as they are benefit from the loose tax regulations applicable to HHB, less stringent enforcement of labor regulations, social security regulations, financial and tax reporting requirements. These larger HHB that benefit from this ambiguity provoke complaints from formally registered enterprises for unfair competition. According to World Bank Enterprise Survey (2015), 17% of firms surveyed say that “practices from the informal sector” was ranked second among the top 10 business environment constraints in Viet Nam.

69. **Productivity in HHBs are generally lower than that of formal domestic enterprises.** Though improving recently, the *revenue per labor unit* of household businesses remains much lower than that of other types of enterprises, and the gap keeps broadening. Average revenue per labor unit of HHBs were merely D 0.13 billion in 2009 and D0.24 billion in 2013 while the figures were respectively D 0.67 billion and D 1.06 billion in the case of formal domestic private enterprises.²⁴ One worker in the formal domestic private enterprises generally generates more revenue than his or her counterpart in the household business sector.

70. **Improving the performance and efficiency of HHBs is highly important given that the sector accounts for 30.4% of GDP but only contributes to 1.56% of state budget revenue and to an extremely limited share of social insurance coverage.** Any improvement in performance of HHBs will help to boost the overall productivity of the economy. The formalization process will also help to accelerate the reallocation of resources from the HHB sector to the formal private sector where productivity is higher, and the use of resources are more effective. In reality, the Resolution No. 10-NQ / TW issued in 2016 of the 5th plenum of the XIIth Party Committee on the development of the private sector emphasized the priority of “...encouraging and creating conditions for household businesses to expand their scales and raise the efficiency of their operation ... to transform them into enterprise ...”. The SME Support Law introduced in mid-2017 also introduces a program to support HHB to register as enterprise through tax exemption and reduction, advisory services on taxes, accounting, management.

23 According to the Enterprise Law 2014, HHBs that employ more than 10 workers or have more than two business location are obliged to register as enterprise.

24 *Formalization of Household Business in Viet Nam*. CIEM and ADB (2017).

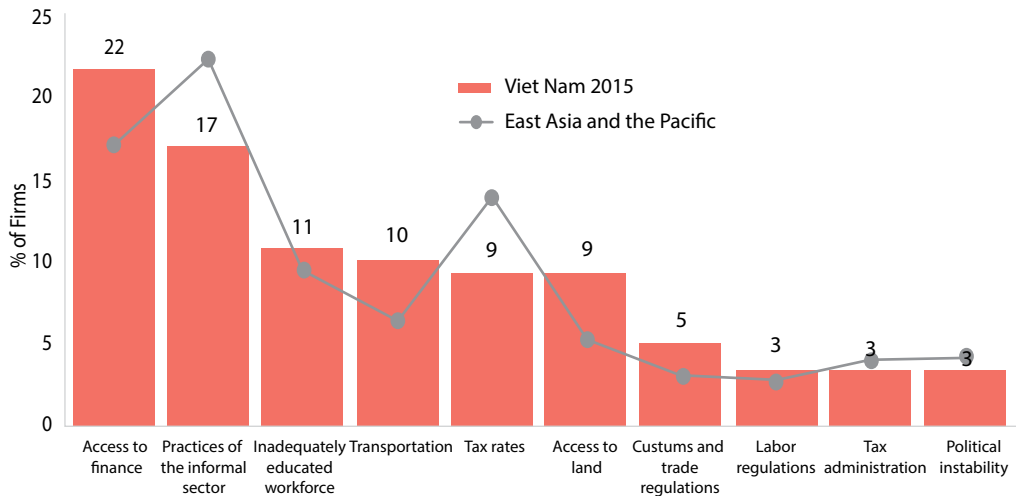
71. The HHB sector is diverse and heterogenous but HHBs are currently all subject to the same regulations. This one-size-fit-all regulatory approach has not been very effective. There is no well-functioning and comprehensive database that classifies HHBs into categories for management and policy making. In reality, the lion's share of HHBs are micro and tiny and are being run out of necessity to support the livelihood of the owners. Hundreds of thousands of HHBs are larger, more sophisticated, and have big business volume.²⁵ Mandatory formalization of large HHBs with big business and sales is necessary and justifiable, but the same coercive measure is not relevant for the majority of subsistence HHBs, especially those that are running out of necessity. Government policies toward the HHB sector should consider this diversity and heterogeneity and should be supported by evidence and data on HHBs across the country. However, the existing databases on HHB is inadequate, fragmented, and is missing much-needed information. A national database on HHB with adequate necessary information will help give a detailed description on the HHB by segmentation, sector, industry, and geographic location, etc. Only then can policies and support measures by the government toward HHB can be most effectively designed and implemented. The Theme Chapter of this report discusses further the issues related to HHBs and proposes some measures to reform the HHB sector, thus reducing informality of the economy.

II. BUSINESS ENVIRONMENT AND EXTERNAL ISSUES

1. General business environment issues

72. The business environment has significant room for improvement. Private sector enterprises still suffer from weak business regulatory environment. There is unequal access to economic resources between enterprises of different ownership structure. According to World Bank Enterprise Survey in 2015, the major business environment constraints in Viet Nam are access to finance, unfair practices of the informal sector, inadequate educated workforce, transportation, access to land, customs and trade regulations. Figure 38 illustrates the business environment constraints that are more problematic by enterprises in Viet Nam—higher than the average in the East Asia and the Pacific.

²⁵ In 2017, there were 102,095 HHBs with regular sales and revenue of more than d1 billion per year. Many HHBs even have sales of few hundreds of billion Vietnamese dong per year (GDT, 2018).

Figure 38: Top ten business environment constraints in Viet Nam

Source: World Bank Enterprise surveys - Viet Nam 2015 country profile

73. There is still a lot of work to be done to level the playing field between private enterprises and SOEs, and between domestic private enterprises and FIEs.

According to a survey by VCCI released in 2017, private sector enterprises remained to be the most disadvantaged group. In 2016, more than 38% of businesses claimed that “the favoritism of provincial authorities toward SOEs caused difficulties to their firm’s business operation,” a statistically significant increase of 6 percentage points compared to 2013. More than 42% of businesses agreed with the statement “the provincial authorities seem to prioritize FDI attraction to domestic private sector development,” up 14 percentage point from 2013.²⁶ The government’s past economic strategies to assign a leading role to the SOEs has however held back private enterprises from fully exploiting opportunities of global integration. The government has sheltered SOEs from competition through preferential access to resources and restrictions on market access for private enterprises. State economic groups were granted preferential treatment in access to land, export quotas, credit, and government procurement contracts including favorable tax rates (Knutson et al. 2004).

74. The cost of doing business remains high. Though improved in recent years, Viet Nam is still ranked 68 out of 190 economies in terms of the ease of doing business on the World Bank’s Ease of *Doing Business* index, just a bit higher than the regional average for East Asia and the Pacific (World Bank, 2018). In addition, the costs of complying with

²⁶ VCCI and USAID. 2017. *The Viet Nam Provincial Competitiveness Index: Measuring Economic Governance for Private Sector Development. 2016 Final Report.*

regulations and administrative procedures remain high. Administrative procedures are time-consuming and costly, particularly relating to business licensing and trade facilitation. According to the Government Office, there are 5,719 different administrative procedures and licenses that are valid and applicable to business and citizens as of March 2017. Business licenses are numerous and burdening on business. The number of business licenses stipulated by ministry is highest at the Ministry of Industry and Trade (1,200 type of licenses) and lowest at Ministry of Construction (106).²⁷ In practice, more work is necessary to address business concerns associated with regulations that affect businesses after start-up. In the annual survey by VCCI, “about 72 percent of firms answered that they spend over 5 percent of their time on regulatory procedures, which means time away from managing and growing their business” and that “for the three consecutive years (2014–2016), one in every three enterprises in the median province had to spend more than 10 percent of its time on compliance with administrative procedures.”

Figure 39: Common to pay informal charges

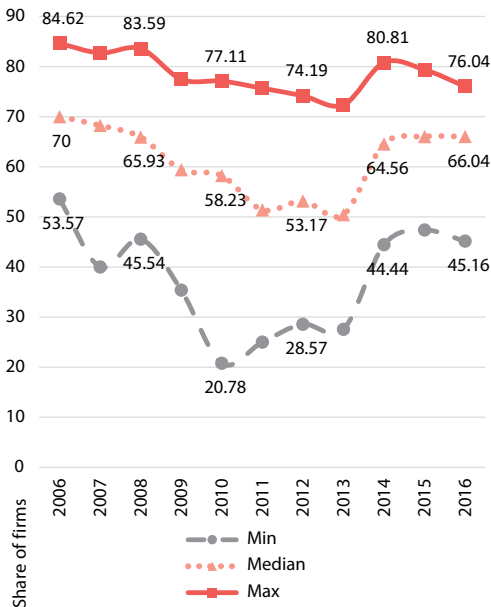
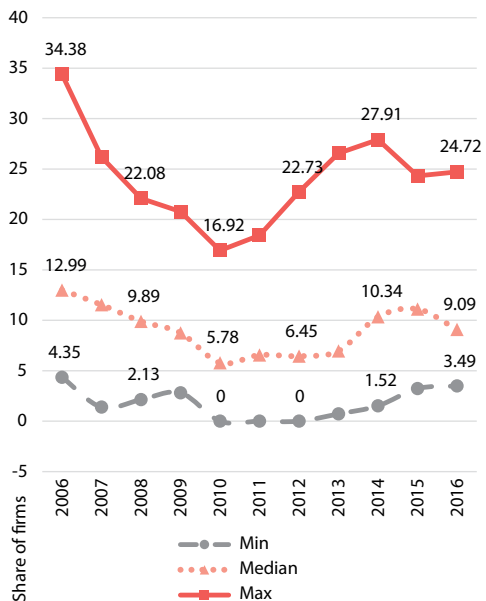


Figure 40: Enterprises paying >10% of revenue on informal charges



Source: Viet Nam Provincial Competitiveness (PCI) Report (2010-2017), USAID, VCCI.

²⁷ Office of the Government. Press Conference (8 March 2017).

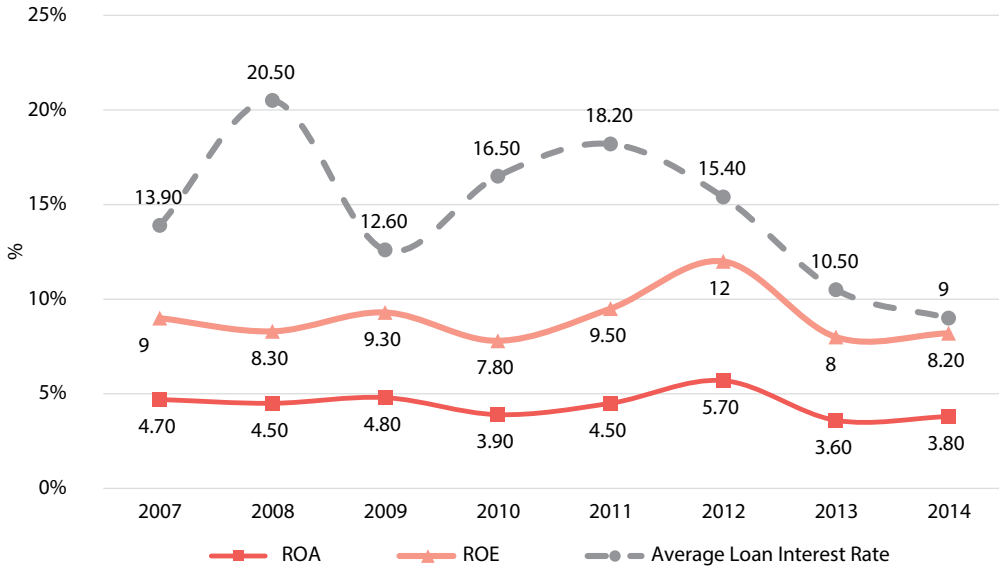
75. Informal cost is a critical issue facing all business sectors, especially the private sector in Viet Nam. The lack of transparency in the business environment in Viet Nam has created more opportunities for corruption. Under the Provincial Competitiveness Index (PCI) survey by VCCI, informal charge is used as a proxy indicator on the level of corruption that private sector businesses face in Viet Nam. According to the survey, the informal charge in the 2014–2016 period saw no sign of improvement compared with the 2006 baseline. In 2016, about 66% of businesses in the median province had to offer a bribe or make informal payments to public officials, which was 12–15 percentage points higher compared to the 2008–2013 period. Eleven percent of firms in the median province claimed that such informal payments represent more than 10% of their total revenue, a sizeable financial burden for any business. In addition, many enterprises agreed that “it is common for businesses to experience informal charges related [to] harassment during administrative procedures.” This indicator, despite improvements over the last two years, remained much higher than in the early years of the PCI.²⁸

76. Unfair access to resources is also reflected for firms with and without ‘close connections’ with authorities. Accessibility to land and credit is often limited for firms without close contact with either government authorities or with banks and financial institutions. “In a context of weak institutions, connections have become the key to opportunities and success in doing business” (VELP 2013). This is especially the case for SMEs, with inaccessibility to credit accounting for 21% of the reasons for recent closure or withdrawal from the market (VELP 2013 - VCCI VBIS 2012).

77. Access to finance is a major constraint for private sector enterprises. As mentioned above, World Bank Enterprise Survey 2015 data show that 22% of formal private sector enterprises characterize access to finance as the top business environment constraint in Viet Nam. Private and informal businesses are at an even greater disadvantage in accessing finance because formal financial institutions are reluctant to lend to them, or to consider securing a loan with anything other than immovable assets such as land and buildings.

28 VCCI and USAID. 2017. *The Viet Nam Provincial Competitiveness Index: Measuring Economic Governance for Private Sector Development, 2016 Final Report.*

Figure 41: ROA and ROE of domestic private enterprise in the manufacturing sector and the average loan interest rate of commercial banks (%)



ROA = return on asset, ROE = return on equity.

Source: State Bank of Viet Nam Annual Reports (2008-2016), Annual Reports of Vietcombank and Techcombank (2008-2016), VCCI Annual Business Report (2013-2016), GSO and author's calculations

78. Interest rates charged on loans by banks are generally higher than the rate of return of private enterprises. Bank lending rates have been declining in recent years. However, the lending interest rates remain high when compared with the profitability of private sector enterprises and with those being paid by their peers in other countries in the region. Foreign invested enterprises operating in Viet Nam face less of this high interest problem as compared with domestic private ones. FIEs in Viet Nam could borrow loans from foreign sources or from banks at their home countries at much lower rates. For example, Japanese FIEs were borrowing at the interest rate of 3.3% per year, while FIEs from Taipei, China and the Republic of Korea were borrowing at 2.9% and 4.7%, respectively, during 2006–2016. In some other countries, the interest rates applicable to enterprises are only 6.6% in the PRC, 6.9% in Thailand and 4.9% in Malaysia. Meanwhile, Vietnamese private sector enterprises were borrowing loans from banks at the interest rate of 8%–10% (SBV, 2017). The interest rates charged on domestic private enterprises remained almost three time higher than the return on equity (ROE) of the domestic enterprises. With ROE being lower than bank lending rates, investors are not encouraged to invest into private enterprises. Rather, they would be attracted by other options like bank savings, properties, and real estate etc.

79. **The quality, range, and depth of financial services is limited.** Underdeveloped financial markets and a lack of adequately strong regulation can result in speculative bubbles emerging and an overheating of the economy. A gradual deepening of the financial system and regulatory framework must be developed for this risk to be avoided (CIEM, 2010). Problems in accessing funds are exacerbated by stringent collateral requirements, poorly functioning land registration, an inefficient registry for movable collateral, and inadequate protection of creditors' rights. Collateral requirements in SME lending is prohibitively higher than most comparator countries.

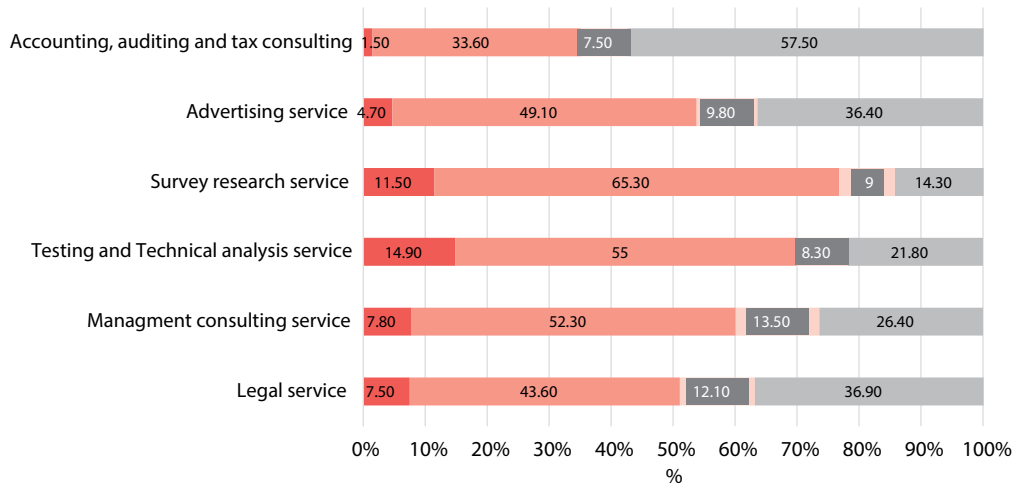
80. **The financial infrastructure is underdeveloped in Viet Nam.** The financial sector in Viet Nam is dominated by commercial banks, most of them offering a limited set of traditional financial products and services. Institutional sources of investment capital are scarce, especially for startups and SMEs. A large proportion of their investment capital is sourced from family and friends. The commercial banking sector suffers from cross-ownership, including SOEs owning joint-stock commercial banks, which has neutralized safe banking regulations and increased the volume of nonperforming loans (NPLs) (VELP, 2013). Business activities of firms are diverted to paying back these loans, while new firms have no access to credit. "In the short term, the weakness of the banking system is the main factor leading to the slow growth of [the domestic private firm and agriculture] sectors." (VELP, 2013).

81. **Regulators' understanding of alternative financing needs to be further promoted.** Alternative financing includes venture capital, financial technology, and angel investing. Innovative financial technology (fintech) could be used to expand access to financial services. However, businesses, consumers, regulators, policy makers and even existing financial providers need to further understand this. Fintech needs to be promoted and different actors need to understand the potential benefits of fintech.

82. **SMEs and startups in Viet Nam suffer from low access to debt and equity financing.** The lack of equity—or risk—capital provided by professional investors is a constraint to private sector development. This stems from multiple factors including underdeveloped financial infrastructure, unreliable reporting standards for SMEs, and budget funded policy banks which distort credit pricing and discourage broader market participation. In addition, there is a limited quality, range, and depth of financial services available, as well as weak business planning and accounting skills within firms, and low corporate governance standards. Regulators are yet to focus on the development of alternative financing in the financial sector policy and regulatory framework.

83. **Many SMEs lack awareness of existing BDS.** BDS include any nonfinancial services used to help the functioning or the growth of firms, for example training, consultancy, management services, marketing, packaging, computer services, distribution logistics, information technology, accounting services, courier and advertising. Private enterprises need to outsource the BDS which are non-core to their business to other service providers, thus helping them to use time and resources better. Use of BDS is essential to improve productivity at enterprises. However, the use of BDS among private sector enterprises is limited. This is due to both to the demand and supply side in the BDS market in Viet Nam. From the demand side, private enterprises are unaware of and do not understand about BDS, the importance and the effectiveness of using BDS. From the supply side, the BDS service providers are yet to be developed and the service quality yet to match the expectation of users (VCCI, GTZ, SwissContact, 2002).

84. **After almost 2 decades, the level of awareness, understanding, and use of BDS has not improved.** The Business Sentiment Survey in 2015 conducted by VCCI assessed the demand and use of by 600 enterprises and found a high level of enterprises who stated that they are either “not aware of” or “aware of but do not use” such BDS as market survey, technical testing, management advices... The BDS that are more used are accounting services, tax advisory services, legal services, and advertising. The level of awareness, understanding, and use of services have not improved as compared with the results disclosed in the survey on 1,200 enterprises conducted VCCI, GTZ, SwissContact in 2002. In addition, private businesses like HHBs operate informally and, as a result, face a number of disadvantages, including inability to participate in effective business assistance programs and development services that are funded by the government, nongovernment organizations, and donors.

Figure 42: Awareness and use of BDS in Viet Nam

Source: Viet Nam Business Annual Report, VCCI (2016).

85. Viet Nam remains to be far from a technology-driven and innovation-led economy. The World Economic Forum (WEF) Global competitiveness index ranks the capacity for innovation of Viet Nam as 79th globally (WEF 2017/2018). Research has shown that young SMEs (aged 0–5 years) contribute disproportionately to job creation and growth. In Australia, young SMEs made the highest contribution to net job creation, with start-up activity responsible for most of this growth. Viet Nam targets 30%–35% of Vietnamese enterprises conducting innovation activities.²⁹ The country needs a well-functioning ecosystem to support innovation and startups to reach this target. Building an innovation ecosystem is a complex and long-term undertaking and Viet Nam can look to the Republic of Korea; Singapore; and Taipei, China as examples.

86. The performance of Viet Nam in terms of innovation is unsatisfactory and the private sector should be encouraged to play a stronger role. The government aims at R&D expenditure reaching 2% of GDP in 2020 as articulated in the Strategy for Science and Technology Development 2011–2020. However, most of these expenditures are likely to be spent by public or government research institutes and centers. Reality in recent years shows that a very limited amount of state budget for R&D has been spent by the private sector players, contrasting the fact often observed in countries where the level of science and technology development is much more advanced. The Global Competitiveness Report 2017/18 ranks Viet Nam 55th globally on overall competitiveness, 84th on higher education and training, 79th on technological readiness, and 84th on innovation

²⁹ Government's Resolution 35/NQ-CP to support and develop enterprises by 2020.

and business sophistication. In terms of patenting, Viet Nam just has 0.02 patents per 100,000 people, compared with 0.12 in Thailand, 0.44 in the PRC, and 29.09 in Korea (US Patent and Trademark Office 2013). In South East Asia, in terms of research performance, Viet Nam presents high activity but average or low impact in mathematics, computer sciences, agricultural and biological sciences, immunology, and microbiology (British Council, 2015).

87. Private sector research and development institutions is limited. According to the Ministry of Science and Technology (MOST), only about 300 companies are accredited as science and technology companies as of end of 2016, generating a total revenue of D14,000 billion (MOST, 2017). The number of private sector science and technology research institutes is highly limited due to lack of clear policy support and due to regulatory constraints.³⁰ Their performance faces numerous constraints and their accessibility to state budget for research and development is limited.

88. Infrastructure for research and development is generally of poor quality and funding is scarce. Infrastructure deficiencies in communications, transport, and energy distribution, and the weaknesses of key specialized laboratories and research equipment has constrained the expansion of enterprises, their integration into global value chains, and their ability to innovate (OECD/ World Bank 2014). The WEF Global Competitiveness Index ranks the quality of scientific research institutions of Viet Nam as 90th globally, with university–industry collaboration in R&D ranking 62nd (WEF 2017/2018). Only a small amount of FDI is concentrated on knowledge-intensive or R&D based activities. “Public sector research is poorly funded, and, overall does not satisfy criteria of excellence or relevance. With some exceptions, it contributes little to social and economic development” (OECD, 2014).

89. STEM and innovation curriculums remain underdeveloped. Science, Technology, Engineering, and Mathematics (STEM) subjects are in high demand by employers and are a backbone of modern industry and corporations. However, in Viet Nam the Science and Technology curriculum has not been updated since 1998 (OECD/ World Bank 2014). The World Economic Forum’s Executive Opinion Survey (WEF, 2016) found that an inadequately educated workforce was the most cited problematic factor for doing business in Viet Nam. The country was ranked 78 out of 136 countries in terms of the availability of scientists and engineers (WEF, 2017/2018). The national innovation system is in a nascent, fragmented state (OECD/World Bank 2014). University and business

³⁰ Science and technology companies can be established according to the Science and Technology Law (2013), Decree No. 80/2007/NĐ-CP of the Government and Decree No. 08/2014/NĐ-CP. Establishment, registration and operation of science and technology research institutions are subject to Circular 03/2014/TT-BKHCN by MOST.

linkage is weak. Except for a few cases, private enterprises are yet to become a driver in translating R&D results, innovation into highly commercialized products and services.

90. Access to advanced technologies, including information and communication technology, in agribusiness, manufacturing and services have yet to be fully exploited. Exports are still largely concentrated in low technology and low-value-added industries, with competitiveness based on cost rather than quality. As described above, due to the weak link between domestic private enterprises and FIEs and SOEs, technology transfer is needed to raise the productivity of domestic enterprises. Information gap exists between potential technology users and the owners of technology and intellectual property across the globe. Technology providers might be unable or unwilling to take the costs and risks involved in adapting technology into Viet Nam. These include costs associated with both regulatory adaptations, and technical adaptations to meet affordability requirements. There also remains the risk of a 'Mexican phenomenon' (World Bank, 2016) occurring.³¹

91. The enforcement of intellectual property laws and regulations is ineffective, resulting in rampant violation of intellectual properties, trademark, and copyrights. According to MOST, the ministry found 32,474 cases of violation of the Intellectual Property Law between 2013-2014. Violation cases unfound by the ministry must have been many times higher. Rampant intellectual piracy, violation of copyrights and intellectual property dampens the interest and the desire to innovate of the people in general and of private sector businesses in particular.

2. Institutional issues

92. Coordination between government agencies in support of private sector development is lacking. The role of the government with regard to private sector development is split across several government agencies, and development partners are actively involved in supporting the private sector in Viet Nam. Many ministries are involved in the development of the private sector.³² There is room for improvement for the coordination of policies and policy implementation between the ministries. Many ministries do not have a private sector or enterprise development department inside the

31 "Mexican phenomenon" is used to describe economies in which a highly productive FDI manufacturing sector works in parallel to and does not spill-over to the lower productivity domestic firm producers, affecting the objective of sustainable economic growth.

32 Main government ministries responsible for or involved in private sector development include the Ministry of Planning and Investment, the Ministry of Science and Technology, the Ministry of Education and Training, the Minister of Agriculture and Rural Development, the Ministry of Finance, and the State Bank of Viet Nam, the Ministry of Industry and Trade, the Ministry of Construction, the Ministry of Justice, the Ministry of Labor and Social Affairs, the Ministry of Natural Resources and the Environment, Ministry of Transport, Ministry of Public Security, Ministry of Information and Communications, and the Ministry of Culture, Sports, and Tourism.

institution nor have private sector development stated as one of its main mission as in the cases of MOLISA, Ministry of Education and Training, and the Ministry of Information and Communication. However, these ministries do play important role in private sector enterprise development, e.g., through labor policy, education and training programs, innovation, intellectual property policies, etc. Private sector and enterprise development therefore need to become an official and prioritized mandate of these ministries as well.

93. Private sector development policies and programs are fragmented. The crosscutting nature of private sector development means that support programs tend to be implemented by a variety of government agencies. There is a lack of understanding of enterprise needs, which results in poorly targeted initiatives, and low quality and impact of business support programs. Many SMEs are not aware of the existing business support programs. Although well-intended, government private sector development (PSD) initiatives are constrained by inherited modes of old-fashioned way of support delivery, and burdensome coordination and implementation processes. These result in numerous uncoordinated and fragmented policies and programs.

94. Viet Nam lacks well-performing and inclusive business associations. Stronger interaction between the government and the private sector should be promoted through increasing capacity for businesses and advocacy organizations, as well as increased public private dialogue. Business associations (BA) operating in economic sectors play an important role in raising competitiveness of companies, supporting dynamic and sustainable development of economy. Some Vietnamese associations recently have grown up and started to play an important role by representing interests of their members domestically and internationally. However, most of the associations lack the competence and skills required to attract participation of members, especially in development of strategy and industry standards, supply of services to members, and in policy advocacy work.³³ Large enterprises find it easier to exert influence and to have their voice heard. Small enterprises need BAs to exert influence. However, their owners rarely have the clout—or time—to organize collective efforts. They also have the problem of being taken less seriously because of the large firm bias among many public officials. Some public and private dialogue forums that have been active recently are more dominated by large enterprises. HHBs, though accounting for more than 30% of GDP, are considered to be informal and are yet to have a business association to advocate for their interests and to support their operation, performance, and formalization.

33 Le Duy Binh et al. *A Journey toward Strong Linkage: Best Practices of Vietnamese Business Associations*. TAF and VCCI (2015).

95. **The political will to support women's owned business is strong but concrete actions and support are still in the making.** The policy to support women's owned business (WOBs) in Viet Nam is at an initial phase of integrating the principles of gender equality into different relevant regulations. The SME Support Law which was introduced in 2017 includes articles on women-owned businesses and uphold policies to support WOBs. This is an encouraging development. Nevertheless, the supporting policies for WOBs have not been followed by action plans with specific budgets for implementation.

96. **The support by international donors and development partners to PSD is declining.** Donors active in PSD include the African Development Bank, Asian Development Bank, the Government of Australia, the EU, the Government of Finland, the Department for International Development, United Kingdom, GIZ, Japan International Cooperation Agency, International Labor Organization, the World Bank, the International Monetary Fund, the International Finance Corporation, United Nations Development Programme, United Nations Industrial Development Organization, United States Agency for International Development, etc. Donors and development partners have been contributing actively to PSD in Viet Nam. The cooperation between donors and with government agencies in PSD are robust and effective. As Viet Nam has been lifted to lower middle-income status, donors' contribution to PSD has become significantly less as compared with a decade ago.



03

CHAPTER III

**OPPORTUNITIES, OUTLOOK, AND
RECOMMENDED POLICY FOCUS**

I. OPPORTUNITIES AND OUTLOOK

97. **The continued strong economic growth, robust economic structuring and institutional reform efforts create a conducive environment for the private sector to thrive.** And on its part, the private sector plays an important role in fueling and driving such growth. The Viet Nam economy growth averaged over 6.5% annually during 1991–2016, reached 6.81% in 2017 and 7.08% in the first half of 2018. The macroeconomic conditions have been relatively stable in the last decades and promise to be so in the coming years. According to a survey by GSO in December 2017, business sentiment is improving. The large majority of business asked by GSO in the survey disclosed that their business would be improved or be stable in the coming years (GSO, 2017). These are obviously good environment for the private sector enterprises to grow.

98. **The political determination in and commitment to PSD has been repeatedly reaffirmed.** The year 2017 is undoubtedly an important milestone as the 5th plenary meeting of the Party Central Committee issued Resolution No.10-NQ/TW, reaffirming the determination of making the private sector to become an important driving force of the socialist-oriented market economy. The resolution articulates that “development of a healthy private economy under the market mechanism is an objective, imperative and long-term requirement in the process of improving institutions for and developing the socialist-oriented market economy” and reiterates that “the private economy is an important driving force for economic development”. This political determination and commitment is important foundation for the even more vigorous development of the private sector in the coming time.

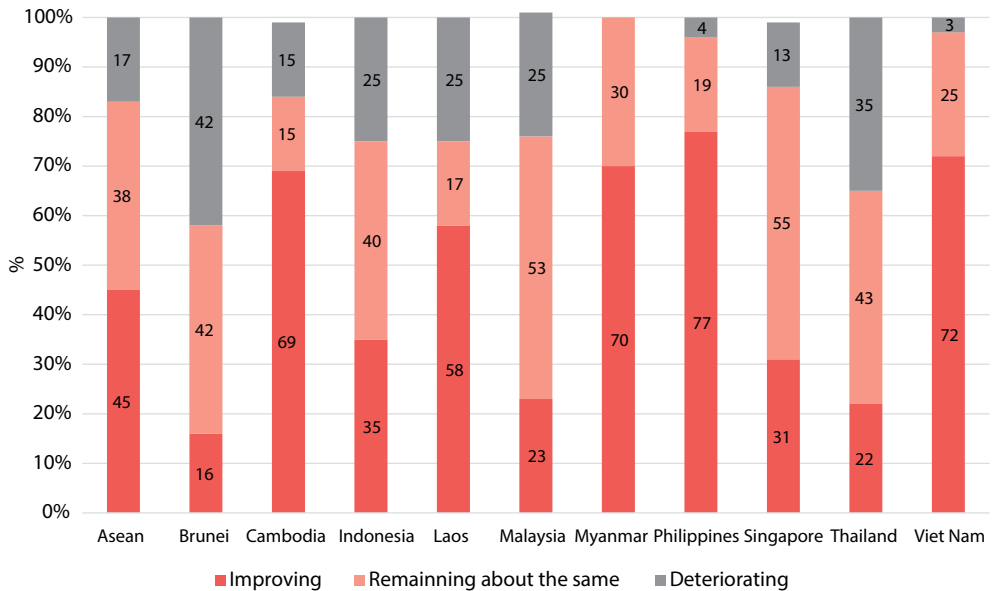
99. **The government has been increasingly adept in playing the “facilitating and enabling” role to create a business environment in which the domestic private sector can start up, grow, and prosper.** More recently the government has introduced multiple measures to promote the growth of the business sector through the adoption the SME Support Law and multiple government resolutions to develop enterprise and improve the business environment and national competitiveness. In a similar manner, some provinces have become more active in supporting the development of the business and of the private sector. Reform has happened the fastest in provinces where local government has a good understanding of the problems faced by the private sector and is willing to respond to their needs. There is an increasing number of provinces that are highly committed to supporting the private sector and business. These provinces have been very effective in introducing business environment reforms, innovative initiatives to respond to the needs of the private sector.

100. Viet Nam's geographic position and membership of regional and international and trade agreements provide precious opportunities for the private sector. Viet Nam is in the heart of Southeast Asia. It borders with the PRC and has a long coastline. The good geographic location is conducive to cross-border trade. Membership at the WTO, ASEAN, and the AEC opened the country to international trade and investment. In particular, the ratification of the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP)³⁴ agreement, the EU-Viet Nam Free Trade Agreement will provide both opportunities for the private sector of Viet Nam in exporting to a wider market, but also the challenges associated with adhering to the new protocols and requirements that the two agreements would enforce.

101. Foreign direct investment remains high and there is a stronger awareness on the urgency and benefits of stronger linkage between domestic enterprises and FIEs. Viet Nam is considered one of the most attractive destinations for foreign investors in the Asia and Pacific region, largely due to its low labor costs, favorable demography, ideal location, and political stability. Recent surveys reflect continued interest of foreign investors in Viet Nam and FDI capital keep flowing in. Rising FDI inflow give domestic private enterprises precious opportunity to strengthen the linkage with FDI sector, and then with the global supply chains. According to the 2017 ASEAN Business Outlook Survey, Viet Nam remains one of the most popular destinations for expansion within the ASEAN region with the highest outward FDI flows from the PRC; Taipei, China; Hong Kong, the Republic of Korea, and Singapore. The interests have been backed by actions by foreign investors in Viet Nam. As of November 2017, there were over 24,500 FDI projects in Viet Nam with a total registered capital of over \$316 billion, and with total disbursed capital of over \$170 billion (54% of total commitment). In 2017 alone, foreign investment capital inflows soared, totaling \$35.6 billion, up 44.2% compared with that in 2016. The opportunity to link up with FDI sector and with the global supply chain is emerging. It is important that the domestic private sector seize the opportunity, thus enabling Viet Nam to avoid the Mexican phenomenon that some countries have been trapped in.

34 Originally named as Trans-Pacific Partnership (CPTPP)

Figure 43: Perception on overall investment climate in the response location by foreign investors



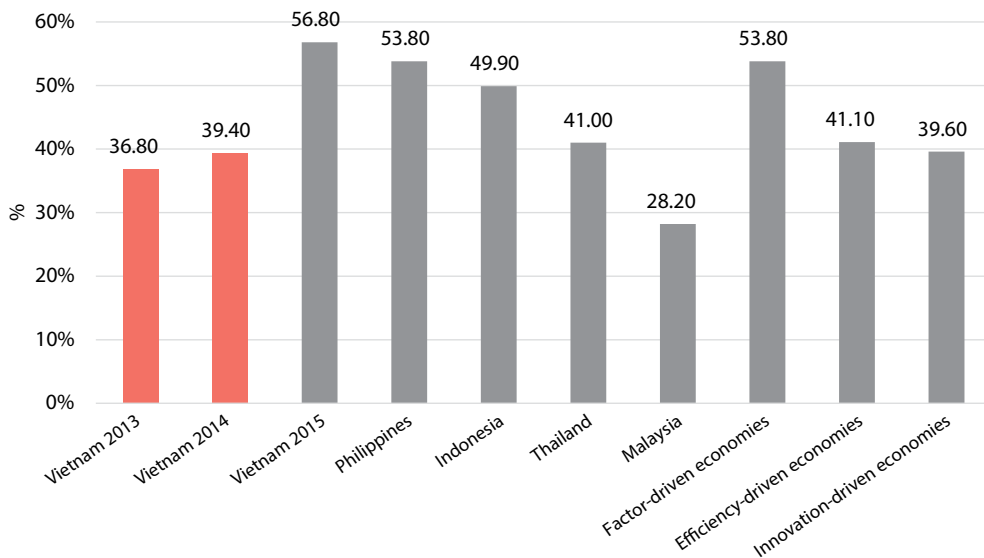
Source: ASEAN Business Outlook Survey 2017

102. Accelerated efforts by the government to divest from SOEs and to reform the SOE sector is also an opportunity for the private sector. The government has stepped up efforts to divest from SOEs. In 2016, the prime minister approved a project on the restructuring of SOEs for 2016–2020, with a focus on state-owned economic groups and corporations. According to the project, the government will divest from 137 SOEs from 2016 to 2020 by way of equitization. The government will wholly own only 103 enterprises after 2016–2020.³⁵ By the end of 2016, total equity of 583 SOEs was equivalent to \$60 billion, and their total assets was \$133 billion (CIEM, 2017). As such, with the equitization plan by the government until 2020, the total capital divested by the government from these SOEs between 2016–2020 is estimated to reach dozens of billions of dollars. It is highly likely that billions of dollars in capital and assets will change hands and will be transferred to the private sector in the coming years, giving a precious opportunity for the private sector in Viet Nam to grow and expand. But it is also important that this opportunity need to be seized by domestic private sector enterprises, rather than only by FIEs.

³⁵ Prime Minister's Decision No. 58/2016/QĐ-TTg dated December 28, 2016

103. Opportunities for the private sector include important public works and infrastructure projects, which used to be reserved for SOEs. Recently, private sector enterprises invested in development of airports, expressways, sea ports, power plants, etc. With the total need for investment into infrastructure reaching \$480 billion until 2020, private sector investment is expected to meet the larger chunk of such amount as the state budget can meet only one-third of such demand. If private sector enterprises are to participate in large infrastructure projects and in public works, the trickle-down effect on SMEs in the private sector will be significant.

Figure 44: Perceived opportunities in Viet Nam in 2015³⁶ (%)



Source: The Global Entrepreneurship Monitor (2016)

104. Entrepreneurship among Vietnamese people is improving dramatically, and is continuously supported by the improving business environment and by public information programs. According to Global Entrepreneurship Monitor, the proportion of adults noticing the opportunity for starting a business in Viet Nam jumped from 39.4% in 2014 to 56.8% in 2015, higher than the average rate of the countries that are in the similar stage of development in Viet Nam (factor-driven economies).³⁷ The improved level of entrepreneurship, and if further supported by good initiatives by the government and an enabling business environment, is important factor to unleash the tremendous potential of the private sector in Viet Nam, and for billions of dollars that are being held

³⁶ Percentage of 18 to 64 population who see good opportunities to start a firm or a business in the area where they live.

³⁷ "Global Entrepreneurship Monitor Viet Nam 2015/2016", GEM and VCCI (2016).

by the private sector to be put into productive use to support stronger growth of the economy.³⁸

105. The internet, Industry 4.0 and the platform economy will bring about tremendous opportunities for entrepreneurs and small business. The internet, the application of big data, new algorithms, and cloud computing will create a borderless digitally based new economy in which starting up and running a business can be even easier than ever. Such a new economy will make innovative business models, products and services. Business ideas can be tested and put into practice at much faster rates. Private sector companies can reach out to customers and international markets, doing business with international partners much more easily and much less costly. The Industry 4.0 and the platform economy provide precious opportunities and an enabling environment for private businesses to invent, innovate, and apply new and unprecedented business models, services, and products, and to get funding from more innovative financing sources rather than only from traditional source like banks. The requirement for a business of being capital intensive and having abundant financial resources to go global as often required just a few decades earlier is of less importance now. Private sector enterprises will have a good chance to frog-leap to knowledge-based, innovation-led economy and to become national and international players without having to rely overly on capital at the first place. The opportunity is even more important for Vietnamese private sector enterprises as the majority of them are undercapitalized and have limited financial resources.

II. RECOMMENDED POLICY FOCUS

106. Improving the competitiveness of enterprises and private sector are one of the key components of Viet Nam competitiveness. Viet Nam's competitiveness foundations, which were elaborated on the basis of Michael Porter's conceptual framework on the determinants of national competitiveness, was introduced in Viet Nam Competitiveness Report 2011.³⁹ The model for Viet Nam is condensed to microeconomic competitiveness as the sophistication of companies, the state of cluster development, and the business environment quality, against macroeconomic competitiveness as social and political infrastructure and macroeconomic policy environment. A comprehensive set of strategies is required to address each of these foundations to increase overall competitiveness of Viet Nam. The model also shows that improving the competitiveness of enterprises and private sector is one of the decisive components of Viet Nam competitiveness.

³⁸ Some economists estimate that billions of dollars are kept under the mattress by the Vietnamese people in the form of gold or foreign currency without being put into productive use. In addition, billions of dollars are also transferred into Viet Nam in the form of overseas remittance (about \$13 billion in 2015 and \$9 billion in 2016).

³⁹ *Viet Nam Competitiveness Report*. CIEM and National University of Singapore (2011).

107. Continued efforts to improve the business environment should be one of the most important priorities. This is to sustain the business confidence and the increase in private sector investment. Improved business environment will also help to improve the performance and profitability of private sector enterprises, thus contributing to the growth in size, efficiency, and sophistication of business.

108. Data in the preceding sections call for a shift in the focus of the government on the quality of growth of private sector enterprises. Rather than merely aiming at the target of hundreds of thousand enterprises being set up in the coming decades, the policy focus should be more on quality indicators, e.g., productivity at firm level, size of business, level of technology adopted, innovation, financial performance, and the level of linkage with global supply chains.

109. There should be a clear policy statement on domestic formal private sector enterprises being the pillar of the national economy and competitiveness. The fanfare about the recent incredible growth of the private sector have eclipsed the fact that formal private sector enterprise only account for 8.2% of GDP. Much of the total 38.64% of GDP as contributed by domestic private sector are from household business sector—a sector still seen as informal. With declining share of SOE thanks to the SOE reform process, it is imperative that the formal private sector enterprises to grow faster, more efficiently and productively, avoiding an imminent overdependence on FDI and a less productive household business sector.

110. Within the business sector, there should be measures to facilitate the reallocation of resources to the enterprises that use resources (capital, labor, land) more efficiently. The policy emphasis on the creation of a strong and robust formal private sector enterprises need to be accompanied with policy to shift the resources, including capital and labor, to the economic sectors that have proven to use them more efficiently. SOE reform, formalization of household businesses, formalization of informal business sector are the structural transformations necessary for the reallocation of resources to more effective use, thus helping to improve the overall productivity and competitiveness of the private sector.

111. Unleashing the tremendous potential of the HHB sector by appropriate measures will contribute a greatly to the stronger performance and higher productivity of the private sector. Efforts to encourage HHBs to register is a step in the right direction. However, such efforts should be implemented considering that the large lion share of the HHBs are of micro scale and are being run out of necessity. It is reasonable and justifiable to require large HHBs and who capitalize on the ambiguity of

the regulations on HHBs for tax evasion to register and be subject to more transparency. However, hastily pushed one-size-fit all measures to force all HHBs to formalize will drive many of them out of business and therefore might be counterproductive. The formalization process should take into account the heterogeneity of the HHB sector. Some regulatory reforms need to be introduced to find the most relevant legal form for HHBs to register with lowest possible compliance cost. International practices in the development of sole proprietorship business form can be further studied and applied in the overall effort of transforming the HHB sector and making them contribute more to the productivity gain and prosperity of Viet Nam in the future. The Theme Chapter of this report discusses further the issues related to HHBs and proposes some measures to reform the HHB sector.

112. Policy measures to strengthen the linkage between domestic private enterprises with FDI enterprises and with SOE need to be introduced. Measures to encourage FIEs and SOEs to purchase from, to subcontract to, and to partner with private domestic enterprises need to be introduced. Some economies like the Republic of Korea; Japan; or Taipei, China have proven to be successful in forging such a linkage through introduction of relevant laws and regulations.⁴⁰

113. The “missing middle” phenomenon should be addressed. The domestic private sector enterprise composition structure need to be transformed into a healthier shape with a larger share of medium-sized enterprises. More medium-sized enterprises mean a higher chance of having more enterprises to graduate into large ones in the medium future. Consequently, there will be more enterprises that can capitalize on economies of scale and become more productive. Medium and large-sized enterprises have higher capacity and opportunity to become part of the global supply chain, to link with FIEs and SOEs, and to build their competitiveness on the basis of knowledge, capital, research and development, technology, and innovation rather than only on low labor cost and cheap natural resources as the cases of the majority of Vietnamese micro and small enterprises.

114. Measure to address the missing middle should be supported by explicit policy statements and policy measures to support capital accumulation and the growth in size of domestic private sector enterprises. The policy measures should lay adequate emphasis on encouraging capital accumulation by both internal sources and by way of merger and acquisition, equity investment, etc. Improving profitability and encouraging

⁴⁰ For example, the Republic of Korea introduced the Fair Transactions in Subcontracting Act, the Facilitation of Purchase of SME- Manufactured Products Act, the Promotion of SMEs and Encouragement of Purchase of their Products Act, and Act on the Promotion of Collaborative Cooperation between Large Enterprises and SMEs for this purpose.

companies to retain profit and to plough it back to the business can be achieved through business environment reforms, tax policy reforms, and in building up a business culture in which private enterprises will have a long-term vision, strong commitment to sustainable and long-term growth, to social progresses and social values.

115. Policy priority should be given to increasing the capacity of private sector enterprise to adopt technologies. Technologies can be adopted from abroad or from FIEs. Strategic, continuous, persistent, and smart technology adoption will lead to accumulation of know-how and technology, and eventually to innovation and invention. They also need to be supported to translate new knowledge and technology into higher productivity and growth. The capital accumulation process need to be supported with polices to encourage R&D, adoption of new technology, creation of new knowledge and innovation. To support the innovation by private enterprises, government R&D budget need to be allocated more to private sector enterprises and institutions. An effective and transparent mechanism need to be set up for this purpose. R&D budget should be allocated on merit-based basis, regardless of the ownership of the institutions. There should be an explicit policy support to the development and operation of private sector science and technology research institutes, enterprises, and institutions. Regulations should be reformed so private sector science and technology research enterprises, institutes, or centers can be set up more easily and be accredited in an easier and more transparent manner. Private sector companies and institutions should have fair access to study and research funds of the government. International practices show that private sector research institutions and companies can be very instrumental in mobilizing additional funding from the private sector into science and technology research, helping to improve the science and technology of the country and the adoption and innovation technology at business sector.

116. STEM curriculum need to be constantly updated and reformed. University and business linkages need to be strengthened. Technology adoption and innovation, building more on knowledge and know-how to growth will obviously improve business sophistication and the competitiveness of the private sector enterprises. More effective enforcement of laws and regulations on intellectual property will strengthen and foster the interest and desire of the private sector and of the business to renovate, invent, create, and to commercialize their innovations and inventions.

117. In line with the development of Industry 4.0, the private sector growth needs to be led by innovation, be geared toward higher productivity and competitiveness in the coming decades. The focus of SME promotion and PSD initiatives and programs

should be less on the number of enterprises being registered, and on the amount of capital being registered or invested. Rather, it should use more impact indicators in terms of value added, innovation and invention, productivity, the economic, technological, social, and ecological progresses.

118. It is imperative that the private sector be prepared for the rising wage and the “population dividends” being spent off in a near future. As the private sector is much dependent on low-cost and young labor to grow in the last few decades, the private sector should shift to the efficiency-based business model—one that uses more capital, technology and knowledge rather than overrelying on cheap labor and resources.

119. In designing and implementing programs to support enterprises and the private sector, priority should be given to the efficiency, effectiveness, and impact of the support programs. Given the limited resources, business support programs need to be more focused, addressing prioritized needs of the private sector enterprises. The design and implementation of support policies and programs by the government should be based on evidence and on well-collected data. The data and statistics on enterprises in general and on private sector enterprises in particular need to be improved. In addition, a national database on HHBs will help to provide a clearer picture on this important component of the private sector. Lack of comprehensive and accurate data and information on private sector enterprises and HHBs have resulted in one-size-fits-all solutions without considering the heterogeneity and the diversity of the enterprises and businesses in the same sector. Only when support policies and programs are based on good data, information and evidence, can they be well-designed and effectively implemented.



04

THEME CHAPTER

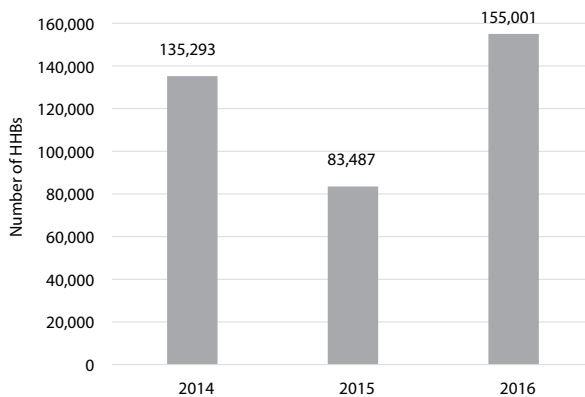
**PRODUCTIVITY GAIN THROUGH REFORMING
HOUSEHOLD BUSINESS SECTOR**

In many respects, HHBs plays a unique and highly important role in the economy of Viet Nam. However, the sector is widely considered to be informal or quasi-formal. Statistics show that average household productivity is generally lower than that of other business sectors. Given the fact that HHB sector contribute to 30.4% of Viet Nam's GDP, improving productivity and enhancing the formality of the sector will be of great significance for the efforts in narrowing the informal economy while enhancing the productivity of the private sector in particular and of the economy of Viet Nam as a whole.

I. A PARADOX

According to the General Statistics Office, there are currently around 4.9 million households in the country. HHB is particularly a favorable and convenient means for a person to start a business, especially as a self-employed or when out of necessity. In 2016, 150,000 new business households entered the market. This number was 83,000 in 2015 and 135,000 in 2014. Business households are preferred because it can be conveniently registered with extremely simple procedures right away at the district level authority. Regulatory requirements applicable to household businesses in terms of bookkeeping, accounting, tax and financial reporting are generally loose and not so costly.

Figure 45: Annual Increase in Number of HHBs



HHB = household business.

Source: General Statistics Office (2017)

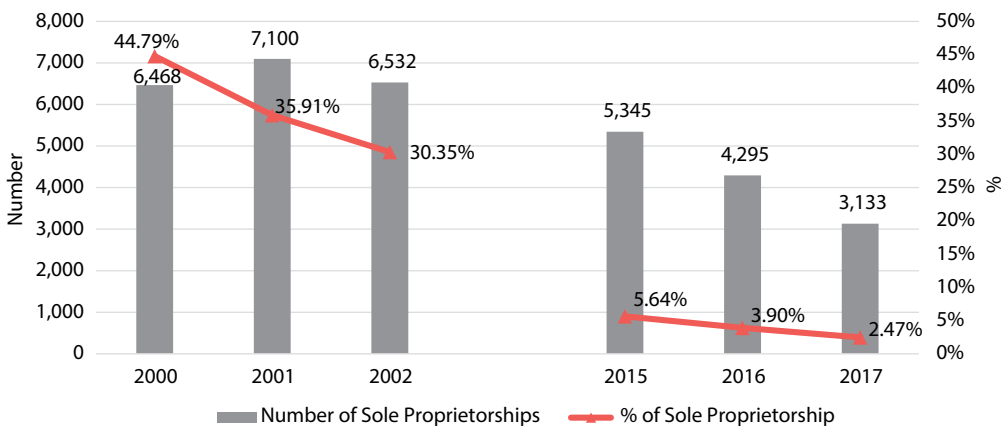
HHBs are not strictly bound by the regulations related to social insurance, conditional business lines, environment, fire-fighting prevention, etc. Most important of all, HHBs may apply the form of "lumpsum tax" and have the opportunity to "negotiate with the tax authorities" on the amount of tax to be paid. As a result, taxes paid by HHBs are often

much lower as compared with formally registered businesses. Though accounting for 30.4% of GDP, HHBs only contribute to 1.56% of the state budget revenue according to estimates by the General Department of Tax.

Despite the fact that HHBs are mentioned in the Enterprise Law and that they are preferred prevalently, HHBs are not considered to be a legal form of enterprise and thus being seen as informal or quasi-formal. In addition, no longer does the Civil Code 2015 have any stipulation on HHBs, nor does it recognize HHB as a legal party in a civil transaction.

Meanwhile, the form of *sole proprietorship* is formally recognized as a form enterprise by the Enterprise Law. It is one of the first legal forms of private enterprise that was introduced in Viet Nam through the Law on Sole Proprietorship in 1990. Paradoxically, this form of enterprise is losing its attractiveness and is no longer a preferable choice for the people when starting a business and when registering their enterprise.

Figure 46: Number and percentage of sole proprietorships out of total enterprises registered annually (Early 2000s and recent years)



Source: CIEM (2005), Ministry of Planning and Investment (2017)

In the early years of the Enterprise Law 1999, almost half of the enterprises were registered as sole proprietorships (44.7% in 2000, 35.9% in 2001). However, only a very small proportion of entrepreneurs now choose sole proprietorship when registering their business (3.9% in 2016 and 2.47% in 2017).

This paradox is unfortunately happening in practice. The business form of sole proprietorship, though officially recognized in the Enterprise Law, is no longer preferred. Meanwhile, HHBs that are not recognized as a form of business under the Enterprise

Law, has become a popular choice. In terms of rights, sole proprietorships do not differ much from HHBs. However in terms of obligations, sole proprietorships have far more responsibilities. They have to comply with regulations applicable to an enterprise registered under the Enterprise Law. The Enterprise Law, especially the chapter on sole proprietorships, do not have specific and detailed stipulations that allow lesser legal obligations on sole proprietorships. As a result, sole proprietorships owned by a single proprietor and mostly of micro size, must fulfill all the obligations in terms of accounting system, financial statements, social insurance regulations, tax payment in accordance with the regulations that have been developed and applicable to all types of businesses, regardless of their size, legal nature, and characteristics. Compliance costs for implementing these regulations are disproportionately high for sole proprietorships given their micro size. This deprives sole proprietorships of the advantages and of the attractiveness compared with HHBs.

“ D 181.2 million is the minimum amount of annual regulatory compliance cost of an enterprise registered under the Enterprise Law, regardless of their business or corporate form and legal nature. ”

According to the prevailing regulations, sole proprietorships can be registered only at the business registration office at the provincial level (there are only 63 of them in 63 provinces). This means that when registering their business as sole proprietorship, sole proprietors or sole traders have to go to the provincial centers that are often far away and will cost them significant amount of time and money for travelling. Though online registration is now possible but is yet to be convenient and relevant to sole proprietors and people who live in the rural, mountainous, and remote areas. Meanwhile, HHBs can be registered with district people's committees (there are 713 of them across the country), making it highly convenient and cheap for people to register their business. To make it easy for people to register their businesses as sole proprietorships, it is important that sole proprietorships can be registered at district people's committees, as in the case of HHBs.

Sole proprietorship becomes much less attractive compared to one-member limited liability companies. One-member limited liability company may also be owned by an individual, but it has legal status. Furthermore, the owner is only legally liable for the company's obligations within the limit of the capital contributed. The used-to-be-favored sole proprietorships now loses this advantage, especially after the one-member limited liability company was introduced. In the form of sole proprietorship, the owner has unlimited responsibility for the obligations of the business. Furthermore, sole proprietorships have no legal status.

II. INTERNATIONAL EXPERIENCE AND PRACTICES

International experience shows that sole proprietorship is a very popular form of business in many countries. For example in the EU, out of the 2.3 million businesses established in 2012, 1.6 million or 70% are registered as sole proprietorships. This rate is particularly high in some countries, for example 92.3% in France, 86.9% in Poland, 86.4% in Netherlands, and 86.1% in Czech Republic (Eurostat, 2013). In Hungary, of the 450,733 active enterprises, 53% are in the form of sole proprietorship (OECD, 2016). 73% of small businesses in the United States are sole proprietorships (US Small Business Administration, 2013). In Southeast Asia, of the 907,065 enterprises registered in Malaysia, 554,900 enterprises or 61.2% are sole proprietorships (SMECorp Malaysia, 2017).

“Of the businesses registered annually in EU, sole proprietorships account for 70%. The percentage is 92.3% in France, 86.4% in the Netherlands, and 86.1% in Czech Republic. Of the active small businesses registered, sole proprietorships account for 73%, in the US and 61.2% in Malaysia.”

Literature and studies show that the HHB is a unique business form in Viet Nam. In other countries, HHBs do not exist but the main form that is used instead is sole proprietorship or sole trader. Sole proprietorships or sole traders, especially in EU countries or OECD countries, are officially registered. Sole proprietorships or sole traders can be easily and conveniently registered with the local government or online. Costs of compliance with legal regulations, accounting regime, financial reporting are much simpler than and less burdensome than in the case of other types of companies due to the legal nature and the size of this type of business. Legal compliance costs and tax payment applicable to sole proprietorships or sole traders are therefore within the range of the owner or proprietor of sole proprietorships. This is a decisive factor for the attractiveness of this type of business, making sole proprietorships or sole traders widely popular in these more developed and advanced countries.

Some of the anomalies related to some of the business or corporate forms as described above should be fixed through legal reform measures to promote the advantages of HHBs, and at the same time to promote the strengths of sole proprietorships or sole traders, bringing this form of business into full play. Upcoming legal reforms will need to reaffirm the relevance of sole proprietorships or sole traders as a very strong and highly relevant means to unleash the entrepreneurship in Viet Nam. Especially, it is an important

factor for the reform of the HHB sector, encouraging the voluntary formalization of the household sector, enhancing the formality of the private sector. This, in turn, will improve the overall efficiency and effectiveness of the private sector in particular and of the economy in general.

III. THE LEGAL FORM OF HHB

An important question raised is whether we should maintain both two legal forms of *household businesses* and *sole proprietorships* in parallel? Given the actual situation in Viet Nam and international practice, the answer is no. Viet Nam should unify the concept, legal definition, and stipulations for *household businesses* and *sole proprietorships* to develop a clear legal framework and create a unified and firm foundation for the sustainable development of household business, sole proprietors, and sole traders in the future. Unifying regulations applicable to sole proprietorships and HHBs is a feasible and appropriate solution. This should be considered as one of the priority actions to reduce informality, increase productivity and efficiency of the HHB sector in particular and of the whole private sector in general.

IV. PROPOSED MEASURES FOR REFORMING THE HHB SECTOR

Combining the strengths of *household businesses* and *sole proprietorships* will have significant impact on the development of enterprises in general, the reform and the formalization of the HHB sector in particular. Thus, household business sector reforms will be closely linked to the promotion of the legal business form of *sole proprietorship* and *sole traders*. Key reform measures are proposed as below:

Firstly, an accurate term in Vietnamese for *sole proprietorships* should be worked out and agreed upon. The current Vietnamese term used for *sole proprietorships* is literally translated as “private enterprise” (*doanh nghiệp tư nhân*). The term “private enterprise” is used officially in the Enterprise Law and all other legal documents but the terms fails to carry the meaning of sole proprietorship or sole trader. The current term as it is in Vietnamese now is difficult to understand, and does not reflect the nature of this type of business, thus causing great confusion in practice. Consequently, it creates a lot of difficulty for the implementation process. Alternate names in Vietnamese can be *doanh nghiệp cá thể* or *doanh nghiệp một chủ*, which literally reflect better the meaning and legal nature of sole proprietorships.

In the process of revising the Enterprise Law and its implementation decrees in the coming time, the new term should be used. In addition, there will be no regulation or

stipulation on HHBs to unify the concept of HHBs with sole proprietorships. It should also be noted that the Civil Code 2015 no longer refers to HHBs. HHBs are no longer eligible to be a legal party of a civil transaction according to the Civil Code. Legal documents in other sectors, such as the banking sector, are also being amended to be in line with this new development in the Civil Code.

Despite the revised Enterprise Law being silent about HHBs, existing household businesses will continue to operate normally. In particular, no measure will be taken to force the household business to convert into enterprises or to register under the revised Enterprise Law for at least 5 years after the effectiveness date of the new stipulation of the revised Enterprise Law. During this period, only large HHBs with significant labor size and turnover are required to register under the Enterprise Law to ensure the fair practice in the business environment.

Measures to encourage HHBs to re-register as an enterprise, especially in the form of sole proprietorships, will be implemented strictly on voluntary basis.

In the inception or transition period (possibly 5 years), entrepreneurs wishing to register in the form of HHB will still be able to register the business as an HHB. However, at the time of registration, he/she will be advised and encouraged to register as a sole proprietorship. He/she will also be advised that after 5 years from the effective date of the to-be-revised Enterprise Law, the regulatory framework will no longer have the definition of HHBs but only enterprises as specified under the Enterprise Law, including sole proprietorship. In considering between HHB or sole proprietorship, sole proprietorships should be a better choice.

However, the prerequisite condition and underlying principle for encouraging and recommending people to register as a sole proprietorship instead of an HHB is to ensure that the compliance cost and regulatory burden, the tax imposed on sole proprietorships will not be higher than the level at which household businesses are currently incurring. At the same time, the advantages of the sole proprietorship and those of household businesses should be combined, making sure that HHBs will only benefit from the better if they follow the sole proprietorship business form. Only if this principle is warranted, should new regulatory reforms on HHBs and sole proprietorships be introduced as suggested above. Measures to ensure that this underlying principle is observed include the following:

- In addition to reaffirming the legal nature of sole proprietorship, the Enterprise Law should add more specific provisions to the current chapter on sole proprietorships.

This is to ensure that sole proprietorships shall not be subject to the same rules and regulations applicable to other types of enterprise under the Enterprise Law in terms of accounting, reporting, and social insurance. Sole proprietorships can implement a simple accounting system that is similar as those applicable to existing business households, though with a bit higher level of transparency.

Furthermore, it is necessary to review and adjust the relevant legal documents to ensure that the compliance costs, taxes and duties applicable to sole proprietorships will be as low as currently being paid by HHB. A study by Economica Viet Nam in 2017 reveals that if a household with a size of 10 employees registers formally as an enterprise, the compliance cost that it incurs will immediately rise to at least D181.2 million per year⁴¹. Sole proprietorships are subject to the same amount of compliance costs because the Enterprise Law and prevailing regulations do not have regulations applicable separately to this type of business despite the fact that they are small in size, the legal nature and operation of this type of business is very close to the household business, and that they are markedly different from the form of limited liability or joint-stock companies. Such one-size-fit all regulations have made the compliance cost incurred by sole proprietorships to be unduly and excessively high.

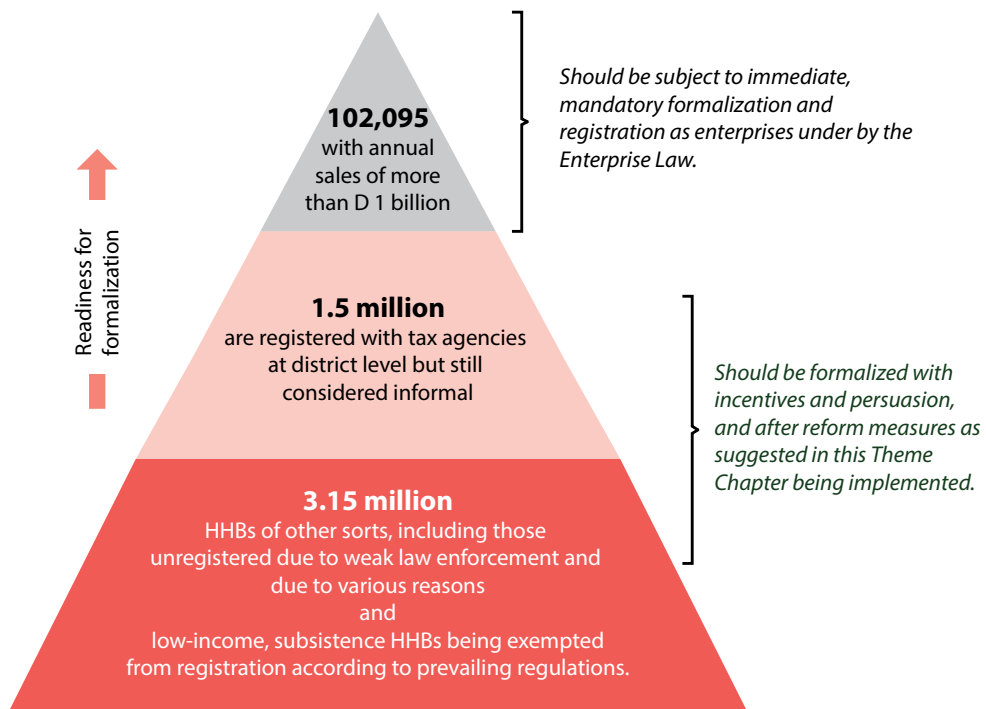
- In parallel with this process, the registration of sole proprietorships should be decentralized to the people's committee at the district level. It should be possible for sole proprietors and sole traders to register their business as sole proprietorships at 713 district level administrative units where they inhabit. The national enterprise registration information system needs to be adjusted and expanded so that registration officers responsible for business registration in 713 districts, cities, towns across the country can perform the registration of sole proprietorships.⁴² As a result, HHBs and sole proprietorships can be registered in the same place and can be handled by the same officials. It will make it easier for the local business registration officer to advise and recommend to the applicant to choose the form of sole proprietorships instead of HHBs. And if the applicant agrees, his/her sole proprietorship can be promptly registered, with procedures not so much different than those applicable to HHBs, right at the district, with the same business registration officer and without having to go all the way to the city center as they have to as now.

41 Le Duy Binh and Pham Tien Dung. Formalization of Household Businesses into Enterprises: Legal Compliance Cost Barriers. Viet Nam Legal Journal, (36)163/9 - 2017

42 Good practices in many countries and territories show that sole proprietorships and partnerships can be registered with the local governments equivalent to district level in Viet Nam or with local chambers that are nearest the entrepreneurs e.g. in the US, France (registration with local chamber), Sri Lanka. In many countries, sole proprietors will just need to notify about their existence or establishment online (e.g., in the UK).

- Procedures and papers required for registration of sole proprietorships should be as easy and simple as those currently applicable to HHBs. In fact, online registration through the National Business Registration Portal is becoming more and more popular, but decentralizing the registration of sole proprietorships to district level People's Committee is still one of the keys to ensuring the success of these proposed reforms. The decentralization is psychologically favorable for the business applicants as they do not feel the difference between registering as a sole proprietorship or an HHB. Now instead of registering an HHB, they will go to the same place, meet the same registration officer, undergo the same procedures and process, submit the same papers and get their business registered promptly and conveniently. The only difference is the business type written in their business certificate will now be *sole proprietorship* instead of household business.

Figure 47: Household Business Pyramid in Viet Nam



Source: Developed by the author on the basis of data by GSO, and General Department of Tax (2018)

- At the inception (or transition) period (possibly of 5 years), sole proprietorships will be subject to the same tax rate and tax regime (reporting, bookkeeping, etc.)

as currently applicable to HHBs.⁴³ During this time, tax regulations will be adjusted so that sole proprietorships will apply the same tax regulations, even the lumpsum tax method as applicable to HHBs as now. The revisions to tax regulations will make it easy to comply and will make the compliance costs and amount of tax payable by sole proprietorships in par with those applicable to HHB. In other countries, sole proprietors are subject to personal income tax regulations. Sole proprietors shall declare their tax obligations annually just like the procedures applicable to a normal citizen. This helps to reduce the compliance burden for sole proprietors in terms of number of tax reports, accounting papers and tax report submission frequency. These principles and practices should be considered and adopted in reforming tax regulations applicable to sole proprietorships in Viet Nam.

- Five years after the effectiveness of the proposed amendments to stipulations on sole proprietorships under the Enterprise Law, people wishing to register their business as an HHB will have the only choice of registering as sole proprietorship. Before that, regulations on accounting, bookkeeping, tax, social insurance, etc. will have been amended in a way that all sole proprietorships will be subject to low compliance costs and to reasonable tax and social security obligations as described above. This will not cause any disturbance to production and business activities of household businesses. Neither will it affect nor dampen the intention of the people who intends to set up a business as a household business. By this way, existing HHBs and people who wish to register their business as HHBs will be more willing and more supportive of the efforts in formalizing HHBs. The reason is the reformed sole proprietorship format will provide them with a convenient, low-cost, and recognized-by-law business form for starting up and doing business.
- By then, active HHBs will not be required to re-register or to convert into an enterprise (except for large HHBs and those which are highly prone to tax evasion risks as mentioned above) within this five-year period. Within this period, if HHB are re-registered, they will be encouraged and advised to register as sole proprietorship or as a business form as specified in the Enterprise Law, depending

⁴³ This leads to another question about the existing proprietorships which were already registered under the Enterprise Law so far (about 49,100 of them as of 2017) – those that already applied the full accounting and bookkeeping system and have been subject to normal tax rates and tax payment procedures. In addition, some entrepreneurs whose business is big might register their business as sole proprietorship to take advantage of this new regulation. Obviously, the upcoming regulations on sole proprietorships should provide clearly the definition, legal characteristic, criteria, and the restrictions of this type of this business. On that basis, existing proprietorships which were already registered under the Enterprise Law can be reviewed once again. They can be advised to convert into other form of business (e.g., liability limited, joint-stock). They can also stay as sole proprietorships and benefit from the new tax regulations applicable to sole proprietorships but will be well-informed about the restrictions of the form of sole proprietorship in doing business. The approach is to give the space and options for the owners and proprietors to choose.

on their needs. If they do not wish to, they can still register as HHB as usual. During this five-year period, all tax and social insurance regulations applicable to sole proprietorships will be reformed to ensure stronger transparency and to be in line with international practices. In all cases, the reforms should strictly respect and be persistent with the principle of low compliance costs, affordable tax rates and simple tax procedures applicable to sole proprietorships.

- After this five-year period, after these reforms are made and the legal framework for sole proprietorships is improved to make the registration and running of sole proprietorships easy, convenient and low-cost, HHBs which are already registered with district authorities by then will be automatically converted into sole proprietorships.⁴⁴ The conversion will not require HHB owners to come to the district authorities to re-register. It will be automatically executed on the database of business registries (based on the merger of the existing business registration database with the HHB database). HHB business registration certificate will be renamed as sole proprietorship business registration certificate. HHBs will start implementing new regulations that will have been developed and formulated for sole proprietorship. Such new regulations will strictly observe the principle of minimal compliance costs, affordable tax obligations, thus will not cause any disruption or disturbance to the normal business of HHB.
- Information and awareness raising campaigns will be implemented to promote for the business form of *reformed sole proprietorship* and keep the public informed on the advantages of this enterprise form. Sole proprietorships will be communicated and promoted as a convenient, low-cost and formally recognized business form and is a good substitute for HHBs. These information and awareness raising campaigns should be honest and be backed by real regulatory reforms to be implemented to ensure the real advantages of sole proprietorships as described above. In addition, the restrictions inherent to the form of sole proprietorship as compared with other types should also be communicated so the entrepreneurs and business people will be well-informed in choosing and making decision on the business form which are most suitable to their business.

These proposed reforms will not affect the current operation of the HHB sector. They help avoid the coercive measures by the local authorities to force HHBs to be formalized—a

⁴⁴ According to prevailing regulations, subsistence HHBs, low-income HHBs or HHB which are being run out of necessity, those which at the very low base of the HHB pyramid, are not required to register. In case this proposed automatic conversion is accepted, such automatic conversion will not be applicable to HHBs of these sorts. These HHBs will continued to be exempted from the legal requirement to register. Therefore, this raises the need for a comprehensive database on HHBs in Viet Nam, including those registered and unregistered. Such a comprehensive database will be especially helpful for the government in the formulation of appropriate policies and regulations and in developing support measures which are most relevant to different types of HHBs.

move which so far has not been welcomed by the business sector and multiple stakeholders due to the sudden rise in compliance costs, tax, and legal requirements involved with such formalization. The reform measures as proposed will give the freedom for the HHB to choose and to make their own decision on whether or not to move to new corporate forms in which they have more space and opportunity to grow. The formalization of HHB will be implemented on a voluntary basis, in full respect of the right and the freedom of choice of HHB owners while contributing to the objective of improving the formality of the economy. Such measures are also in line with international practices.

These proposed reforms are in line with the new developments in the Civil Code. Regulations and laws related to banking, capital, taxes which are all being gradually adjusted and revised to reflect better the legal nature of household businesses and to be in line with the Civil Code. In particular, the definitions on types and forms of enterprises and the approach toward enterprise management, business registration will become clearer and more coherent. The advantages of sole proprietorship as a business form will be put into full play, thus creating more favorable conditions for entrepreneurship in Viet Nam to be further unleashed. This will contribute to the goal of one million active enterprises in Viet Nam in the next few years as articulated by the Resolution No. 10-NQ / TW issued in 2016 of the 5th plenum of the XIIth Party Committee on private economic sector. In particular, these reforms will play an important role in narrowing the informal sector of the economy, improving formality and enhancing the efficiency and productivity of the private sector.

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