

Dissertation Thesis Summary

The Development of Small and Medium Enterprises in Vietnam

submitted by

Trinh Quang Long

National Graduate Institute for Policy Studies

It is indisputable that the small and medium enterprise (SME) sector plays an important role in many countries, especially in developing economies where small-scale production is still dominant (Tybout, 2000). This sector generates a large number of jobs and income in many countries (Nichter and Goldmark, 2009). Mead and Liedhom (1998), for example, found that the SME sector generates nearly twice as many jobs as large private firms and the public sector combined. In many Latin American and Asian countries, micro and small enterprises employ over half the working population. ILO (2003) finds that firms with fewer than 10 workers created jobs for 58% of the total employment in Paraguay, 54% in Mexico, and 53% in Bolivia. The contribution of the SME sector to GDP varies considerably across countries. It is for example, 31% in the Dominican Republic, but it is as low as 11% in Pakistan and 13% in Kenya (Nichter and Goldmark, 2009). In any case, it should be noted that these figures do not fully capture the contribution of this sector to a country's GDP due to the widespread existence of informal firms (Gamsler, 2003).

Vietnam has achieved remarkable economic growth and stability, foreign trade and investment expansion, poverty reduction, and human resource development since she started her economic reform in 1986. Such successes have been largely attributed to the development of the private sector, which in turn is dominated by a large number of SMEs, including numerous household business entities (e.g., Rand et al., 2008). The SME sector has contributed 39% of the gross domestic product (GDP) and 32% of the total investment outlays in 2006 in this country. SMEs have also played an important role in creating jobs, maintaining the high mobility of the

labor market, and narrowing the development gaps among the localities of the country. By 2005, 97% of the regular employees worked in the SME sector. Of all the registered capital, this sector accounts for 87% (Rand et al., 2008). However, there are a number of obstacles that SMEs in Vietnam face. While these constraints have been documented (e.g., CIEM, 2013; CIEM, DoE and ILLSA, 2014), the causes behind them remain open questions despite the SME sector's potential to be the agent of economic growth and job creation.

This dissertation attempts to address two issues that have hindered the development of the SME sector in Vietnam. The first is related to management capacity, while the second is related to the causes of low and infrequent capital investment.

While the important roles of management in determining firm performance have long been studied in other disciplines, it is new in economics. In their seminal paper, Bloom and van Reenen (2007) develop a measure of management practices and present evidence that the measure is closely correlated with those indicators of firm performance with which economists are familiar, such as productivity, growth, and survival by using firm-level data from Europe and the US. Bloom and Van Reenen (2010) and Bloom et al. (2012) apply the measure to firms in some emerging market economies and transition economies and find a highly significant correlation with total factor productivity. McKenzie and Woodruff (2015) develop a similar measure suitable for firms in developing countries and also find a positive correlation between business practices and firm performance.

It seems to be useful to extend these studies in two directions. First, since the results of these studies are based on cross-section data, the analysis of panel data will help us understand the relationship between management practices and business performance better. A difficulty in doing such an analysis is that panel data sets that contain information on management practices are scarce since the measurement of management practices is relatively new in the economics literature. Second, the analysis of data from different countries will bring us a better understanding of the importance of management practices as a determinant of firm performance

relative to governance, market-supporting institutions, and the degrees of infrastructure and educational development, among other factors.

Chapter 3 of this dissertation attempts to improve the analysis by using rich panel data collected from both small and relatively large firms bi-annually from 2005 to 2013 in Vietnam. The use of panel data is expected to mitigate the estimation bias problem arising from the correlation between the unobserved heterogeneity of firms and the adoption of good management practices.

The empirical analysis in this chapter show that the adoption of good business practices results in improvement in firm performance. On average, five (out of seven) business indicators have positive associations with firm productivity. In addition, most of selected business indicators are positively correlated with firm employment. I, however, find a heterogeneity in the associations between each business practice indicator and firm productivity and employment by firm type. The analysis also shows that each business practice indicator is associated with different performance indicators of different type of firms in a very different pattern.

The estimation results also indicate that the measured business practice score has a positive and statistically significant impact on productivity, productivity growth, employment and employment growth. These results complement empirical results in McKenzie and Woodruff (2015). I further estimate separately two groups of firms. The first group consists of household businesses and private business entities (so-called sole proprietorship firms), while the second group includes cooperative, limited company and joint stock companies (so-called incorporated firms). The empirical evidence shows a stronger effect of the business practice score on the performance of sole proprietorship firms. With regards to factors that explain why some adopt better business practices while some others do not, the results suggest that firms having more employees with a university or college degree and firms having low market power, measured by the price-cost margins, tend to have a higher business practice score. This is in line with the theoretical predictions of Van Reenen (2011) and the empirical results of Bloom et al. (2012).

Chapter 3 extends the literature in several aspects. First, this chapter is related to a large number of existing studies that examine the major sources of productivity differences (see Syverson, 2011). I examine how adopting business practices differs in informal and formal firms and whether the differences in the business practices adopted affect firm performance. While most of the current studies use data collected in developed economies, this chapter uses data from a lower-middle income country. Second, this chapter is also related to the growing literature on the impact of business training on firm performance. In recent years, a growing number of randomized experiments have been conducted in developing countries. Such experiments have shown that business training has a positive effect on performance, although the effects are rather weak due to a number of problems relating to the experiment design, implementation, and evaluation time frame. This chapter complements those studies by using a routinely collected dataset instead of using data collected in the framework of randomized experiments. It also supplements the current literature by examining the heterogeneity in the relationship among different business practice indicators and different firm performance indicators. Third, this chapter also attempts to explain why some firms adopt good business practices while some others do not. Such attempts are still few. Except for Bloom and Van Reenen (2007), Bloom et al. (2012) and McKenzie and Woodruff (2015), other studies using data from developing countries are from randomized experiments, so it is rather difficult to explicitly examine this question. Using fixed effects estimators also helps to mitigate the endogeneity bias when using cross-sectional data, as in McKenzie and Woodruff (2015).

Chapter 4 examines the effects of macroeconomic uncertainty on investment behavior among SMEs in Vietnam. Recently, there has been a renewed interest in the analysis of the impact of uncertainty on firm-level investment in developing countries (e.g., Pattillo 1998; Bigsten et al. 2005; Bo and Zhang; 2002; Le et al. 2004; Demir 2009a, 2009b; Leefmans 2011; Kandilov and Leblebicioglu 2011; Bianco et al. 2013). While theoretical models offer different views on the role of macroeconomic uncertainty on firm investment (e.g., Dixit and Pindyck, 1994; Abel and Eberly, 1996; Bernanke 1983; Oi, 1961; Hartman, 1972; and Abel 1983), most empirical studies find

only a negative relationship between macroeconomic uncertainty and firm investment (e.g., Bond and Meghir, 1994; Leahy and Whited, 1996; Guiso and Parigi 1999; Ghosal and Loungani, 1996; Bulan, 2005, Shaanan, 2005; Bloom, Bond and Van Reenen 2007; Baum et al., 2010). Moreover, such studies have examined the uncertainty-investment relationship in the context of developed economies. Empirical evidence on the relationship between macroeconomic uncertainty and firm investment in developing economies, especially that of SMEs, is relatively scarce, although firms in developing countries are faced with high and diverse uncertainty (Bloom, 2014).

Using the firm-level panel data of SME firms in Vietnam collected bi-annually from 2005 to 2013, a period considered as the most uncertain after Vietnam's market reform started in 1986 (CIEM, 2013), chapter 4 shows that macroeconomic uncertainty has a negative and statistically significant effect on the productive investment rate while it has a positive and statistically significant effect on the non-productive investment rate. The results also suggest that the negative effect of macroeconomic uncertainty on productive investment is smaller among firms that have no contacts in the banking sector, are able to access to bank loans and to finance most of their investment by bank credits than those firms that either have at least a contact in the banking sector, are more likely to access to bank loans or can finance most of their investments by bank loans. It also shows that an increase in macroeconomic uncertainty has a higher correlation with the increase in the non-productive investment rate, which is more reversible than a productive investment, among firms that have at least a contact in the banking sector or have access to bank credit or are able to finance most of their investments by bank loans. I also find that there is a heterogeneous effect of macroeconomic uncertainty by the firm's ownership type, but such an effect is rather small.

Chapter 4 contributes to the literature in several ways. First, this examines how financial condition affects firm's investment behavior. Instead of using either a traditional approach (i.e. the cash-flow sensitivities) or direct elicitation, to separate firms into credit constrained and credit unconstrained group, I, however, divide firms based on several indicators that reflect firm's advantage in access to bank loans, firm's access to bank loans and the role of bank loans in

financing their investment. Secondly, this chapter extends the literature by examining the effects of macroeconomic uncertainty on small- and medium-sized firms' investments under different conditions in regard to their financial source of funding for investment. As mentioned earlier, most of the current empirical studies on investment using developing countries' data look at these issues separately, mostly due to data limitations. The 10-year data span allows me to investigate the heterogeneity effects. Thirdly, this chapter is also related to the literature on the non-productive investment behavior of firms in the real sector in a developing country. While Demir (2009a, b) focuses on listed firms in Turkey and Argentina which are in their later stages of becoming developed economies, I focus on small- and medium sized firms in a developing economy in their early stages of industrialization. Moreover, to my knowledge, this study is among the few that explore the choice between productive and non-productive investment in small- and medium sized firms.

This dissertation consists of five chapters. Chapter 1 presents the background, major findings and contributions of the study. Chapter 2 reviews the literature related to the relationship between business practices and firm growth and the effects of macroeconomic uncertainty and credit constraints on firm investment. Chapter 2 also discusses the features of the data set used in my study and some descriptive statistics from the sample. Chapter 3 investigates the effects of the adoption of good business practices on micro and small firms' performance in Vietnam. Chapter 4 analyzes the impacts of macroeconomic uncertainty and credit constraints on firm investment. Finally, chapter 5 concludes the dissertation and discusses implications for future research and policy debates.