

**STUDY
ON
THE PROMOTION OF SMALL AND MEDIUM SCALE
INDUSTRIAL ENTERPRISES
IN
THE SOCIALIST REPUBLIC OF VIETNAM**

GENERAL SUMMARY REPORT

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Glossary of Names for Organizations.

(New organizations/units proposed in this study)

CTS: Center for Technical Support

(technical support center to provide technical assistance for SMEs to be established under the umbrella of SMESCs)

CPSIT: Center for Promotion of SI Transaction

(information support center for promoting SI transactions)

DOSMEP: Department of SME Promotion

(SME promotion department at local people's committee)

OSAD : One- Stop Advisory Desk

(SME service desk prepared at local people's committee, industrial organizations or other appropriate place to provide necessary information to SMEs)

SMEFC: SME Finance Corporation

(financial institution for SME policy finance)

SMEPA: Small & Medium Enterprises Promotion Agency

(SME promotion organization to be developed at central government)

SMESC: Small & Medium Enterprises Support Center

(regional function center to support SME to be established in core of a region)

(Abbreviations for existing organizations)

HEPZA: HCMC Export Processing & Industrial Zone Authority

MARD: Ministry of Agriculture and Rural Development

MOET: Ministry of Education and Training

MOF: Ministry of Finance

MOI: Ministry of Industry

MOLISA: Ministry of Labor, War Invalids and Social Affairs

MOSTE: Ministry of Science, Technology and Environment

MPI: Ministry of Planning and Investment

NEDCEN: Non-state Economy Development Center

SBV: State Bank of Vietnam

UAIC: Union Association of Industry and Commerce

VCCI: Vietnam Chamber of Commerce and Industry

VICOOPSME: Central Council for Cooperative Alliances and Small and Medium
Enterprises in Vietnam

VIETRADE: Vietnam Trade Promotion Commission

VIZA: Vietnam Industrial Zone Authority

(special terms frequently used in the report)

Supporting Industry: SI

Industries which provide major manufacturing enterprises with material processing or formation services such as pressing, metal mold manufacture and heat treatment, or component supply function. SI constitutes the basis of the integration of manufacturing industries which requires multi-steps of processing and assembly work.

Venture Capital

Venture capital is an establishment for investing into the venture business by equity investment or by purchasing a quasi-equity debt instrument issued during the period of initial start-up of either the investee's enterprise as a whole or a distinctive part of its business when the young business is in dire need of capital. The purpose of such investment is placed in the promotion of the venture business and subsequent capital gain for the venture capital. Venture business is defined as an enterprise established and managed with innovative and/or creative ideas and technologies by an entrepreneur of aggressive aspiration and spirits in taking risks for business success.

1. OBJECTIVE AND SCOPE OF STUDY

1. Objective and Scope of Study

1.1 Objective of Study

The objective of this study is to prepare plans and policies to promote SMEs (Small and Medium Enterprises), mainly focusing on the manufacturing sector and taking into account the SOEs (State Owned Enterprises) thought likely to be reformed.

In concrete terms, this covers:

- (1) Provision of a basic framework for policy and measures to promote SMEs.
- (2) Devising policies and measures to promote SMEs with focus on the manufacturing sector.
- (3) Devising SME promotion for main industrial sectors.

The background reasons for focusing the spotlight on the manufacturing sector in this study can be found in the situation of Viet Nam's economy and industry as indicated below.

- 1) In view of their real potential, the SMEs in manufacturing industries, mainly the private sector in Viet Nam, are not performing an adequate role in either qualitative or quantitative terms.
- 2) A major factor for the inadequate role performed by SMEs is that systematic policy formulation and implementation promoting SMEs have not yet been put in place.
- 3) The promotion and strengthening of Viet Nam's manufacturing sector will enhance its export competitiveness, which in turn is expected to have a vitalizing impact on the economy. In addition, this sector will play a major role in the development of domestic and overseas markets, and it is also expected to contribute to an expansion of the economy and employment. However, at this time there are not enough SMEs able to support the industrial foundations of the country.

Taking these factors into consideration, the scope of this study was decided through discussion with Viet Nam's Ministry of Planning and Investment (MPI).

1.2 Scope of Study

The main target of the promotion measures developed in this study is focused on the SME segment within the manufacturing industry. In Viet Nam, SMEs in the manufacturing industry are underdeveloped both qualitatively and also in terms of the industrial structure, and consequently lack international competitiveness. Moreover, they will increasingly have to cope with trends in the international business climate. However, when studying the legal framework, financial system and training of human resources, consideration was also given to the application of these measures to the general SME sector including non-manufacturing areas. Moreover, the field survey has mainly focused on the SME groups in major cities such as Hanoi and Ho Chi Minh City. Naturally, it is very important to achieve broad-based development of the SMEs nationwide and to achieve stable, well-balanced development in order to advance the level of industry within the nation's economy. As the study team and MPI are both fully aware of these requirements, consideration was given to the need to establish this base in our formulation of measures.

The individual industries covered by the promotion measures and promotion plans are as follows: machinery & parts industry, electric & electronic industry, and the garment industry. Regarding other priority sectors (food processing, wood processing & handcraft, ceramic, and plastic industries), these were limited to identifying their needs for policy measures. The scheduled period for the plan to be in operation is as follows: short-term up to 2005 with the inclusion of current-term up to 2002, medium-term from 2006 to 2010 and long-term to 2020.

In the formulation of promotion policy measures, the target of our study was SMEs in the manufacturing sector willing to make a real effort to take risks to achieve growth. This means, enterprises willing to take up the challenge of expanding sales of their existing products, in both export and domestic markets, creating new markets and products, and being willing to make the requisite efforts to achieve these aims. In addition, consideration was given to the support of entrepreneurs willing to start up new businesses with the foregoing commitments.

2. PRESENT STATUS OF SMALL AND MEDIUM ENTERPRISES (SMEs) AND DIRECTIONS OF RELATED MEASURES

2. Present Status of Small and Medium Enterprises(SMEs) and Directions of Related Measures

2.1 Present Status of the Small and Medium Enterprises (SMEs)

There are various definitions of small and medium enterprises (SMEs) in the world, due to the unique development situations or directions of industrial and economic policies of each country. The Vietnamese government in June 1998 tentatively defined SMEs by No.681/CP-KTN; that is, a corporation that has capital of less than 5 billion dong or has less than 200 employees. This includes small and medium private enterprises, SOEs and cooperatives. As observed in the following two tables, by using this definition, 91.3% of the enterprises categorized by capital and 74.2% of the enterprises categorized by the number of employees fall into the small and medium enterprise category. From this we can see that almost all of the enterprises operating in Viet Nam, excluding SOEs, belong to the small and medium enterprises category.

Table2- 1 Number of Enterprises by Capital Amount (1995)

Mode of enterprises	Total	Less than 5 billion D	Less than 10 billion D	Less than 20 billion D	Less than 30 billion D	Over 30 billion D
SOE	5,873	4,376	691	421	141	253
Foreign enterprise (including JV)	692	353	104	96	42	97
Private enterprise	10,916	10,882	26	4	1	3
Joint stock	118	90	12	9	4	3
Limited liability	4,242	4,123	72	26	10	11
Cooperative	1,867	1,827	22	12	3	3
Household enterprise	1,879,402	1,879,402	-	-	-	-

Source: Industrial Department, MPI , 1999

Table2- 2 Number of Enterprises by Employees (1995)

Mode	Total	Less than 100	100-199	200-499	500 and over
SOE	5,873	4,087	190	263	1,333
Foreign enterprise (including JV)	692	406	15	33	238
Private enterprise	10,916	8,120	165	351	2,280
Joint stock	118	92	3	3	20
Limited liability	4,,242	3,276	105	142	719
Cooperative	1,867	1,096	38	97	636
Household enterprise	1,879,402	1,879,402	-	-	-

Source: Industrial Department, MPI , 1999

Statistics used in the following discussion are based on government statistics, derived from the first comprehensive investigation carried out GSO in 1995, and estimated by Industrial Department of MPI. No subsequent investigation of the same scale has been implemented since.

According to the GSO investigation, the number of manufacturing enterprises was estimated as 8,577. Of this number 7,373 were classified as SMEs and they were 2,000 in the SOEs category. Further there were 1,500 cooperatives and 5,000 private enterprises. From these figures, the ratio of SMEs, having less than 5 billion VND in capital, to the total number of manufacturing enterprises is estimated at 86% and at over than 90% when considering employee size.

As for the situation since 1995, the General Statistical Office (GSO) estimated that private enterprises in the manufacturing sector (not including cooperatives) numbered 5,620 in 1998, as shown in Table 2-3. Of this total, the ratio of enterprise having less than 100 employees is 93%. There is no data available for enterprises having employees of less than 200, but it would be safe to assume that this would bring the ratio to over 95% of the total of 5,620 enterprises. Except for garment and footwear industries, SMEs account for high share of enterprises in private sector.

No formal estimates of the contribution SMEs to GDP have been released. However, MPI estimates that SMEs compose a 24% share of GDP. However, this figure includes the contribution of SOEs. From another investigation by the GSO, the contribution to the GDP by private enterprises in the manufacturing industry was estimated to be very low, at about 2 percent. Even with the inclusion of household businesses sector that are not registered companies, it is thought to be only about 5 percent. There is exceedingly great potential for

expanded SME activity in the manufacturing industry with the progress of registration of such businesses, the advancement of existing private enterprises, and the rationalization of existing SOEs.

Table2- 3 Private Manufacturers by Size across Selected Industries 1998 (est.)

	Less than 100 workers	100 to 299 workers	300 to 499 workers	500 or more workers	Total
Total Firms	5,155	299	72	94	5,620
Food & Beverage	3,026	48	10	21	3,105
Garment	88	85	24	23	220
Leather	14	13	7	31	65
Wood	371	25	5	6	407
Non-metallic	627	26	3	1	657
Others	1,029	102	23	12	1,166

Source : General Statistical Office (1999)

Table2- 4 Share of GDP by Economic Sector, 1995-1998

	1995	1996	1997	1998(est.)
GDP*(in billions of VND)	228,893	272,035	313,624	368,692
Total	100.0%	100.0%	100.0%	100.0%
Services	44.1%	42.5%	42.2%	41.3%
Industry and Construction	28.8%	29.7%	32.1%	32.7%
Agriculture, Forestry and Fisheries	27.1%	27.8%	25.8%	26.0%

Source : General Statistical Office (1999); *GDP based on current prices; in 1998, 11,745VND=US\$1(Source: Economist Intelligence Unit)

Table2- 5 Share of Manufacturing GDP by Enterprise Sector, 1995-1998

	1995	1996	1997	1998(est.)
Manufacturing GDP* (in billions of VND)	34,329	41,301	51,710	63,677
Total	100.0%	100.0%	100.0%	100.0%
State Sector	56.5%	53.3%	51.7%	50.4%
Foreign-Invested Sector	11.4%	13.7%	18.5%	22.4%
Households and Farmers	19.9%	20.5%	18.9%	17.5%
Formal Private Sector	10.7%	11.1%	10.0%	9.0%
Cooperativ Sector	1.5%	1.4%	0.8%	0.7%

Source : General Statistical Office (1999); *GDP based on current prices

2.2 Directions of Enterprise Reformation

By taking advantage of the doi moi policy, various measures promoting private enterprise have been implemented. Through reviewing these activities, the present status and problems related to these enterprises, especially the SMEs are discussed below.

Firstly, since 1987, a self-supporting accounting system for the SOEs has been introduced and government subsidies to the SOEs have been removed. However, various supports are still in place. For instance, when SOEs experience a loss, the government or national banks has supplied financial support. In this sense, government subsidies are still continued implicitly. This may create a situation of moral hazard, in that there is less incentive for the SOE's management to correct the loss-generating behavior.

Secondly, the government embarked on the promotion of private enterprises in the early 1990s, albeit without any particular provisions for official financial assistance. Because of this promotion, the estimated number of private enterprises has increased from 6,808 in 1993 to 26,021 in 1998. However, the benefits, which the SOEs continue to receive, are still larger than that of the private enterprises. This point will be discussed in a later section.

Thirdly, in 1994, reformations of the SOEs were implemented to improve competitiveness. However, the reformations have resulted in producing cross subsidies, because the enterprises, receiving benefits from this system, have combined several poor performing SOEs with ineffective business foundations into one poor performing SOE.

As a result reforming the state enterprise sector is preceding, but a more active approach to the promoting of private enterprises must be implemented. The implementation of this more active approach has taken on some urgency. The reason for this can be summarized in the following two points.

First: after 2005, Vietnamese industries will be subject to drastic changes related international economic behaviors. In particular, (1) the export quota system, which is presently monopolized by the SOEs, is scheduled to be removed on January 1st, 2005, under the WTO textile agreement. (2) Viet Nam must abolish non-tariff trade barriers and must reduce import tariffs to 5% or less in compliance with AFTA regulations by January 1st, 2006. Consequently, the import substitution industry, which mainly consists of SOEs protected by government, will have big impacts. (3) When Viet Nam become a member of the WTO, Viet Nam will face the obligation of implementing full compliance with WTO guidance by around 2010 or so. Thus, the Vietnamese government will be required to give the same business opportunities to foreign affiliated enterprises operating in Viet Nam that Viet Nam's domestic enterprises currently receive. Further, benefits, which the domestic enterprises have monopoly access to at present,

will have to be abandoned at the time. Also, when Viet Nam makes a trade treaty with the USA in 1999, the U.S. government will demand the removal of such protections in return for their investment to Viet Nam. Reforming of the SOEs, currently under the tender protections of the government, is urgently required in order to cope with these changes.

Secondly, there has been a remarkable increase in the number of non-SOEs in the manufacturing industry, and particularly in the private sector (see Table 2-6). However, according to an investigation, this increase has not always been in an upward direction, especially when examining the comparison of the state versus non-state enterprise during 1986 to 1996.

Table2- 6 Number of SOEs and non-SOEs

	1998	1990	1992	1994	1996
SOE	3,111	2,762	2,268	2,062	1,958
Controlled by central Gov.	681	589	537	588	549
Controlled by local Gov.	2,430	2,173	1,731	1,474	1,409
Non-SOE	350,909	390,756	374,837	499,603	612,977
Cooperatives	32,034	13,086	5,723	1,648	N/A
Private enterprises	318	770	1,114	4,909	N/A
Household Enterprises	318,557	376,900	368,000	493,046	N/A

Source: Enterprise Reform Project, 1998 (Mallon R funded by ADB)

Table2- 7 Composition of Production Value between SOEs and non-SOEs (%)

SOE	1996	1998	1990	1992	1994	1996
Controlled by central Gov.	56.3	56.5	67.6	70.5	72.4	68.0
Controlled by local Gov.	33.8	32.2	46.0	50.5	52.2	45.2
Non-SOE	22.5	24.3	21.7	20.0	20.1	22.8
Cooperatives	43.7	43.5	32.4	29.5	27.6	32.0
Private enterprises	28.1	23.9	9.1	2.8	1.1	0.8
Household Enterprises	15.6	19.6	23.2	26.6	26.5	31.2
	100.0	100.0	100.0	100.0	100.0	100.0

Source: Enterprise Reform Project, 1998 (Mallon R funded by ADB)

Also, the investigation by the JICA Study Team, on the sales amounts per employee of

the garment industry in Ho Chi Minh City, indicates that the sales amount by the SOEs segment is higher than that of the non-SOEs segment. In addition, the most recent growth rate of value added by private enterprises is lower than average growth rate of GDP.

Table2- 8 Sales Value per Employee of Garment Industry in HCMC

	SOE (16 enterprises)	Private enterprises (140 enterprises)
Total sales	1,220,615 million D	722,924 million D
Total number Of employees	29,906	32,456
Sales value per employee	40.82 million D	22.27 million D

Source: Statistics Bureau of HCMC

Table2- 9 GDP Growth Rate by Industry

	1995	1996	1997	1998 (estimated)
Nation	9.0%	9.3%	8.2%	5.8%
SOE	9.4%	11.3%	9.7%	5.7%
Non-SOE	4.2%	10.6%	6.2%	5.3%

Note: Cooperatives are excluded from Non-SOE.

Source: General Statistics Office (1999)

Aside from the position of SMEs in terms of the number of enterprises and scale of industry, advancement is also required in terms of the industrial structure toward higher division of labor and closer business relationship. In Viet Nam, SOEs generally engage in an inefficient total production even if they are of relatively small size. Even firms engaged in single processes such as casting or forging usually have few ties with other firms, and their production is held to an inefficient scale. Meanwhile, privately owned SMEs typically develop their business independently and have not built relationships with foreign capital or SOEs. As such, an organically interlinked industrial structure has not taken shape.

If private enterprises are left under inferior or discriminatory conditions and the industry as a whole continues to lack an organically interlinked structure as described above, private enterprises will be unable to carry the Vietnamese economy into 2005 and beyond, when the drastic changes are to occur in the international environment. Therefore, promoting private enterprises now is an urgent subject.

2.3 Directions of SME Promotion Policies

In Viet Nam, government policies on privatization of the enterprises only appeared after 1996. The orientation of policy on SMEs promotion was explicitly set forth beginning in 1998. For instance, when our study team members visited Viet Nam in 1996 to 1997 and made a proposal for SMEs promotions, as a part of the market economy development and support program promoted by JICA, the privatization in Viet Nam was just in the starting stage. As such, MPI was supporting privatization issues from the private enterprise standpoints and MOI was supporting privatization issues from industry standpoints. Since 1998, the government has proceeded with private enterprises policies for the purpose of export competitiveness, employment creation, management effectiveness etc. Also in this period, support has been given to Viet Nam from international organizations such as UNIDO, IFC, ADB, etc.

First: Since 1998, support centers have been established at VCCI, VICOOPSPSME, and MOLISA (Ministry of Labor, War Invalids and Social Affairs). In addition, industrial associations have been established. These associations have contributed to opening up communication channels between the Government and private enterprises. These associations have also formed a base to link the SOEs and the SMEs together.

Second: In 1998, expansions of the right of trading, simplifications of registration for new business foundations, and a bidding system for part of the export quota have been introduced.

Third: In 1998, a provisional definition for SMEs has been decided. As noted, the government has adopted the provisional definition by No.631/CP-KTN, that is a corporation with less than 5 billion Don in capital or less than 200 employees. This definition includes small and medium sized private and state enterprises or cooperatives. According to this definition, 50% of SOEs, 75% of local government enterprises, and 90% of private enterprises fall within the SME category.

Fourth: Vietnamese government is eliminating the discrimination that exists between state and private enterprises, or between large enterprises and SMEs, and is thereby, equalizing the competitive conditions among these groups. Also, as part of institutional changes, the government is now planing to introduce a credit guarantee system and to establish a governmental organization for the promotion of SMEs. The government is aiming for an early implementation of these measures. This line is clearly presented in the Private Sector Promotion Program (PSPP) announced by the government in September 1999

Basically, Viet Nam has been lagging behind China in the promotion of private enterprises, especially in terms of consistency in the policy. For instance, in China, removal of people's commune and the promotion of township and village enterprises were started in the

1980s. They implemented many measures in rapid succession, such as the removal of concessions given to the SOEs or breaking up of state enterprises that were financially in a loss. On the contrary, in Viet Nam, (1) although the importance of the privatization of the SOEs was often emphasized, no plans for the privatization of the General Corporations or large SOEs have been implemented. Only small SOEs were targeted. (2) Bribery demanded by officials to the enterprises is expanding, while the government direct enforcing of anti-corruption disciplines has not.

The various activities in the course outlined above clearly manifest the government's commitment to SME promotion. In short, it is attempting to raise the level of the economic sector, which has been comparatively backward, and make the transition to a new stage, i.e., a multi-sector economy embodying a higher degree of fullness. In this context, much is expected of the role to be played by SMEs in a diversity of aspects. In society as a whole, there is a rising awareness of and sense of anticipation about SMEs. At the same time, some arrangements have begun to be made as regards the setup of concerned agencies and the legislative foundation for promotion of SMEs. The time is consequently ripening for the formulation and execution of major concrete measures to this end.

**3. MANAGEMENT ENVIRONMENT OF SMEs
AND POLICY OBJECTIVES FOR SME
PROMOTION**

3. Management Environment of SMEs and Policy Objectives for SME Promotion

3.1 Problems and Management Reforms of SMEs

The study team members have visited approximately 150 enterprises including 45 SMEs in Hanoi, Ho Chi Minh City and their suburbs. These were selected by MPI. The team assessed each enterprise current status, needs for management, future development directions, and associated problems. Through the study, the current situations of SMEs and their major problems are summarized in Table 3-1. Today, the SMEs in Viet Nam have many problems. Most of the problems confronted by SMEs are due to insufficient management capabilities and lack of the technical skills that are essential for the enterprises. This situation has been exacerbated by an industrial and social policy that gives precedence to the state enterprises and cooperatives and accords unequal treatment to private enterprises. In addition, there are many problems that SMEs would be unable to resolve by their own efforts, such as the shrinking and slumping of markets in the wake of the Asian economic crisis. In this study, the following were cited by many SMEs as problems: (1) insufficient funds, (2) lack of market and technology information, (3) business environment differences between the SOEs and non-SOEs, (4) frequent changes of government policies, (5) shortage of human resources, and (6) difficult access to land.

The Nomura Research Institute, the representing organization of the joint venture to conduct this study, carried out a survey through visits to 20 enterprises and sent questionnaires to 251 enterprises in Hanoi and Ho Chi Minh City, in order to determine the problems of the SMEs. These activities were a part of a study, conducted in 1997 titled "Study on Economic Development Policy in the Transition toward a Market-Oriented Economy in Viet Nam." The management environment of SMEs has not changed greatly since 1997, excluding the effects of the Asian economic crisis in certain areas. But what impressed the Study Team member this time, compared to 1997, is that business managers speak their mind more openly and include criticism of the government. This change suggested that a base for communication between industrial associations or private enterprises and the government is beginning to form. This also indicates an improvement of circumstances for the execution of measures of SME promotion, one of the key factors in which is an approach "from the bottom up," i.e., based in actual needs in management.

As shown in Table3-1, SMEs in Viet Nam are confronted with a host of problems and issues. Many of them can only be resolved in due time along with the progress of persevering

programs of education and training, systemic reform, incremental improvement of infrastructure under the market economy, and the development of the country's industry per se. Nevertheless, it must also be observed that acquisition of the energy needed for the initial phase of SME promotion may be made more difficult because the combined action of these problems could work against effort to induce a full exercise of capabilities by businesspersons, executives, and entrepreneurs. This issue is heavily bound up with those of a level playing field (LPF) and administrative reform taken up in the next section. A symptomatic indication of it is the sparsity of ties of trust between executives (and especially those of SMEs) on the one hand and the administrative authorities and financial institutions on the other. SME managers typically complain about interference by authorities and the wasteful expenditures of time and other resources in dealing with them. Some have deliberately held the scale of their business down in order to curtail such trouble. Interviewees frequently emphasized the increased complications and lower profit accompanying a larger scale. Even a newspaper issued by a well-known and semi-public industrial organization in Viet Nam has difficulties in obtaining executives' approval in reporting of their own success stories. This fact reveals the complex state of relationships between the government and the society. And, such a phenomenon may be proof that the present market economy system in Viet Nam is not yet mature enough to attract many participants including enterprise founders.

The needs for policy measures submitted from the enterprises are summarized in Industrial Report.

In addition to this study, there is some research on the actual status of business in Viet Nam. One recent report by MPDF focused on private enterprises in the manufacturing industry that were relatively large enterprises having 100 employees or more, and selected from among the SME category of the manufacturing industry. The report points out the followings as business management problems: (share of respondents citing each of following issues as a management problem)

Lack of capital funds	53%
Lack of information	41%
Insufficient cash flow	39%
Economic crisis in East Asia	19%
Unsteady policy of the government	16%

Table3- 1 Problems of the SMEs in Vietnamese Manufacturing Industries

(private enterprises focused)

<ul style="list-style-type: none"> • Funds raising 	<ul style="list-style-type: none"> • The majority can not get long-term funds • No collateral for fund raising, or too low value • Inability of preparing business plan for funds raising • Lack of trust in financial organizations • Dependency for financial sources on relatives and friends
<ul style="list-style-type: none"> • Acquisition of Land 	<ul style="list-style-type: none"> • Slow development of industrial parks for SMEs in Hanoi • Preventing expansion of plant sites as well as limited funds raising • No firm business plan due to uncertainty for the future land loan from state enterprises • Environmental problems arising due to zone mix of residence and industry in Hanoi and Ho Chi Minh City.
<ul style="list-style-type: none"> • Taxation System 	<ul style="list-style-type: none"> • Disorder caused by implementing VAT system • Delay of VAT taxation and refund process relating to export goods made from imported materials • Variance of custom duties depending on individual custom staff • Discriminate assessment of value and tariff • Complicated taxation system
<ul style="list-style-type: none"> • Technology 	<ul style="list-style-type: none"> • Low quality and low productivity due to old machinery imported from the Soviet Union and Eastern Europe (2-3 generation older) • Non availability of the latest information of products, manufacturing technologies, and materials • No skilled staffs to bring in latest machinery from abroad • Poor knowledge of production control and quality control. Dependent on manager's sixth sense • No business relations with large enterprises nor foreign affiliated enterprises to get continual technical support • Insufficient funds and technical supports for improvement to respond to severe business environmental changes • Difficult to import new technologies, from cost and system standpoints
<ul style="list-style-type: none"> • Export & Marketing 	<ul style="list-style-type: none"> • No information of overseas market, and domestic market as well • Delay of collecting cyber information, due to high communication cost • Difficulty to obtain credit guarantee approval, and to secure export quota for textile, etc. • Product-Out concept, underlying old-fashioned manufacturer's sense, that is "What is produced is sellable" • Pull out from domestic market due to dominant contraband
<ul style="list-style-type: none"> • Management Control and Recruiting 	<ul style="list-style-type: none"> • Difficult to recruit good human resources for private firms, especially for manufacturers • No skill of management control and business planing for market economy • Education focussed on theoretical study, not practical training because of old educational facilities • Uncertainty of the future industry directions to establish a management policy

<ul style="list-style-type: none"> • Business Environment Differences With State Enterprises 	<ul style="list-style-type: none"> • State enterprises privileged in starting joint business with foreign enterprises • All exporting to be through SOEs until 1998, no free trading • Big difference from state enterprises in easiness to obtain land utilization rights from the government • Difficult to funds raising due to lack of collateral to be offered as well as banks discriminative attitude to SMEs • Disadvantage in obtaining market & technology information to which SOE has an easy access
<ul style="list-style-type: none"> • Administration System and Procedures 	<ul style="list-style-type: none"> • Loss of time and cost due to the complicated and frequently changing government administrative procedures • Time and cost consuming by the frequent visits of many government agencies which have scented profitable business. • Various procedures of custom duties, valuation of land and other similar procedures are being determined unfaithfully and intentionally by officers. Thus difficult to establish a long term business plan

Source: JICA Study Team

As stated previously, financing problems are often cited as a major concern. On the other hand, it is also a fact that respondents often can neither identify which sales channels to use when production is increased as a result of facility investment, nor demonstrate the profit projection in case of sales expansion. This provides supporting evidence for the often heard comments by government agencies and bankers, that “private SMEs are not sensitive enough about the profit but just eager to increase the production and dream simply more business without a firm business plan”. However from the MPDF study on relatively large private enterprises, it is reported that about 41% of the enterprises have a problem in obtaining information on market and technology. Attention should be given to the fact that the private enterprises are conscious of the necessity of developing new markets or importing new technologies, when pursuing a business expansion for more growth, but lack the necessary information or means of accessing that information.

The characteristics and the status of the activities by the SMEs are described in Table3-2. This table focuses on the business process from manufacturing to marketing, of the important industries in manufacturing, which is the main target of this study. Each industry is in its own development stage and has different characteristics and problems from others. For instance, the garment industry is already in the mass production stage and has problems of overseas market development for export, problems of improvement of cost and quality competitiveness, and the problem of product development capability in order to move to the next higher stage.

In the traditional industrial arts such as pottery and woodworks, the SMEs sometimes look for direct export to overseas customers, but not in a systematic way because they have limited connection to and information of the overseas market. On the other hand, there are other problems in that there are few successors that will take over the current business and

maintain these traditional and human-oriented technologies.

Table3- 2 Status and Problems of SMEs in Viet Nam by Industry and Process

Industry / Process	Machinery / Parts	Electric / Electronics	Garment	Others (Pottery, Food Processing, Plastics Forming, Wood Works)
Development/ Design Works	Few development and design capability. But, have some design and production of imitations, followed by after the market.	Few development capability. But some SMEs can design of electric parts for industry.	Mainly consignment productions, But some SMEs are exporting original products.	Few SMEs have original products. Only imitations of foreign products with simple modifications.
Production	Many items and small volume productions by old facilities	Mainly handwork assemblies with labor oriented services	Mainly by sewing machines and labor oriented services	Mainly labor oriented services with old facilities.
Procurement	Mainly material procurements. Rarely procurement of parts.	Mainly material procurement. But some SMEs procure parts from overseas	Mostly raw material consignments from consignors	Raw material procurement are from on-site trading companies or other domestic enterprises
Inspection	Mostly No inspection. And low quality mind.	Mostly No inspection. And low quality mind.	Careful inspections applied for needles	No positive attitudes to inspections. Only following inspections and testing required by the legislation.
Sales	Limited for retail market places. But some of repair parts for facilities are delivered to enterprises.	retail market oriented.	Delivery is mostly for consignors	Limited for retail market places. But some are on direct sales

Source: JICA Study Team

In the industries such as the machinery and parts, and the electronic and electrical industry, the situation is characterized by too many problems so that it is difficult to win competitiveness in the international market. These industrial sectors are too far behind the current world standard that it is difficult to identify which problems to confront first, especially in a growing and severely competitive market. Now, the government is required to frame a policy to form the basis of industry development and to secure a competitive position within ASEAN with a certain length of time horizon.

Individual problems and measures for the promotion of SMEs are described by industry in detail in Industrial Sector Report. Judging from the study results, the management problems of the SMEs in Viet Nam are represented by the following five major ones:

- To secure fundamental resources such as funds, land, etc.
- To strengthen management capability including production control and quality control
- To establish, expand and diversify the market network and the trade network
- To obtain new technologies and the latest technological information
- To create more attractive incentives for entrepreneurs

3.2 Reforms in the Corporate Operating Environment Necessary for a Market Economy

In sections 3.2 and 3.3, policies and systems that are important in the external environment surrounding the corporate sector will be examined. These systems and policies also form major background issues for the operations of SMEs, as previously mentioned. In section 3.3, policy issues are identified in areas where concrete measures are suggested for the promotion of SMEs mainly in the manufacturing sector.

Prior to that, a summary is given of the issues required to create the foundations necessary for corporate activities under a market economy system, mainly focussing on 1) the creation of a level playing field (LPF) for the promotion of private sector enterprises, 2) administrative reform, 3) direct investment environment for foreign investors and 4) tax system reformation.

3.2.1 LPF (Level Playing Field) in Promoting the Private Sector

As indicated in Table 3-1, the SMEs in the private sector point out the problem of inequality in terms of their operating environment compared to that of the SOEs. In concrete terms, this LPF problem consists of the acquisition of operational resources such as fund raising methods for the private sector enterprises and the gaps between them and the SOEs in the area of access to business opportunities such as overseas markets and export opportunities. These problems are exacerbated by the sense of values prevailing in Viet Nam, that is that the SOEs and public sector officials are considered to be of greater value.

Here, these problems are briefly examined.

*** Land System**

Compared to the SOEs, one of the greatest areas of discrimination suffered by the private sector enterprise is in the acquisition of land for industrial and commercial activities. The SOEs are allocated land by the government. However, the land needed by the private sector enterprises to undertake business operations is not covered by this system. There are many limitations in terms of land acquisition and utilization of land assets. The most important are as follows.

- Limitations on transfer of land utilization rights and use of land as collateral.
- The relatively low evaluation placed on the rights of the private sector to own land
- Limitations on the use of land use rights in investments when forming a JV with foreign firms.
- Lack of clarity in terms of restrictions on transfer of land use rights

If there were to be an increase in flexibility regarding access to land and the use of land as an asset, this would make a major contribution to the development of the manufacturing industry, a sector that needs to make long-term operational plans. Especially, companies engaged in labor intensive operation need additional land, because some of them are obliged to move out to new areas due to environmental issues

* Financing Systems

Regarding borrowing from banks, the private sector enterprises are required to pay higher interest than the SOEs. In addition, in the case of the SOEs, they are not always required to provide collateral. However, the private sector enterprises are required to provide collateral. This situation is slowly improving. However, the overall attitude is an overwhelmingly strong tendency for collateral to be demanded. This is restricting the fund raising activities of the private sector enterprises. However, in defense, the financial sector side frequently cites the risks attendant on lending money to the private sector enterprises to fund their operations.

* Access to investment from overseas sources

There is also discrimination in terms of access to investment funds coming into Viet Nam from outside the country. When operating a joint venture, if the foreign investor chooses a SOE as its partner, this makes it easier to obtain permission for investment and easier to negotiate due to the fact that there is a closer relationship with government and competent officials. This is not necessarily only a problem of the systems in place, but also due to the fact that private sector enterprises tend to be in a disadvantageous position. Problems existing in the area of systems include that fact that use of land use rights to encourage investment is allowed for the SOEs but not for the private sector enterprises. In addition, although it is not official policy, in practice it is difficult to obtain permission for small-scale projects, and officially there is a tendency to encourage large-scale projects. In reality, this works as a discriminatory factor against the private sector enterprises as they are in the growth stage and don't have a large enough scale of operations.

* Trade Systems

Up to now, the greatest area of discrimination has been in trade. Up until Decree 57/ND-CP issued in July 1998, enterprises needed a license to engage in import and export activities. Thus, the Ministry of Trade was very powerful. In the system, it was possible to obtain a permit by paying a certain amount of money and fulfilling certain conditions. However, in reality it took a lot of time, and the conditions imposed on the permit included a

minimum capital level as well as an evaluation of the applicant, a very unclear and discretionary area. Today, it is still possible to run the system along unclear lines such as in the import and export procedure. There is still a lot of discretionary practices in deciding on the level of trade tariffs and the distribution of import and export quotas, and in reality the SOEs are given precedence in the allocation of quotas, etc.

From 1989 onward, many restrictions have been relaxed. However, there are still a lot of problems that must be cleared away before a real LPF situation evolves. Measures based on the following two points are keys to overcoming the LPF problems mentioned above. These will allow Viet Nam to vitalize and promote the growth of private sector enterprises, mostly made up of the SMEs, so that they can take on a major role in the economy to promote the growth of Viet Nam's industry overall along with the other sectors.

- Efforts to increase awareness of the importance of private sector enterprises in society.
- Measures to improve and modify systems that generate discrimination and their applications.

The following are concrete measure areas:

- Continuous sustained publicity aimed at gaining awareness of the importance of the development of private sector enterprises
- Reforms of laws to bring about an improvement in the LPF problem mentioned above
- Improvement in the implementation of the enterprise registration system to encourage potential players such as independent enterprises to register as legal entities and so perform a core role in the economy.

3.3.2 Engagement in Administrative Reform

In Viet Nam, the roles, responsibilities and duties of the government ministries are unclear. In addition, legal systems are frequently changed. Consequently, there are many major problems in terms of implementation of administrative work. In addition, to a great extent, decisions regarding procedures for granting permits and authorizations and also taxation procedures are left to the officials on the spot. This leaves room for bribery and corruption and so administrative reform is considered necessary. In the process, it must be borne carefully in mind how the current system fails to present future prospects of crucial importance for motivating management to prepare challenging plans, and brakes the speed of decision-making in the routine conduct of business. This is because, in market competition, speed ranks alongside cost and quality as an extremely important factor in production, imposing high importance on the measures for these issues.

In 1996, at the 8th communist party general assembly, discussions were held on administrative reform. At this convention, it was pointed out that it is necessary to reform the administrative systems, organization and personnel. Thus, it was decided that there is a need to reform administrative procedures that lead to bribery, corruption and other social evils, and to abolish regulations of regional areas that go against the policies of the central government. In addition, it was also decided that there is a need to achieve transparency in all administrative functions, operations and responsibilities. Since this assembly, the government has decided to implement the following administrative reforms in a more severe way.

* Administrative procedures

- A transition from a “case by case” granting of permission to automatic granting if certain conditions are met.
- The establishment of an administrative court.
- The establishment of a “one door” system for obtaining permission and authorization.
- Simplification of procedures for export, resident registration, corporate entity registration and entry visas.
- Transfer of rights to the regional bodies in the areas of regional issues, regional development, public sector investment and expenditure and revenues.

* Procedure for filing suits against the administrative issues

- Clarification of procedures for filing complaints against the government.

* Greater transparency in expenditures and revenues

- Transferring the right to control expenditures and revenues to local people’s committees.
- Disclosure of information on the utilization of assets and expenditures and revenues by the administration.
- Preparing reports on the utilization of assets, expenditures and revenues by the local people’s committees (every 6 months).
- Audits on all bodies using government budget funds.

In addition, studies have begun to examine the possible integration and reshuffling of ministries and agencies. It is needed and expected that there will be major changes in the administrative structure and the actual implementation of policies in Viet Nam.

3.2.3 Direct Investment Environment for Foreign Investors

In 1987, the Vietnamese government enacted legislation for induction of foreign capital. The law in question makes provisions for the establishment of enterprises that are owned wholly by foreign firms, reductions of and exemptions from the corporation tax for prescribed periods, and guarantees for foreign-exchange remittance. This step opened the door to investment in Viet Nam by foreign firms. The law was amended in 1990, 1992, and 1996 with respect to its substance and enforcement in response to requests by foreign firms for its improvement. The major amendments were as follows.

- * Extension of the period of subsistence of joint ventures and wholly-foreign-owned enterprises to 50 years (1992)
- * Recognition of application of tax privileges to wholly-foreign-owned enterprises as well (1992)
- * Permission for private enterprises to be the sole Vietnamese partners in the establishment of joint ventures (1992)
- * Clear delineation of fields and regions for encouragement of investment, and publication of a list showing special projects for investment promotion and fields where foreign investment is allowed under certain conditions (1996)
- * Increase in corporation tax privileges to two years of exemption followed by two years of reduction for ordinary firms owned wholly or partly by foreign firms, four years of exemption followed by four years of reduction for those meeting numerous conditions under the scheme of investment encouragement, and a maximum of eight years of exemption for special projects for promotion of investment (1996)

In spite of these efforts to improve the investment regime and the growth of the Vietnamese economy, however, foreign direct investment (FDI) went into decline in 1996 and fell by about 50 percent against the previous year in 1999. Although the impact of the economic crisis in Asia is certainly one cause, it has been pointed out that the decline was also caused by Viet Nam's lack of attractiveness relative to other countries in the region as an investment destination, based on the experiences of firms that had already sited there beginning in the early 1990s. As is also evidenced by the findings of a survey conducted with 749 Japanese firms by the Export-Import Bank of Japan shown in Table 3-3, interest in Viet Nam among foreign firms was fading even before the crisis.

It might be added that, under the circumstances prevailing since the Asian economic crisis, foreign firms have begun a tough reassessment of the proposition of investment in the region. As a matter of fact, many international institutions of investigation have observed that the Vietnamese economy has a low economic efficiency overall and that its enterprises

possess only a weak competitiveness. At present, the following elements in the legislative/systemic framework continue to work against campaigns to attract FDI.

- * Limitation of, or requirement of authorization of the national government for, transfer of ownership
- * The underdeveloped arrangements for financing
- * Requirements imposed on management organization in joint ventures
- * Limitations on use of land-use rights as collateral
- * Limitation of the duration of corporate subsistence (failure to regard enterprises as going concerns)

Table3- 3 Evaluation on Attractiveness for Investment by Japanese Firms

Ranking	Promising country for investment in the long term perspective (in 10 years)									
	98		97		96		95		94	
	Country	Ratio (%)	Country	Ratio (%)	Country	Ratio (%)	Country	Ratio (%)	Country	Ratio (%)
1	China	64	China	73	China	74	China	78	China	93
2	USA	34	India	36	India	39	Vietnam	41	Vitenam	40
3	India	25	USA	31	Vietnam	33	India	36	Thailand	32
4	Indonesia	20	Vietnam	24	USA	31	USA	30	USA	30
5	Thailand	19	Indonesia	21	Indonesia	24	Indonesia	24	Indonesia	29
6	Vietnam	18	Thailand	16	Thailand	24	Thailand	24	Malaysia	15
7	Brazil	14	Brazil	11	Malaysia	12	Myanmar	15	India	13
8	Philippines	13	Philippines	11	Myanmar	11	Malaysia	13	Mexico	9
9	Malaysia	7	Malaysia	9	Philippines	11	Philippines	11	Singapore	8
10	UK	6	Myanmar	5	Mexico	6	UK	6	Taiwan/ Philippines	7

Source: EXIM Japan FY 1998 Survey, Research Institute for International Investment and Development (The Export-Import Bank of Japan)

Furthermore, decisions in joint ventures require the unanimous approval of all investors, regardless of their capital subscription rates. This proviso also has a constraining effect on the powers of the foreign partners for swift action (it should be noted that this rule was relaxed in certain fields as a result of a 1997 amendment of the law for induction of foreign capital). Besides such inherent systemic restraints, there are many problems with the operation of policy and schemes pertaining to foreign capital. Arbitrary decisions by officials in charge are apt to lead to operation in a manner divorced from the principles laid down in the regulations.

There are other difficulties related to the status of industrial development. As compared to other countries that are its prospective competitors in ASEAN markets, Viet Nam is chronically lagging in respect of the level of trunk industries such as machinery and electrical equipment. It may also be noted that, as suggested by the results of a survey conducted by the Japan External Trade Organization in June 1999 with Japanese firms operating in various Asian countries, investment in Viet Nam does not necessarily hold

sufficient advantage now that operating costs in other countries have fallen in the wake of the currency and economic crisis.

Table3- 4 Comparison of Business Operation Cost among Major Cities/Regions in Asia
(Unit : US\$)

		Hanoi	Ho Chi Min	Dalian (China)	Batam (Indonesia)	Cebu (Philippines)
Salary/wage	Worker	79-109	76-132	63-155	58	108-137
	Engineer	188-314	165-275	87-230	192	194-500
	Middle management	478-557	401-540	118-362	534	723-1210
Office rent	Office rent (m ² /month)	22-25	16-22	37	8.69-12.27	8.42
Communication cost	Telephone (month)	20	20	4	4.63	34.82
Utility cost	Electricity (kw/hour)	0.07-0.08	0.07-0.08	0.07	0.09	0.08

Source: Comparison of business operation cost among major cities/regions in Asia (June 1999),
Japan External Trade Organization (JETRO)

Also notable in this connection are the latest ratings of the investment climate in Viet Nam by Taiwanese, Korean, and Japanese firms visited in the course of this study. While the ratings vary somewhat with the time of initial investment, type of industry, purpose of investment, and the nationality of the parent, the overall trend is one of decline. The key points that emerged from the ratings in the manufacturing industry, which is the focus of the study, were as follows.

- * Viet Nam retains its status as an important investment destination over the medium and long terms.
- * The companies continued to give Viet Nam high marks for the latent capabilities of its workers, but had a low opinion of capabilities in the management layer.
- * There is a deep sense of disappointment among firms that made big leading investments in anticipation of the growth of the domestic market. In this connection, many are dissatisfied with the arbitrariness of government policy on the domestic market (i.e., the lack of consistency in the making and application of policy).
- * The companies did not give high ratings to Viet Nam for machining and other fundamental technical industries, and were extremely wary about import tariff hikes and demands for higher local contents in conjunction with them.
- * Companies which had made large investments in Viet Nam (mainly Korean) have been hit hard in all aspects by the Asian economic crisis, and many are facing a need for a radical readjustment of their investment in the region.

* The Taiwanese firms, however, value Viet Nam as one country in their portfolio of direct investment destinations in Asia, partly to mitigate the concentration of the same to China.

In general, it can be said that the government of Viet Nam must take great care in the determination and operation of policy on foreign capital. This is especially true in the manufacturing industry, where foreign firms will be the primary source of the technology and information needed for advancement. Ability to harness these management resources effectively will essentially determine the industry's competitiveness in the international market. It may also be observed that, in light of the current shape of its technical and industrial foundation, Viet Nam must forge ties with foreign firms for slow but steady progress toward long-range goals. As such, it must properly put together and operate policies to attract FDI in accordance with this objective.

This same line has additional dimensions set against the background of the trends in the international economy, and particularly the market unification and liberalization proceeding within the AFTA and WTO frameworks. The construction and maintenance of good relationships with foreign firms could even be considered an absolute precondition for the development of Viet Nam's SMEs up to the level of qualification for transactions with international firms. Their growth into suppliers for the resident operations of these firms would effect a sure increase in the self-supply rate of Viet Nam's entire industry and give the domestic industry a more solid structure. Viet Nam's manufacturing industry in particular could play a certain role in the schemes of mutual complementation being hammered together by international firms in the Asian region. By so doing, it would become organically interlinked with the rest of the Asia-Pacific economic sphere. As this implies, policy for SME promotion with attention to collaboration with foreign firms would also make a positive contribution to the attainment of the larger goal of adaptation to the international economic environment.

3.2.4 Tax System

(1) Current status in the tax system

Viet Nam's tax system was introduced from the beginning of the 1990s. In 1990, the transaction tax law, the special consumption tax law and the profit tax law were enacted, and in 1991, the import-export tariff law was put into operation. This completed a tax system covering corporate activities. Subsequently, advances were achieved in the shift to a market economy, and there was an increase in fiscal expenditure such as the building up the infrastructure, and support for the training of human resources. To deal with this increase in expenditure outflow, the government engaged in building up and improving the tax systems.

As a result, in January 1999, various new taxes were introduced including the turn-over tax, and a VAT system and business income tax were brought in to replace the profit tax.

Table3- 5 Tax Income Breakdown by Type of Tax (1991~1998)

Type	1991	1992	1993	1994	1995	1996	1997	1998 Est.
Indirect tax	46.2	41.1	47.1	54.2	53.7	52.9	52.7	53.3
1 Sales tax	24.3	18	15.4	19.6	18.1	18.8	19.7	18.6
2 Domestic consumption tax	8.8	8.7	5.7	6	5.7	6	7.5	7.8
3 Trading tax	13.1	14.4	26	28.5	29.9	28.2	25.6	26.9
Direct tax	33.9	38.6	33.8	29.1	27.9	30.8	31.1	31.2
4 Profit tax	15.1	15.1	18.7	18.5	16.8	17.9	18.8	18.6
5 Individual income tax	0.7	1	0.7	1	1.2	2.5	2.6	2.8
6 Natural resources tax	9.5	12.3	7.6	4.9	4.4	5.6	5.4	5.3
7 Agricultural land tax	8.5	8.5	5.5	3.2	3.5	3.5	2.9	3.5
8 Land tax	0.1	0.1	1	0.6	0.7	0.7	0.6	0.5
9 License tax	0.9	0.5	0.9	0.4	0.5	0.5	0.7	0.6
Tax revenue from JVs	0	0	0.9	3.5	4.8	5.3	7	8.2
Other tax revenues	19.9	20.4	18.2	13.2	13.6	11	9.2	7.3
Total tax revenues	100	100	100	100	100	100	100	100

Source: WB, 1998, The Statistical Appendix Part; CIE, 1998, p.60; MOF

Looking at a breakdown of Viet Nam's tax revenues by item during this period, it is important to focus on the fact that indirect taxation is very high compared to direct taxation. According to the figures for 1998 (estimated), indirect tax accounted for 53.3%. The tax on trade was particularly high and accounted for 26.9%. Transaction tax (an indirect tax) and profit tax (a direct tax) were both the same at 18.6%.

(2) Problems in the tax system

Vietnam's tax system is considered to have many contradictions and problematic areas. The government has carried out many tax reforms, but the taxation level is still high, and many people don't pay any tax. The following discussion indicates the problems in the current tax system.

1) The tax system is complex and changes are made frequently

Changes are frequently made in the tax system and taxation rates. Thus, taxpayers such as the corporate sector and tax officers are often confused. For example, there are two methods of calculating value-added tax, the direct method and the deduction method, and so confusion prevails. There are four different rates for value-added tax on intermediate products

and final products. Depending on which rate is applied, either the direct method or the deduction method can be more advantageous. The existence of two methods has resulted in tax evasion.

Moreover, changes in the tax system are carried out without sufficient preparation. Thus, many problems arise after implementation of these changes. For example, on the introduction of VAT, it was necessary to have receipts to get a deduction. However, many enterprises engaged in the production of primary products such as agriculture and fishery did not issue receipts. Thus, the enterprises that procured raw materials from them firms faced the problem of not being able to get a tax deduction. The General Tax Department of the government introduced a system in which enterprises that purchase agriculture and fishery resources could be given a tax deduction without a receipt. However, some enterprises exist in which this system is not employed.

2) The attitude is “Let’s take tax where it is easy to get.”

In Viet Nam’s tax collection system, there is an attitude of just taking tax from those who have the funds or where it is easiest to get payments. This attitude can be seen in the high dependency on trading tax, as shown in the chart on tax revenues. This is because it is easier to collect tax from traders than from domestic companies. This has caused a rise in the trading tax level. This policy is resulting in a reduction in the profits the domestic enterprises can earn from trading activities and it is also detrimental to the effective use of various resources.

This attitude of collecting taxes from places where it is easy to get is also appearing in acts such as collecting tax from foreign companies who keep proper accounting records and from foreigners who have a record of the salary payments they receive. This attitude of the tax department is one factor discouraging a switchover from independent enterprises to private enterprise by registering as corporate entities.

3) The low efficiency of tax collection

When Viet Nam’s tax collection system is compared to those of other countries, it becomes evident that the efficiency of the system is extremely poor. This is due to high administration costs and the strong desire to avoid paying taxes. However, in the background to this situation can be found the fact that Viet Nam does not employ a self-declaration tax reporting system by taxpayers, the system used in many other countries.

4) Big difference in tax rates

First it should be pointed out that there is a wide range of tax rates in existence. For example, the VAT tax rate ranges over four stages from 0 to 5, 10 and 20%. The business

revenue tax has four stages, 15, 20, 25, and 32%. Domestic consumption tax ranges over 12 stages from 15 to 100% and the tax on transfer of land utilization right has 7 stages from 0 to 50%. Thus, there is a broad spectrum of tax rates currently in use.

There is also a problem of differences among sectors and industries. Foreign companies investing in Viet Nam are in an advantageous position. Thus, there is a feeling of inequality among the domestic enterprises. The capital-intensive industries receive preferential treatment, and labor intensive industries are often subject to a relatively high tax rate.

(3) Directions in improving the tax system

An improvement in the tax system at a time when the economy is moving towards a market economy is extremely effective measure for promoting economic activities. This is a very good time for Viet Nam to review its tax collection systems and related procedures. However, in reality many of the SMEs are avoiding tax payments. Some SOE executives consider this to be reverse discrimination against the SOEs. Many of the management personnel of the SMEs believe that if they have to pay taxes properly in accordance with the laws, the continued existence of their enterprise would be difficult.

Regarding tax systems, before considering a system designed to promote the SMEs, it is first necessary to undertake actual improvements and modifications in the system. The tasks that should be given precedence include the creation of a tax system suited to a market economy and a tax system that does not conflict with administrative reforms. Tax incentive has to be designed carefully not to increase probability of management energy being wasted in trying to comply with these systems and not directed where it is most needed in the manufacturing sector, that is in improving competitiveness by cutting costs, developing and discovering new markets and creating new technologies. The following should be implemented systematically and structurally.

- Designing a tax system compatible with administrative reforms
- Clearly establishing the object of each tax system
- Coordination and adjustment among the various tax systems
- Realization of fairness in tax rates among enterprises in terms of sectors and industries
- Improvements in the tax collection methods
- Educating the taxpayers about the reason for taxation

3.3 Policy Issues Related to SME Promotion

The preceding section (3.2) presented the policy issues in individual areas that must be addressed to permit the deployment of measures for SME promotion.

In the following areas, the study identified problems that are distinctive to SMEs and call for urgent action.

- 1) Laws and regulations
- 2) Organization
- 3) Financial system
- 4) Land system
- 5) Promotion of export
- 6) Promotion of technology and SI
- 7) Support for human resource development and more sophisticated management

This section profiles the problems in these areas. Measures developed in this study are briefly described in Chapter 4 of this General Summary Report. A more detailed presentation of the current situation, issues, and measures in them can be found in Individual Policy Report.

The issues for which measures are developed in this study are followings.

Laws and regulations

- * Elimination of the constraints on corporate activities arising from difficulties such as vagueness in provisions, conflicts between laws, insufficiently detailed enforcement regulations, frequent revisions, and inconsistent application
- * Prevention of disruption accompanying the enforcement of the New Enterprise Law (?) and improvement of procedures for enterprise registration
- * Unification of corporate law
- * Prompt enactment of legislation for SME promotion with a view to alignment of vectors in government, industries, and enterprises in this direction, and enactment of the Basic SME Law for more rigorous approaches

Organization

- * Need for establishment of an institution to serve as the strategic seat of the general deployment of measures for SME promotion
- * Encouragement of coordination among institutions providing SME support services
- * Setups for approaches to SME promotion by provincial people's committees

- * Assurance of the continuity of supporting services after the end of aid from overseas donors
- * Arrangements for provision of supporting information to SMEs
- * Breeding of affinity toward policies and authorities among SMEs
- * Preparation of an environment that stimulates the activities of industrial groups

Financing

- * Provision of financing enabling SMEs to collaborate with foreign firms
- * Qualitative and quantitative improvement of systemic (official) financing
- * Expansion of actual use of policy financing
- * Conditioning of the direct financing market and functions
- * Reinforcement of the capabilities of commercial banks
- * Improvement of the system of credit guarantee
- * Conditioning of the system and organization for financing to promote export
- * Conditioning of the security system
- * Conditioning of the accounting system
- * Correction of distortions in the interest rate structure
- * Development of human resources for financial institutions
- * Increase in the creditworthiness of SMEs

Land system

- * Procedural simplification and information disclosure related to land registration and sales
- * Swift issuance of land deeds
- * Widening of the possibilities of use of land, facilities, and incubators by SMEs
- * Assistance with the cultivation of personnel for industrial estate development

Promotion of export

- * Expedition of export and import procedures, improvement of (and elimination of arbitrariness in) the application of tariff rates and procedures
- * Tighter control of smuggling
- * Improvement of various procedures related to establishment of joint ventures, contracting for consigned processing, and other collaboration with foreign firms
- * Provision of information on overseas markets and possible transaction partners (buyers, etc.)
- * Promotion of trade in cooperation with overseas trade organizations
- * Conditioning of the system of export financing
- * Development of products/technologies and human resources for export promotion

Promotion of technology/SI

- * Practice of production and quality control
- * Diversification and expansion of transactions with large enterprises and foreign firms
- * Support of product development
- * Support for access to all types of technical information
- * Quickening of the activities of industrial groups
- * Transmission of traditional highlands technology

Support for human resources development and management advancement

- * Improvement of education of all administrators, leaders, managers, and skilled labor
- * Provision of instruction oriented toward problem-solving and rooted in actual work situations
- * Publicity about the value of education and training
- * Promotion of corporate education activities

4. SMEs PROMOTION POLICIES

4. SMEs Promotion Policies

4.1 Needs for SMEs Promotion Policies

The SMEs promotion policy must be proceed comprehensive as well as strategic manner in order to solve the problems that prevent the Vietnamese SMEs development and to assure that SMEs are able to take on self sustained high growth power and vitality. Specifically, future changes in international competitive conditions resulting from AFTA and WTO require urgent attention to the development of Vietnamese SMEs, given their current disadvantageous circumstances in social and economic position. As a result, it is necessary to immediately start facilitating the promotion of SMEs. This must be accomplished against the backdrop of the shift from a planned economy to a market economy. Furthermore, the SMEs promotion policy should be constructed with consideration given to both medium and long term effects and therefore must take account of the further international environment that Viet Nam will confront.

Stated below are acute needs for SME promotion policy measures

(1) Solving various problems of the SMEs

First of all, as stated in the previous chapter, it is necessary to solve the various problems of the SMEs, which play a primary role in today's economy. It is required to adjust the basic environment towards a market economy and modify the discriminatory environment that exists between the state and private enterprises. In addition to the main focus on the improvement of administrative procedures, such basic systems as the financial system, the land system and technology promotion that effect industrial infrastructure and competitiveness must be addressed.

(2) Bringing out the power of the managers who currently are constrained

Secondly, it is important to face up to the reality that most of the managers do not bring their full ability to bear in business. Some prevent their business from expanding to a certain range so as not to draw public or social attention, and others, who cannot forecast changes in their business environment, tend to give up. Managers including those in households businesses are often not fully willing to take on the challenge of a new business. These mangers are not able to operate at their full potential. This lack of reaching their full potential results from an immature market economy environment and the discriminatory environment that exists between the state and private enterprises. This is experienced by the managers both in

the opacity and frequent changes of in governmental policies. In addition, as described in the preceding chapters, it is felt in the various types of “harassment” of the private sector by the public sector. It is necessary to create an environment for SMEs managers and potential new business entrepreneurs that will allow them to reach their full potential.

(3) Urgent action to reinforce international competitiveness

Thirdly, urgent action is required to reinforce the international competitiveness of industries including the state enterprises, because of the impact of resulting from the dynamic changes in the international environment caused by AFTA or WTO, which will directly influence Vietnamese industries in and after 2005. In order for current industries to respond quickly to such an environmental change, it is extremely important to develop SMEs characterized by managerial dynamism and business and technical specialties. It is also necessary to develop SMEs not only to enhance industrial competitiveness, but to create an opportunity to acquire foreign capital.

(4) Doing away with the low social evaluation of SMEs

The private sector has been recognized as a legitimate economic sector since the adoption of “doi moi” in 1986, and this legitimacy was reflected in the amendment to the constitution in 1992. At the 8th Communist General Assembly in 1996, the importance of SMEs was pointed out and a political statement to promote private enterprises and SMEs was adopted. However, the social recognition/reputation for SMEs still remains at a low level. For example, graduates of schools and universities have very little interest in working for private enterprises, and such a phenomenon makes it difficult to gain managerial resources for the SMEs, such as funds, land, talent, information and technology. It is necessary to publicly demonstrate the importance of the SMEs in the minds of the people, as well as to improve their social position through the support plan.

In addition to the necessity of solving the existing problems concerning the SMEs’ development stated above, it is also necessary to that the promotion of SMEs development will contribute to Vietnamese economic development and social stabilization for the medium and long-term. The major points are as follows:

Necessity from the viewpoints of advancing industrial structure

A desirable state in the development of Vietnamese industrial activities may be the one in which each industrial organization, state enterprises, private enterprises, foreign affiliated firms, cooperatives and household businesses function actively and engages in industrial partnerships.

However, currently there are very few partnerships between different enterprises and very few private SMEs are the suppliers for SOEs or foreign affiliated firms. By developing SME promotion policy measures, various business relations between SMEs and other industrial sectors will occur, and as a result, a thick-layered industrial structure can be constructed. In this way, SMEs promotion is necessary for advancing the Vietnamese industrial structure to a more integrated and balanced one.

Necessity from the viewpoint of the export promotion and meeting domestic demand

Among the Vietnamese SMEs, garment industry, wooden-handicrafts and pottery industries are currently export competitive. Improving the level of export competitiveness through the promotion of SMEs, even in these industries, is very important for any country's economic development.

It is also important to develop SMEs to meet the nation's domestic demand. This domestic demand is increasing with higher income level thanks to economic development, and will require further supply of various products and services. Current competition with imported products from neighbor countries is becoming serious, and it is important to develop SMEs that will meet domestic demand both in terms of quality and price aspects.

In addition, by improving export competitiveness and satisfying domestic demand it will be easier to acquire foreign currencies, which makes SME development all the more valuable.

Necessity from the viewpoint of a balanced development of the land

Being an agricultural country, the rural area accounts for a large part of the land of Viet Nam. The progress of the market economy may cause a sudden population inflow to big cities from rural areas. Therefore, it is necessary in order to stabilize the society by developing the economy and promoting employment in rural areas. Because of the economic deceleration occurring after Asian economic crisis and with an increase in the unemployment rate that may result from the rationalization or incorporation of state enterprises, regional development is becoming more important. The SMEs should be a core aspect in regional economic development, and a SMEs promotion policy is required from this perspective as well.

4.2 Goals of SME Promotion

The development of SMEs should proceed in order to fulfill the needs and objectives described in the previous section. The goals of the promotion, however, must be adjusted step by step according to the development phases of the Vietnamese economy and the conditions affecting the SMEs. The goals of SME promotion in each stage are shown in Table 4-1. The development process was envisioned as consisting of four stages, the first (and current) running until 2002, the second (short-term), from 2003 to 2005, the third (medium-term), from 2006 to 2010, and the fourth (long-term), from 2011 onwards. The SMEs development scenario for each stage as well as the focal points for the corresponding policy is described in the table. The policy goals are shown up to the year 2010, and for the last stage, from 2011 onwards, one development vision is shown.

(1) Current stage (1999 - 2002)

This stage is to be devoted to the promotion of policy in areas requiring urgent and immediate action for the growth of SMEs. The basic objectives would lie in clear positioning of SMEs in the overall socioeconomic context to implant awareness of their significance, and the nurturing of fundamental SME strength in preparation for the WTO and AFTA regimes. It would also be a time for promotion of measures under the decrees now being prepared.

In this stage, it would be vital to identify and publicize many cases of success achieved by SMEs already in operation, in order to awaken interest among people already managing SMEs or considering going into business. Another key task would be to spread recognition of the meaning and importance of SME promotion in all socioeconomic sectors. As such, the focal SMEs (i.e., those with good competitive strength and growth capabilities) would probably be those engaged in labor-intensive work such as carrying out processing consignments with a certain level of international competitiveness.

The main agenda items would be priority provision of support for the SMEs engaged in this labor-intensive work, conditioning of the basic business environment through improvements as regards LPF and the erection of core setups, establishment of the key institutions and organizations in the SME promotion plans, and construction of the requisite systems and schemes. It would be crucial to create numerous cases of success on the part of SMEs (or the measures of support) through this assistance and to publicize them widely.

Table4- 1 Goals of SME Promotion in Each Stage

	Goals of SME promotion policy			Long-term SME development vision
	1999 ~ 2002	2003 ~ 2005	2006 ~ 2010	2011 ~
Policy goals	Establishment of the basic framework for policy for SME promotion Definition of the socioeconomic standing of SMEs Nurturing of basic strength in preparation for WTO and AFTA regimes Deployment of policy under decrees	Penetration of policy for SME promotion Build-up of the power of the SME promotion setup Nurturing of basic strength in preparation for WTO and AFTA regimes Deployment of policy under the basic law	Nationwide deployment of policy for SME promotion Rapid advancement of SMEs Reinforcement of international competitiveness under the WTO and AFTA regimes	Construction of new programs for phased SME development Strengthening of the international networks of SMEs
Focal SMEs (with good international competitiveness and growth capabilities)	SMEs with competitiveness in labor-intensive work (consigned processing, etc.)	SMEs with competitiveness in labor-intensive work (consigned processing, etc.)	SMEs with competitiveness resting on massing and networking (firms involved in develop-and-export schemes)	Emergence of high-tech venture firms (knowledge-oriented SMEs)
SMEs for priority development	SMEs with competitiveness in labor-intensive work (consigned processing, etc.) Emphasis on advancement of the capabilities of existing managers	SMEs with competitiveness resting on massing and networking (firms involved in develop-and-export schemes) Emphasis on development of entrepreneurs	SMEs based on technical capabilities Emphasis on production of growth-oriented corporate managers and entrepreneurs	SMEs accenting international networks
Priority measures of support	LPF preparation and conditioning of the basic business environment Establishment of the major institutions, organizations, setups, and schemes for SME promotion Initial promotion of SMEs in the major cities Improvement of the infrastructure for promotion of export business Focus on creation of successful cases of SMEs and policy measures	Strengthening of coordination among promoting institutions Full operation of the major institutions, organizations, systems, and schemes for SME promotion Extensive promotion of SMEs in the major cities Identification and spread of success models	Nationwide deployment of measures for support of SMEs Extensive approaches to SME promotion by provincial people's committees Extensive promotion of SMEs in rural areas Support for SME sharing and linkage	Addressing of new issues Development of measures of SME promotion employing the mechanism of inter-regional competition Rooting of measures in rural areas (full-scale application) Coordination between industry and academia, construction of international networks, etc

(2) Short-term stage (2003 - 2005)

The stage extending over the short term would be occupied with the deeper penetration of the SME measures initiated in the first stage and build-up of the power of the setup for promotion. The efforts to nurture fundamental strength in preparation for the WTO and AFTA regimes would continue. In the policy aspect, the main tasks would be the enactment of a basic law in accordance with the decrees and provision of support in line with this law.

In this stage, the SMEs engaged in labor-intensive work such as consigned processing that is internationally competitive would continue to be at the focus, as in the previous stage. However, the emphasis in policy for promotion should shift to firms and entrepreneurs with a competitive strength resting on siting en masse and networking. Also as described earlier, erection of core setups, establishment of the key institutions and organizations in the SME promotion plans, and construction of the requisite systems and schemes, that will form the infrastructure necessary to facilitate the business actions of SMEs should be enhanced. This policy will be conducted primarily in big cities like Hanoi or Ho Chi Minh City, where a group of SMEs are currently exist and in core cities like Haiphong or Da Nang. Successful SMEs along with the SMEs promotion measures should receive wide spread publicly.

(3) Medium-term stage (2006 – 2010)

During the second stage and after, it is expected that the SMEs promotion measures implemented during the earlier stage have yielded good results, and these SMEs may have attained a level of self-sustained growth in their corporate development cycle. Measures for SME promotion would be deployed on a nationwide basis, and the international competitiveness of SMEs would be further strengthened under the WTO and AFTA regimes.

The focal SMEs in this stage would be those with a competitiveness resting on siting en masse and networking. The craft-type industries in fields such as pottery, furniture, and woodwork should constitute efficient systems of production in their areas, and the machinery and parts industries should gather competitiveness by divisions of production labor in their role as supporting industries. The emphasis in policy should shift to SMEs attaching high priority to technical capabilities.

In this stage, the framework for the SMEs promotion measures developed during the previous stage should be introduced all over the country. In big and middle-core cities where the plans were already introduced these measures should be formally institutionalized and the results of the previous stage should become tangible. It should be emphasized that the SMEs promotion measures must also be instituted in the rural areas at this stage. The contents of these support plans will focus on enhancing the collaboration among the SMEs and the promotion of linkages between the SMEs and large enterprises or foreign affiliated firms.

(4) Long-term stage (from 2011 onwards)

During the final stage from the year 2011, the SMEs are expected to enter a new development phase. The SMEs promotion measures implemented during the first and second stages should be widespread and the development of the SMEs should have been vitally supported by these SME policy measures. Some of these SMEs may be high-tech venture enterprises. Therefore, the SMEs with competitiveness and growth capabilities in this stage would presumably be high-tech venture businesses depending on their powers of technology development for growth. Therefore, at the frontier of development the SMEs will be high-tech venture business, that will require access to sources of technology and scientific knowledge.

The SMEs support plans in the rural areas, implemented during the middle stage, will be in full scale utilization in these areas. Meanwhile, a competition mechanism among the regions (provinces) may begin to emerge, and each region's own support program should be encouraged. In addition, industry-university cooperation programs or international cooperation projects intended for high-tech venture enterprises should start.

Using the goals described above as basic guidelines, concrete promotion measures are developed for major policy areas and described in the following sections.

For the measures to be effective however, it can never be over-emphasized that improvement of the general business environment such as LPF, administrative reforms, tax reformation other basic business infrastructure for a market economy has to be hastened and reinforced. The key policy areas for the improvement of SMEs related business environment are listed in the center column of Table 4-2.

Table4- 2 Policy Items to be Considered in Management Reform

	Reform of economic system toward market economy Promotion of private enterprises / Reform of government administration	Promotion of SMEs
Framework	System of Corporate law System of Investment Promotion law Reform of government administration and its services	Legal framework for promotion Organization for promotion
Finance	Establishment of financial infrastructure (capital market, bill & check system) Recovery of financial functions in commercial banks	Pledge system/credibility supplement Financial institution for SMEs
Tax	Establishment of fair and effective taxation system Motivating entrepreneurs	Special tax reduction* Simple tax system for SMEs*
Land ownership	Promotion of land registration Promotion of land transactions Promotion of information publication	Opportunity of land ownership for SMEs Pledge system of land use by SMEs
Export promotion	Simplification and transparency of procedures Support system for quality and schedule Establishment of transport infrastructure	Export finance Access to information of export market Production of export goods/quality control method
Technology development & promotion of SI sector	Production and quality control Technology transfer/Establishment of intellectual property rights system Development of new products	Production and quality management by SMEs Technology transfer from foreign and state enterprises to SMEs Expansion of transactions with foreign and state enterprises
HR development & management advancement	Advancement of general education Intensification of professional education Professional education for managers/ management advisors/professionals in financial businesses	Education for top management and managers Reduction of burden from education and training Environment of management consultancy services

Source: JICA Study Team

(*) These are not be discussed in this report

4.3 Policy Framework for SME Promotion

(1) The structure of SME promotion policy

In this section, the basic framework of the support plans to be performed in order to achieve the objective of the SMEs promotion described above will be discussed. The measures to be taken for the SMEs promotion can be categorized in the following four frameworks:

1) Establishment of a fundamental support system

It is necessary to establish fundamental systems and organizations to develop the SMEs promotion policy. The following seven support systems should be established:

- a) Establishment of a promotion system: Establishment of organizations to promote the SMEs.
- b) Establishment of a legal system: Improving the legal system concerning the SMEs or develop a legal system on which SMEs promotion can rely on.
- c) Establishment of tax system: Developing a fair and appropriate tax system for SMEs.
- d) Promotions of LPF (Level Playing Field): Removal of business environmental differentials between SMEs and other industrial sectors.
- e) Establishment of SME organization: Solving problems by SMEs themselves and focused on their development.

2) Advancement of external management resources

It is necessary to promote policies for SMEs to utilize external business resources like funds, technology, information, factory lands, and favorable export conditions. The following five policies must be promoted for this purpose:

- a) SME Finance: Establishing a system for any SME to obtain necessary funds under a certain conditions.
- b) Export promotions: Facilitating SMEs in exporting their products.
- c) Establishment of land system: Enabling the SMEs to obtain necessary factory lands smoothly.
- d) Technology promotions: Enabling SMEs to obtain necessary technology for their production activities.
- e) Promotions of supporting industry: Enabling the supporting enterprises among the SMEs, such as parts or processing enterprises, to implement technology and business management, so as to establish business connections with their customers.

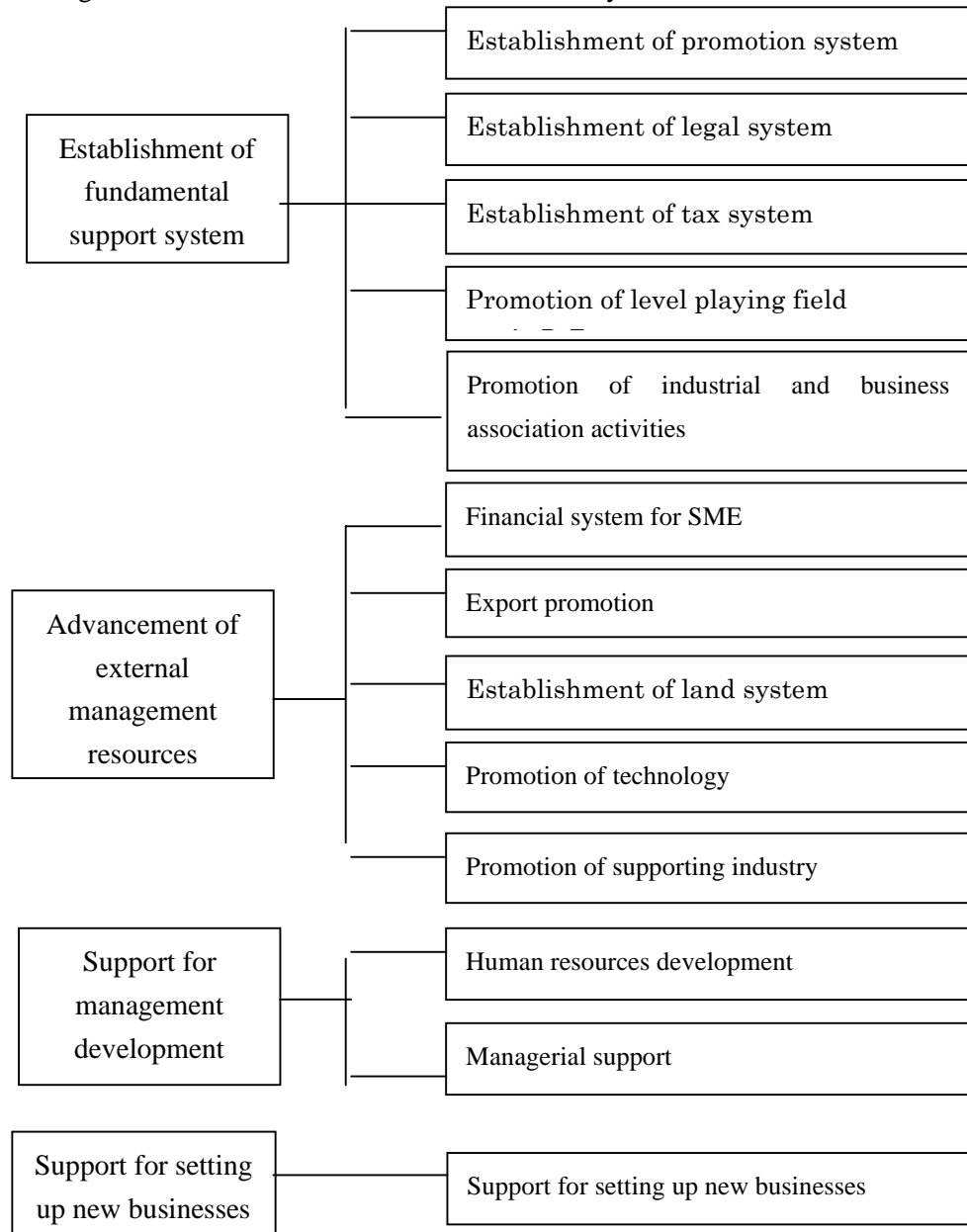
3) Support for Management Development

Positive support is also required to enable the SMEs to improve their own management capacity. The following two support plans must be performed:

- a) Human resources development: Improving managers’ management capability and employees’ skills.
- b) Managerial support: Providing appropriate guidance and advice to the managers from external professionals.
- 4) Support for setting- up new businesses

To activate the SME promotion, not only the support of the existing enterprises, but the promotion of the emergence of new ones is also important. Therefore, “Support for setting-up new businesses” will be required.

Figure4- 1 Structure of SME Promotion Policy in Viet Nam



Source: JICA Study Team

(2) Target Scope of SMEs policy measures

The policies to be performed for activating SMEs are divided into the following three categories from the perspective of their target scope

- 1)The policies whose target scope (those who are directly benefited from the policies) is not limited to SMEs, but are aimed at enterprise as a whole, but their effects are specifically significant to SMEs (export promotion, human training, etc.).
- 2)The policies whose targets scope are limited to SMEs (development of SMEs promotion system and legal system concerning SMEs, etc.)
- 3)The policies whose targets scope are limited to the manufacturing SMEs (technology promotion, land system for enterprises with manufacturing facilities, etc.)

Of the above 3 categories, only categories (2) and (3) are limited to the SMEs, but the necessary policies included in category (1) are also added here, considering that appropriate policy measures should be provided comprehensively as well as strategically.

Table4- 3 Scope of SME Promotion Policies

Objectives	Policy measures	Scope of policies		
		All enterprises, but substantial influence to SMEs	SMEs	Manufacturing industry in SMEs
Establishment of fundamental Support system	Establishment of promotion system			
	Establishment of legal system		Basic Law	
	Establishment of tax system			
	Promotion of level playing field			
	Establishment of promotion organization			
Advancement of external management resources	Financial system for SME			
	Export promotion			
	Establishment of land system			
	Promotion of technology			
	Promotion of supporting industry			
Support for management development	Human resources development			
	Managerial support			
Support for setting up new businesses	Support for setting up new businesses			

Source: JICA Study Team

(3) Priority policy measures for SMEs promotion

Among the conceivable policy measures to be introduced for SMEs promotion, priorities are given to those that are to have substantial impact on SMEs and are constituted as follows:

- Providing basic frames for the promotion policies, and if not preformed in a timely manner would result in confusion in formulating related policies.
- Preventing loss of short-term business opportunities that can be avoided.
- Responding to export environmental changes that occur in the near future.
- Requiring a long time for the effects upon SMEs to be realized but addressing vital needs in forming the basic infrastructure for SMEs development, and therefore should be started early.

Table4- 4 Priority Policies for SME Promotion Policies

Objectives	Field	Priority policies
Establishment of fundamental Support system	Establishment of promotion system	<ul style="list-style-type: none"> • Setting up the SME Promotion Agency (SMEPA) • Setting up SME promotion department at local people's Committee (DOSMEP) • Setting up the SME Support Center (SMESC) • Establishment of "One Stop Advisory Desk"
	Establishment of legal system	• SME Basic law
	Establishment of tax system	
	Promotion of level playing field	
	Establishment of promotion organization	<ul style="list-style-type: none"> • Support for activities of business associations • Support for activities of business cooperatives
Advancement of external management resources	Financial system for SME	<ul style="list-style-type: none"> • SME Finance Corporation • Establishment of collateral system • Establishment of venture capital funded by Government • Establishment of systems for export promotion • Establishment of credit guarantee system
	Export promotion	• Establishment of export promotion system
	Establishment of land system	• Industrial estates for SMEs
	Promotion of technology	• Technology support organization
	Promotion of supporting industry	• SI business promotion organization
Support for management development	Human resources development	<ul style="list-style-type: none"> • Support for management education • Diagnoses and advisory services
	Managerial support	
Support for setting up new businesses	Support for setting up new businesses	• Entrepreneur education and provision of information

Source: JICA Study Team

Each policy measure will be described in the following sections. Details are provided in Individual Policy Report. Since LPF, administrative reformation for business related procedures, FDI environment and tax issues are overall industrial and business issues, they are not included in the theme for developing concrete measures.

4.4 SME Promotion Plan

The major policy measures developed in this study and their implementation plan over time is summarized in Figure4- 2. The measures listed here are briefly described in the following sections. Details are provided in Individual Policy Report..

Figure4- 2 SME Promotion Plan (1)

Policies	2000	2001	2002	2003	2004	2005	2006 - 2010	2011 - 2020
SME Basic Law Organizations for promotion SMEPA SMESC DOSME OSAD (Desk in charge)	Enactment of decree		Enactment of the Basic Law		Establishment			
			Hanoi/HCMC		11 places in major cities			
		2 places			11 places		30 places	45 places
		20 places			120 places		50 places	90 places
							Major provinces/Districts in Hanoi and HCMC	1000 places
Financial System Reform of collateral system Self Judgement of collateral SME Finance Cooperation Export Credit Fund Export Import Bank Trade and Investment Insurance Venture capital Credit guarantee system	Feasibility Study		Initiation of business		2 branches		Expansion of operational region	6 branches/year
	Initiation of business		Necessary legislation				Initiation of business	Expansion of regions set the branches
	Feasibility Study		Foundation		Establishment of national network		Establishment of management system	Measures to react business environment such as strategic loan, other policy loan
	Planning Training		Full operation		Capitalization from public finance			
Land system Development of industrial estates for SMEs Clarifying the land rights Issuing `Red Book` Establishment of land Registration system Reduction of land tax Promotion of land transaction Flexibility of land use zoning Generalization of land use zoning General appointments of land traders	Establishment of Development Fund and feasibility study		(Amendment of existing development plans)		Completion of construction in 2 places (HCMC/Hanoi) (including factory ,apartment)		Development over the nation(20 places)	Expansion of participation by private sector

Source: JICA Study Team

Figure4- 2 SME Promotion Plan(2)

Policies	2000	2001	2002	2003	2004	2005	2006 - 2010	2011 - 2020
Export Promotion System Reform of system Standardization of customs procedures (Preparation of manuals) Reduction of tariffs and commissions Publication of quota bid Open bid Information support Financial support Technical support							Constructing data case of enterprises, customers and markets Intensifying the functions of library Working capital and investment fund SME finance Cooperation Intensifying the inspection function Improving productivity, quality, and schedule Intensifying consulting function Information analysis & precision Development fund Intensifying supports for international competition with ASEAN countries Product development technology	(Expansion of operational regions Reaction to the industrial transformation)
Center for technology support Information technology Contents of technology training (Major programs) Number of facilities Center for promotion of SI transactions Enterprises to be included in data base Enterprises to be presented Market information Number of offices							Information on SOEs Overseas (From foreign organization in Viet Nam) Training of quality control activity Training of TQM and ISO Training of design 10places SMEs in Hanoi and HCMC SMEs in DANAN Foreign enterprises SOE, and Enterprises located in ASEAN Information on existing SOEs Overseas (foreign organizations in Viet Nam) FS/Detail design 2 places (Hanoi/HCMC) 3places (DANAN) 10 places (local major cities)	Collecting overseas information Training of development 20 places (Renewal of data) (Same as left) Collecting and analyzing original data 20 places
Public education and training for stuffs involved in SME promotion Management and technical advisers (accumulation) Education on SME for Government staff (") Staff of One Stop Advisory Desk (") Management instructor (") Cooperate managers *(Participants per year) Diagnoses and advisory system							2000 2500 650 400 10000 Expansion	Education by public center is to be continued at the initial volume. Enterprise management training is to be taken place by private or long-term general education center.

Source: JICA Study Team

* Subject such as general management, production control, and quality control are emphasized. Entrepreneur education is to be regularly set.

4.5 Basic Measures

4.5.1 Legal Framework

(1) Amendment of laws and systems from the viewpoint of SMEs promotion

From the viewpoint of the promotion of SMEs, laws should be amended generally in line with the following five directions.

To make enforcement of laws as detailed as possible to minimize the scope of discretion of officials in charge at the time of the law's application.

- 1) To eliminate inconsistencies among laws and clearly indicate information on the priority of the laws.
- 2) To provide thorough training to administrative officials with enough time at the time of the establishment of new laws in order to correct the present situation in which such officials have not caught up with the amendment of laws and establishment of decrees and decisions.
- 3) To prepare a data base regarding legal systems and make it available to companies in order to clear up the confusion that has arisen from the great number of decrees and decisions.
- 4) To realize a level playing field (LPF) by promptly eliminating discriminative treatment and expressions that are seen in some laws.

(2) Matters necessary in the future regarding the enactment of the New Enterprise Law

It is necessary to promote the following matters urgently in order to improve the corporate business environment after the enactment of the New Enterprise Law.

1) Early enactment of enforcement bylaws

It is necessary to promptly decide the enforcement of bylaws and ensure thorough dissemination of the ways to apply laws. Especially it is important to minimize possible confusion that may arise at the time of the shift to the New Law and help companies or entrepreneurs, who plan to start new businesses, so that they can develop their plans and commercialize their plans without worry.

2) Clarification of the registration office

The New Enterprise Law requires registration with the enterprise registration office. In the past the Department of Planning and Investment of each People's Committee undertook such registration. It has not been clarified whether or not this past practice will be continued.

3) Simplification and actual reduction

Though the New Enterprise Law takes consideration not to lay excessive burden on enterprises by limiting the frequency of their inspection to once a year, harassment-like inspections are not impossible as was seen in the past. It is necessary, therefore, to specify the

rules for the application of the inspection system and endeavor to virtually reduce inspections.

4) Determination of the schedule for unification of cooperatives and State-owned enterprises

Amendment of the SOE Law and the Cooperatives Law is scheduled following the promulgation of the New Enterprise Law. In amending these laws, it is desirable to take into due consideration both the consistency with the New Enterprise Law and the ways to ensure the integration of the three laws in the future. The timing of the integration should be specified.

5) Planning for promoting a shift from household businesses

Against the background of an improved corporate business environment after the promulgation of the New Enterprise Law, those who have operated household businesses are expected to register themselves as private companies. From the perspective of SME promotion, this move is highly welcome. It is necessary, therefore, to clarify the advantages of operating under the New Enterprise Law and promote their emergence as registered businesses and the shift from household businesses.

(3) Establishment of SME Basic Law

1) An Attitude toward the SME Basic Law

In Vietnam, SME Basic Law is to be established to reinforce the management foundation of SMEs and improve the business environment for SMEs. The law should, therefore, be structured to comply with this situation. In Vietnam, it is necessary to increase the awareness of the necessity for promotion of such enterprises, especially private enterprises, and attach greater importance to the ways to improve the business environment for them. Therefore, the law should be based on the necessity of SME promotion and stipulate the basic direction for this promotion and the government's role in this endeavor.

2) Proposed Structure of the SME Basic Law

It is proposed based upon this study that the SME Basic Law should have the following chapters.

Chapter I General Rules

1) Objectives

Specifically, the policy to promote SMEs should have the following three objectives.

- # To solidify SME management foundation in order to enhance their basic operational strength.
- # To construct an environment for SME business operation and development so that these enterprises can achieve growth and development.
- # To facilitate SME start-ups and to expand their business base.

2) Scope of SMEs

Currently SMEs are defined provisionally as having capital less than 5 billion dong or payroll less than 200 employees. This definition seems to suggest a small scale. However, if the two conditions are connected with “or” rather than “and”, the definition would cover virtually all private enterprises in Vietnam, thus making it possible to support the entire private enterprise sector of the economy.

Therefore, in order to support a wide range of SMEs in Vietnam, which are to be responsible for the country’s future economic development, it is advisable to define these enterprises as “having a capital less than 5 billion dong or a payroll less than 200”.

Even after SMEs have achieved proper development and more than satisfy the above conditions, it is desirable to continue to support the growth-minded SMEs that, despite their endeavor to upgrade their management foundation, still face the problems peculiar to SMEs. It is recommended to define such enterprises by the business laws and decrees that are to be separately established in accordance with individual policy measures.

Chapter II Upgrading of SME’s Management Foundation

In order for existing SMEs to gain an independent development capability, they must improve their internal management resources in all aspects including funds, facilities and equipment, technology, business management, and personnel. The law should specify that SMEs should emphatically undertake management modernization, equipment modernization, technological promotion, cooperation among SMEs, and personnel training, in order to solidify their management foundation.

Chapter III Correction of Disadvantageous Business Environment

It should be specified that SMEs in all operational forms are placed in a fair business environment with big SOEs and foreign-affiliated companies. It should also be specified that when a situation arises in disfavor of SMEs, the competent authorities in charge of these enterprises make a recommendation to correct the situation. It should be specified to correct the disparity that is arising between SMEs and SOEs especially in such areas as trade and other business opportunities, land system, fund raising and collection of market information.

Chapter IV Support for Start-ups

It is necessary to increase the absolute number of SMEs in Vietnam. For this purpose, it should be specified that comprehensive support for start-ups is provided. It should be specified that start-up support will be provided in such forms such as the removal of difficulties

with registration, acceleration of the shift from family enterprises to registered businesses, provision of information on start-up and registration, and the nurturing of entrepreneurs.

Chapter V Roles of Administrative Agencies and SME Organizations

The roles of the government and other organizations in charge of promoting SMEs should be specified.

In the government sector, the functions and roles of the SME Promotion Agency as a policy office, SME Promotion Department of the local people's committees and SME support centers must be specified. It should be specified that the SME Promotion Agency has the role of planning and drafting policies, securing of the budget necessary for policy implementation, the execution and supervision of policies, and the undertaking of surveys and data collection for compiling a white paper on SMEs. The roles of industrial associations such as VCCI, VICOOPSME and UAIC should also be specified.

4.5.2 Structure and Operation of SME Promotion Organization

The structure of the SME promotion organization in Vietnam proposed here has been developed, based on the following policies.

- To give importance to the past efforts made by the existing organizations.
- To establish a body specialized in SME promotion within the central government.
- To minimize the central government's direct involvement, and to make the best of the existing external resources.
- To establish a system for succeeding in the ODA projects of overseas donors as long as possible even when they terminate.
- To pay due attention not only to promotional systems in cities such as Hanoi and Ho Chi Minh City but also to those in local areas.
- To establish a friendly advisor's office where SMEs can seek advice freely.

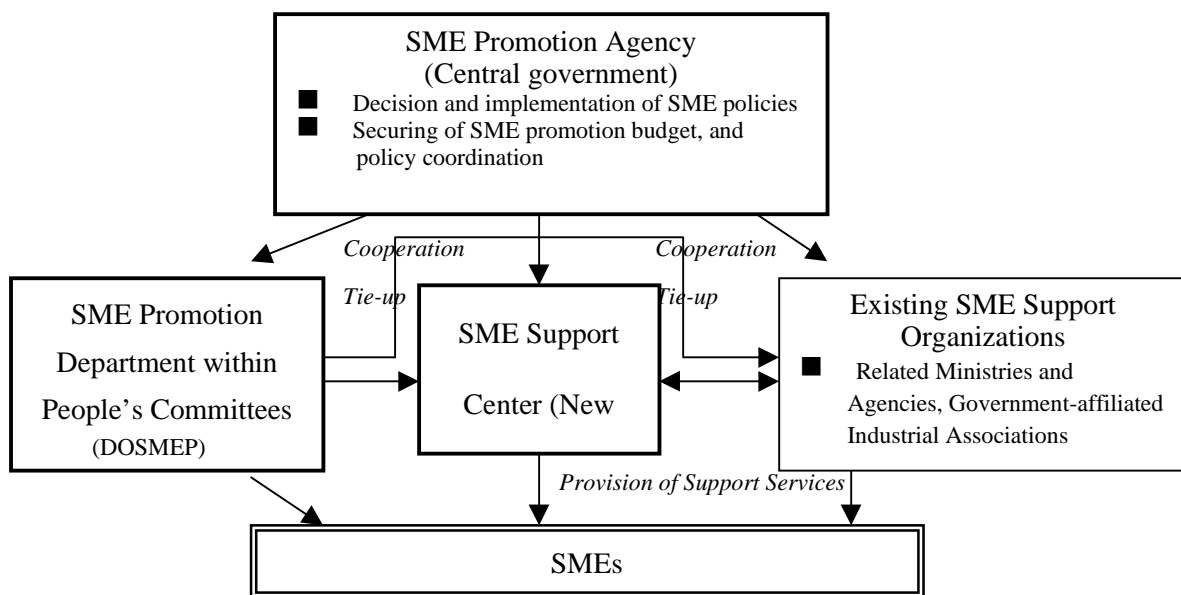
On the basis of these policies, three specialized bodies should be established.

- a) An SME promotion office should be established as a policy office within the central government.
- b) A department specialized in SME promotion should be established within the people's committee.
- c) An SME Support Center should be established as a base for providing services to SMEs in Hanoi, Ho Chi Minh City and other cities.
- d) Other organizations that have endeavored to promote SMEs should strengthen their

support service functions, and improve their SME promotion systems by cooperating with these three organizations.

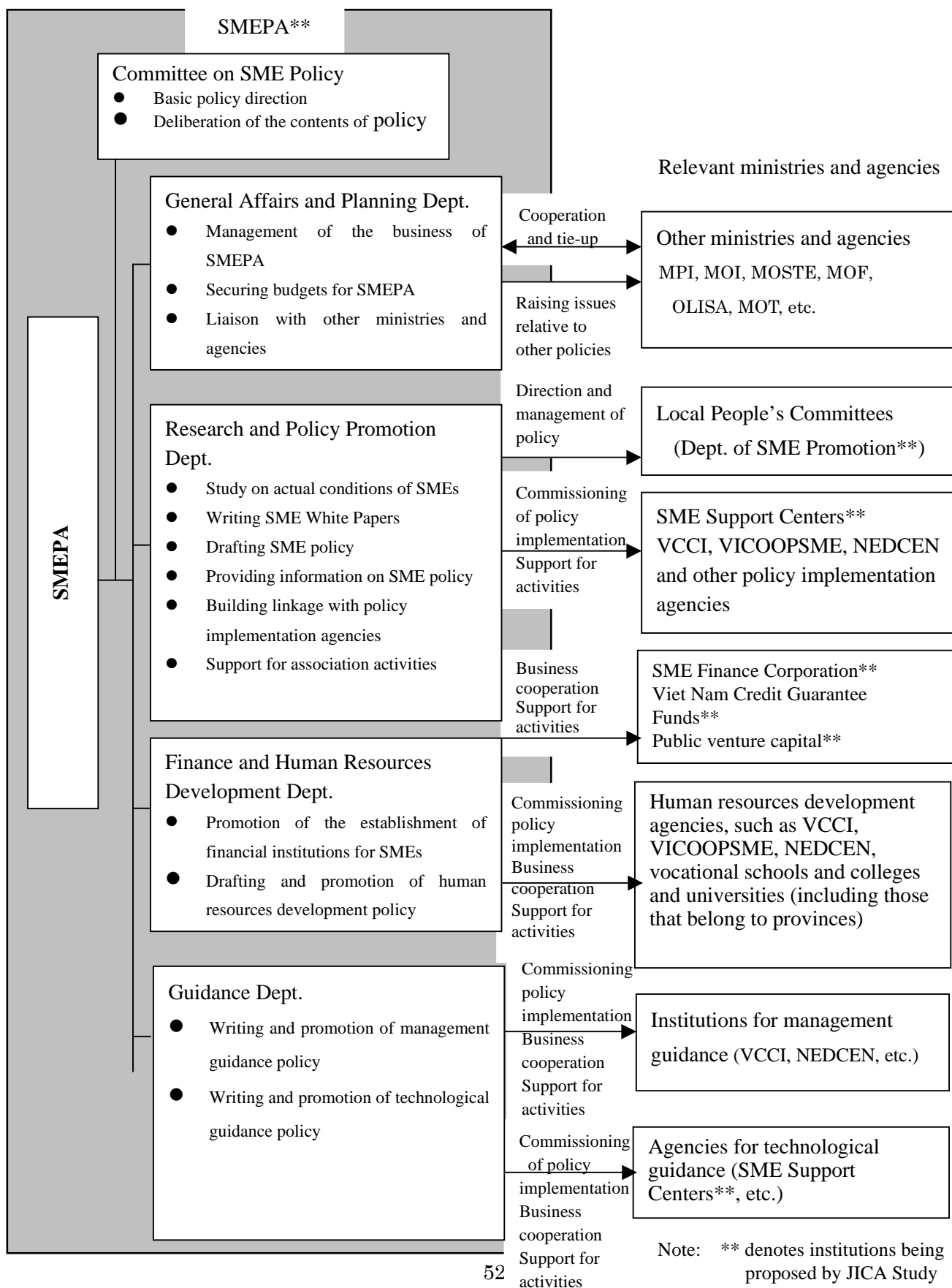
Based on the basic policy described so far, we propose some SME promotion agencies be newly created and enhancement of SME promotion functions of existing ministries and agencies be undertaken.

Figure4- 3 SME Promotion System (From year 2002 onward)



Source: JICA Study Team

Figure4- 4 Roles of SMEPA (Provisional Name) and Its Relationship with Relevant Ministries and Agencies (From Mid-Term On)



Note: ** denotes institutions being proposed by JICA Study Team.

Source: JICA Study Team

(1) Creation of a Department of the Central Government specializing in SME promotion which should be established in the year 2000.

It is necessary to establish in the central government a department specializing in the promotion of SMEs that writes plans and supports SME promotion policies from a comprehensive and strategic perspective. The department should be established as “Small and Medium Enterprises Promotion Agency: SMEPA” to be independent from various ministries and agencies to promote measures that cut across the jurisdictional boundaries of the other ministries.

SMEPA should have diverse functions, including the following:

- Writing SME policies
- Analyses and publication (via a White Paper) of the real situation in which SMEs find themselves—Gathering opinions and requests from SME owners and managers and offering data bases.
- Gathering and releasing market information
- Support for human resources development
- Providing information on policies, etc.
- Raising issues with respect to policies in other areas (land, external trade, infrastructure, the accounting system, etc.)
- Management of councils and committees—identifying issues and making policy recommendations looking to the future.

A committee on SME policy within SMEPA will be established. The committee will be comprised of representatives of various ministries and agencies, government-affiliated industry groups, such as VCCI and NEDCEN, local People’s Committees, privately-owned SME groups, and privately-owned SMEs as well as scholars on SME policies. The Committee will deliberate problems relating to the promotion of SMEs and what is the desirable SME policy to resolve such problems.

(2) Creation of the Department of SME Promotion (DOSMEP) in the Local People’s Committees, which should be established in the year 2002.

Department of SME Promotion (DOSMEP), which will specialize in the development and promotion of SMEs will be established within the local People’s Committees. This department will be a separate body from the Enterprise Registration Department and will have the following functions.

- Provides one-stop information services to SMEs
- Supports SME unions
- Provides information—especially information on policy
- Hears complaints and provides consulting services
- Grasps the actual situation of SMEs and brings issues to the attention of the central government
- Provides its own services (industrial parks, bringing in businesses, public testing and research centers, etc.)

(3) Creation of SME Support Centers (SMESCs), which should be established in Hanoi and Ho Chi Minh City in the year 2002.

SME Support Centers (SMESCs) as comprehensive supporting facilities for SMEs will be established. The Centers will have the following five functions: Provide information, guidance and diagnosis, human resources development support, serve as middlemen for business transactions, and provide technological support. As it would be better for them to provide services to SMEs in large areas, placement of the organization directly under the SME Promotion Agency is desirable or it can be established by people's committee or government-affiliated industrial associations.

(4) Existing ministries

In addition to continuing to take aggressive actions to promote SMEs, the existing ministries and agencies, including the Ministry of Planning and Investment (MPI), the Ministry of Industry (MOI), the Ministry of Science, and Technology and Environment (MOSTE) should cooperate and work closely with the SME Promotion Agency (SMEPA) which will be newly created. It would be necessary for the following ministries to be particularly active in the following areas in promoting SMEs:

(5) Government-affiliated industrial associations

VCCI, VICOOPSME and other government-affiliated industrial associations should enhance their support to SMEs. SME-PC, which comes under VCCI, is expected to enhance its information services and human resources development services, while VCCI should enhance its export promotion functions. NEDCEN, which is a sub-organization of VICOOPSME, should enhance its projects for human resources development.

(6) Financial institutions

Financial support for the promotion of SMEs should be strengthened by creating a SME finance corporation, credit guarantees fund and publicly-funded venture capital.

(7) Private economic organizations

Activities of private organizations, such as the UAIC and various industrial and trade associations, should be supported in terms of funding, information, facilities and affiliation. These associations should be supported because they would make a large contribution to SME promotion through the following activities

- Formulating a vision for future growth of the industry
- Gathering and dissemination of information important for the industry
- Discussion of means of resolving problems common to the industry
- Helping transactions with subcontractors
- Input to government policy—Create forums for discussions with the government.
- Implementation of industry-wide SME promotion projects

Active supportive measures such as funding and guidance for activities of associations should be taken.

(8) Colleges and universities

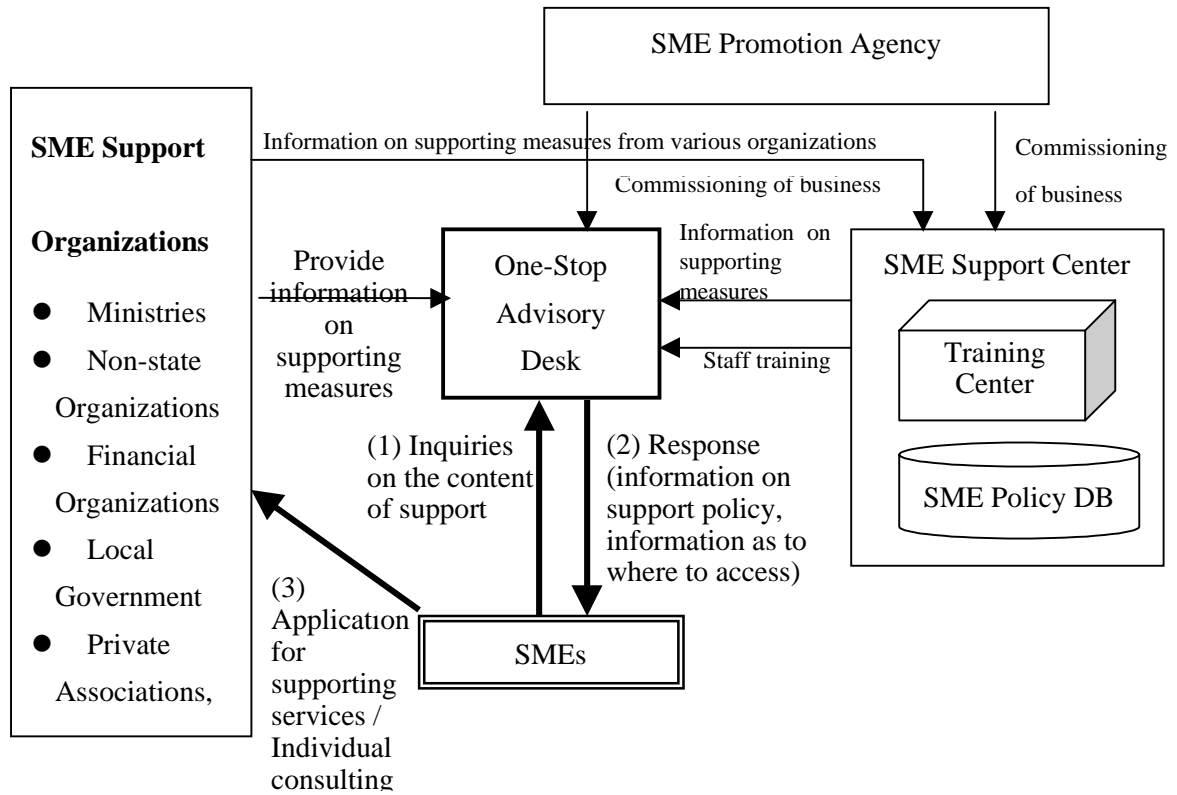
There are such problems as outdated testing and research equipment and facilities in the engineering colleges and the absence of well-developed curriculums for management education in schools specializing in economics and other disciplines. Therefore, enhancement of the functions of colleges and universities is essential.

(9) One-stop Advisory Desk

In Vietnam, its SME promotion policy will be implemented principally via a network through which a large number of governmental institutions provide supporting services by utilizing the record and experiences of various ministries and agencies. In providing such services, the conditions must be readied so that managers of SMEs can obtain information on necessary supporting measures with the minimum effort.

DOSMEP (Department of SME Promotion) to be established within the People's Committee and SMESC (SME Support Center) will play the central role to operate a "One-Stop Advisory Desk", and VCCI (SME-PC), VICOOPSME/NEDCEN and other non-governmental organizations (their headquarters and Ho Chi Minh City branches) will also operate a "One-Stop Advisory Desk", each taking advantage of a region's particular characteristics.

Figure4- 5 An Outline of One-Stop Advisory Desk



Note: (1), (2), and (3) show steps through which SMEs receive supporting services.

Source: JICA Study Team

4.6 Policy Measures in Major Areas

4.6.1 Financial Systems

Policy measures, legal and institutional frameworks required for improving SME financing are large in number and extensive in coverage, out of which the following items are of high priority: 1) realignment of the collateral system, 2) establishment of a SME Finance Corporation, 3) expansion of systems for export promotion, and 4) establishment of venture capital funded by government.

(1) Realignment of the collateral system

The Law on Credit Institutions provides that financial institutions require borrowers of funds to put up collateral, while state owned enterprises are exempted from the requirement. SMEs are left in a handicapped position in two ways; firstly SMEs are in a difficult position to borrow funds because of a lack of collateral, and secondly the competitor enterprises owned by the state are in a preemptive position to obtain financing without collateral.

Current regulations define the eligible objects for collateral in a narrow range within a part of the movable and immovable assets of the borrower enterprises. Knowing that banks will not lend without surrender of suitable collateral, SMEs are customarily in the state that they cannot even visit banks asking for financing. The collateral system should be immediately re-studied for modification in order to enable SMEs to obtain banks' financing for funds required.

First, the decision whether to take collateral or not should not rest upon the government's ruling, but should rather be left to the financial institutions own discretion. Simultaneously, discrimination between state owned and non-state owned enterprises with regard to the collateral requirement should be removed. Secondly, the range of objects eligible for collateral should be expanded so as to enable SMEs to mobilize all and any kind of assets they own. As a practical measure for such expansion, creation of the commercial bills system utilizing promissory note and/or bill of exchange and the assignment system of accounts receivable is recommended.

Further improvement of the collateral system may be attained through the introduction of an advanced system such as the floating charge, in which system objects of collateral encompass not only the assets an enterprise owns at present but any assets which may come to belong to the company under the charge. Further, amendment of the system should be made so as to enable financial institutions to take collateral for future credits to be negotiated. At the same time, the mortgaging system of land use rights should be modified in such respects that access to land use rights by SMEs is made easier, that the requirement of advance payment of rental fees is removed, and that the mortgage registry system should be improved, especially the

information disclosure of mortgage registry.

(2) Establishment of SME Finance Corporation(SMEFC)

Promotion policies for SMEs may not succeed without providing adequate financial support. The prime constituent providing financial support to SMEs within the policy framework should undoubtedly be the policy-based government credits. The implementation of these credits should be carried out by a specialized independent institution working together with competent government agencies. For such a purpose, we recommend that SME Finance Corporation (SMEFC) shall be established and the Corporation should handle all of the policy based government credits. This will allow for their effective implementation under a uniform policy.

The eligibility criteria for SMEFC financing is to be separately defined by the individual policy to be adopted, together with the terms and conditions of lending under the specific policy purpose. The various strategic policy targets and/or target business sector designated by the government should be given special preferential treatment in setting up the relevant policy framework. The kind of targets conceived for SME promotion are, export promotion, modernization of equipment & machinery, employment promotion, market development, introduction of new technology, support for entrepreneur for business start-up, environmental protection, etc.

SMEFC should have a close working relation with the diagnostic support services to be initiated by the SME Promotion Agency through which professional assistance should be provided to SMEs. The assistance would be rendered to enhance managerial capability, ability to prepare business plans and their implementation, and eventually to establish creditworthiness. Particularly, for the enterprise who cannot comply with the collateral requirement, complementary arrangement should be made in which SMEFC will provide financing with the condition that the enterprise accept the diagnostic support and implement the measures prescribed therein.

SMEFC should be established as small in size at its initial stage. While SMEs are geographically dispersed throughout the country, a wide spread network is required to cover substantial number of SMEs. To cope with the situation, SMEFC would provide direct lending to SMEs and at the same time lend through the agency lending system utilizing the commercial banks' network under agency lending contracts between the commercial banks and SMEFC. By utilizing the existing network of commercial banks, SMEs can find easy access to policy based government credits and SMEFC can make avail itself of the relevant functions of credit appraisal and credit administration currently performed by commercial banks.

(3) Expansion of systems for export promotion

In order to promote export effectively, sufficient finances should be made available not only to the exporters who are directly exporting but to the parties who are indirectly involved with export activities. Finances are required at different stages of an export business such as; advance credits for export production; discount of export bills; and through the ultimate collections of sales proceeds.

At present, discussions are under way at government ministries concerned over two kinds of export promotion finances. The first of such is the creation of an Export Credit Fund, which will eventually be transformed into an Export & Import Bank. The second of such is the establishment of a National Export Assistance Fund under the Domestic Investment Promotion Law (Amended). Assistance provided under the Domestic Investment Promotion Law is limited to the projects approved under the law and will face certain difficulties in accommodating the dynamic and ever changing development of international business. Flexibility and quick response are the key elements to be securely built into the institutional set-up, for which purposes the concept of an Export Credit Fund and subsequent Export & Import Bank is preferably recommended.

Eligible enterprises to be financed by the Export Credit Fund should be the ones who are directly engaged in export contracts. No restriction shall be imposed on the commodity to be exported. Special preferential rates of interest may be applied to a distinctive strategic sector that would be designated by the individual policy of the government. The Export & Import Bank, on the other hand, targets not only the direct exporters but also the ones who are indirectly engaged in export contracts. Further the financing menu to be provided should have a comprehensive coverage including plant investment for export production, deferred payment export or import of equipment & machinery for export production. Also the Export & Import Bank is supposed to accumulate professional knowledge and experiences in its organization as the specialized lending arm of the government.

Aside from the deliberation of the Export Credit Fund and the Export & Import Bank, creation of an export insurance system is earnestly recommended. As the volume and market of exports grows, exporters will not always be able to depend upon payment assurance through the letter of credit issued at the importer's end. Exporters are often forced to take the risk of no guarantee, when they try to enter into a market characterized by keen competition. To cope with such a situation, most of the host countries of the exporters provide a government sponsored insurance system through which exporters buy the insurance of credit risks and political risks of importers and their host countries.

Two types of insurance are deemed essential. First, a comprehensive export insurance in which exporters can be insured for all stages of export contracts from contract signing through

final settlement. The second being the export bill insurance in which financial institutions discounting export bills can be protected from the non-payment of the importers. Risks to be covered are both political risk and commercial risk. Insurance premiums should be decided by the government depending upon the types of insurance, risks to be covered, term of coverage, credit standing of the importing country and of the importer. As the key ingredient of the insurance system lies in the effective control and management of the list of importers and their financial standing, the institutional set-up should have a complete control system in place for these elements.

(4) Establishment of venture capital funded by government

The dynamism of SMEs rests upon the rate of new business start-ups and exhibition of entrepreneurship by ventures. Given the existence of new entrepreneurs having an aggressive venture mind, with the appropriate encouragement of both spiritual and physical support and by creating an environment conducive to venture businesses, a self-sustaining chain re-action of dynamic development can be set in motion.

To effectively provide assistance to entrepreneurs for raising seed capital for start-ups, establishment of venture capital is hereby recommended. There are two types of venture funds, one being government funded and the second being privately funded. In this stage of initial development, the government-funded venture capital should be emphasized, given the nature of such funds targeted to newly established and therefore very fragile businesses.

The eligible targets for Venture Capital are the enterprises in the strategic sectors designated by the government and are at the stage either prior to or immediately after incorporation. The purpose of capital investment will be focused upon hatching and nurturing new business initiated by ventures. Capital participation will be made through purchasing equity shares or convertible bonds. Venture Capital lenders should get positively involved with the management of the invested enterprises and play a pivotal role in nurturing them. Venture Capital lenders should maintain a close working relation with the incubator facility, which is being promoted by the government for all-out support of the newly hatched businesses.

Establishment of Venture Capital should follow the completion of the legal framework. The strategic sector targeted has to be clearly identified within the over-all industrial policy as well as its sector-wise promotional policy and the government must make a firm resolution for continued strategic investment. Critical factors for the success of Venture Capital lies in the appraisal of the investment target and its effective management control. While Vietnam has no experience in this field, recruitment should be expanded into the international arena from which personalities of exhibiting the right knowledge, skills and right perspectives can be selected.

4.6.2 Credit Guarantee Systems

(1) Concept of credit guarantee in Viet Nam

In terms of socio-economical demands, the following five items are to be considered as basic elements of the modern credit guarantee system.

- A public organization operating nationwide
- Independent and dedicated organization to carry out appropriate credit guarantee
- Fully available to both SMEs and financial institutions
- Setting of effective ratio for maximum guarantee and holding of a large amount of liquid assets
- Organization with competent and ethical personnel

The operation of the credit guarantee fund focuses on the following three:

- Credit assurance work: Evaluation of appropriateness of SMEs' creditability, and comprehensive analysis of financial situations
- Management work during the specified period: Constant monitoring of the credit guarantee obligations, and management support to SMEs.
- Long-term payment collection plan, management of guarantor's right of indemnity, and support of SME's recovery

To realize these credit guarantee business activities in a rational and effective way, the management division of the credit guarantee organization should be equipped with sufficient flexibility in operation and with computers and networked into the environment.

(2) Overview of Vietnam Credit Guarantee Fund (VCGF)

1) Basis of credit guarantee system

The establishment of a credit guarantee system in Viet Nam is being studied as a core element in the SMEs policies. Thus, the basis of credit guarantees in this case is limited to credit guarantees for the business operational fund liabilities of the SMEs (functionally, joint guarantees).

2) SME sectors to be covered

The basic concept of the credit guarantee system is to expand its range of coverage and provide extensive financing covered by credit guarantees including sound lending not likely to encounter risk (default). It must enhance money circulation and it must follow the law of large numbers principle (expand lending covered by the credit guarantee system and reduce its risk rate) and make provisions to counter risks. Consequently, expansion and opening up of its

coverage range (SMEs and financial institutions) are essential conditions.

Limits set on the SMEs:

Capital of less than 5 billion Dong or a work force less than 200 people.

Industrial sectors covered:

The sectors to be covered should reflect relative ordinances.

Preparing a list of sectors to be covered by the credit guarantee fund and deciding on which are appropriate is also one approach.

Preferential treatment:

Consideration should also be given to preferential credit guarantees for strategic sectors (pinpointed in national projects) such as high-tech venture related enterprises, export product manufacturing enterprises, sectors generating employment, industries related to regional agriculture and sectors manufacturing traditional folkcraft products, as well as provisions for unanticipated disaster relief.

3) Financial institutions to be covered

Currently, the state-owned banks mainly carry out financing in Viet Nam. If various financial institutions come to actively engage in providing loans for business funds of the SMEs, the scope of activities of the credit guarantee system will expand rapidly. This is the reason for deciding to provide credit guarantee coverage for all the financial institutions in Viet Nam. However, it would be better to start the system with limited coverage in the initial stage.

4) Credit guarantee rate

In the world of finance, the *raison d'être* of credit guarantee systems is to provide credit guarantees to individual enterprises or small-scale organizations who are unable to obtain credit guarantee coverage elsewhere. On the other hand, it is important to make measures to avoid risks. Also it is considered to be effective in terms of risk management for the credit guarantee fund to share risks with financial institutions. For this purpose, in most of the countries who have introduced the credit guarantee system recently, or who have an immature financial structure, the credit guarantee system with partial guarantee has been developed. In introduction of such a partial credit guarantee system, sufficient caution and prudent care are required to recognize the independence of the system and its responsibilities, since the credit guarantee organization and financial institutions are supposed to share responsibilities.

In the establishment of this system, Viet Nam is showing a tendency to place expectations on the creation of a partial credit guarantee system as a measure for preventing risks and moral hazard in financial institutions. A partial credit guarantee system can be introduced in Viet Nam while keeping in mind the pros and cons of the system in order to provide for better management of the system.

5) Maximum amount available ratio for guarantee

One social benefit coming from a credit guarantee system is the high rate of fund efficiency. An injection of one billion dong into a credit guarantee fund can be managed by the fund at a ratio of 10 times in terms of the maximum amount available ratio. If the fund can minimize its risk factor, it can offer new loans of 10 billion dong to the SMEs. However, on the other hand, if the credit guarantee fund underwrites larger amounts than its capacity allows, it would immediately fail under the weight of this burden. The decision on the maximum amount available ratio is the most important management guideline for a credit guarantee fund, and it demonstrates the creditworthiness of the credit guarantee fund. Consequently, the credit guarantee fund must undertake cautious and prudent analysis of its own operations and take into account its overall business operation plans, set up an appropriate ratio for the maximum amount available, specify it in its articles of corporation, and keep it in effect.

The setting of the initial maximum amount available ratio of the Viet Nam credit guarantee fund should be decided according to the future balance in the credit guarantee operations, and this is not foreseeable at present. However, caution and prudence should be exercised in the setting of this ratio since this is a vital guideline for the operation of the system.

Thus, the maximum amount available ratio is based on the actual operation of the credit guarantee fund. However, at the beginning of the establishment of the credit guarantee fund, this will be based on an estimate to be decided politically. In order to minimize the burden on the SMEs that use the credit guarantee system, in many cases, the fee rate is set at a low level intentionally. It is necessary to study the systematic structure of the credit guarantee fee, which comprises the basic fee rate and a discount fee rate, which differs depending on the target organizations.

6) Nationwide operational organization

At the beginning credit guarantee fund, organization has to limit its operations to the main regions under a headquarter in Hanoi, but it will be expanded by stages, intending to cover the entire country in the near future. The credit guarantee fund is an information intensive organization, so that the construction of the computer network is a prerequisite for its operation.

(3) Yearly plan

While maintaining conformity and consistency with overall SME promotion measures, it is expected that the Viet Nam credit guarantee fund will be in full-scale operation in the year 2003 and be fully functional for the year 2006 when the Viet Nam's market economy will adopt an open policy internationally.

At the beginning, training in experienced countries and in developing computer skills are requisites for a few years.

1999: Basic ordinances, appointment of senior staff, confirmation of time schedule in preparation for the establishment of the fund

2000: Legal and financial plans, appointment of staff, overseas staff training, and business

- plan development, setting up of rules and regulations
- 2001: Establishment (Hanoi), overseas training, training of computer skills
- 2002: Actual establishment, nationwide organization, guest participation in ACSIC(Asian Credit Supplementation Institution Confederation)
- 2003: Full operation, participation in ACSIC
- 2006: Financial expansion, independent management
- 2010: Review of law and systems

4.6.3 Industrial Land Access Measures

The short-term measures that should be implemented to achieve results by 2005 include the following: development of industrial zones for the SMEs and financial support, a simplification of land purchase transaction procedures and changes in the designation of land utilization purposes and establishing land rules for land usage. There is also a need for the drafting of plans to treat polluted land. The medium-term measures aimed at a timeframe continuing on beyond 2006 include the outright issuance of land use right certificates and the establishment of management know-how. Long-term, sustainable measures needed to continue on beyond 2010 include the training of human resources.

Although progress will be made in the rationalization of land rights and simplification of procedures, this will take some time. Thus, precedence should be given to the implementation of a system to respond to the needs of the SMEs in terms of land for operating their businesses. In concrete terms, this means including the provision of land for the SMEs within the industrial zones development plans of MPI and local government bodies. Industrial zones for the SMEs should be added to the three currently active project categories, EP Zones, IZ (industrial zones) and High Tech Parks, and the authorities should push forward with these developments on a four-pronged basis. It can be said that the bottleneck in developing industrial zones for the SMEs is the lack of the developers. Therefore, measures to alleviate the bottleneck should include the establishment of a fund to provide funding support to developers able to build industrial zones meeting the needs of the SMEs. This would mean setting up funds by the local government bodies along the lines of that established by Ho Chi Minh City.

Measures that we feel should be implemented immediately to promote the development of industrial zones for the SMEs are shown below in concrete terms.

Key points in the promotion of industrial zones for the SMEs

*The approach advocated is to learn from the successful industrial zones projects for the SMEs achieved so far, and create a database and format template. The model should be based on the scheme used by Ho Chi Minh City and the Le Minh Xuan and Tan Tao industrial zones (accommodating about 100 SMEs), and this should be applied to Hanoi and then extended out nationwide.

*This scheme has the intention of moving pollution sources arising from factories in urban areas to the city outskirts. (This aims to achieve a transformation of the cities to green and pleasant places to live in.) The private sector should actively participate in the development of commercial and industrial land for the SMEs led by the government. The developer using funds provided by BIDV would purchase the land. For the buildings and equipment, the urban development investment funds of the local government would be used. The enterprises setting up operation in these zones would be allowed to pay off their debt in installments over a long period of time. After completing payment of the purchase prices, the land rights would be transferred to them.

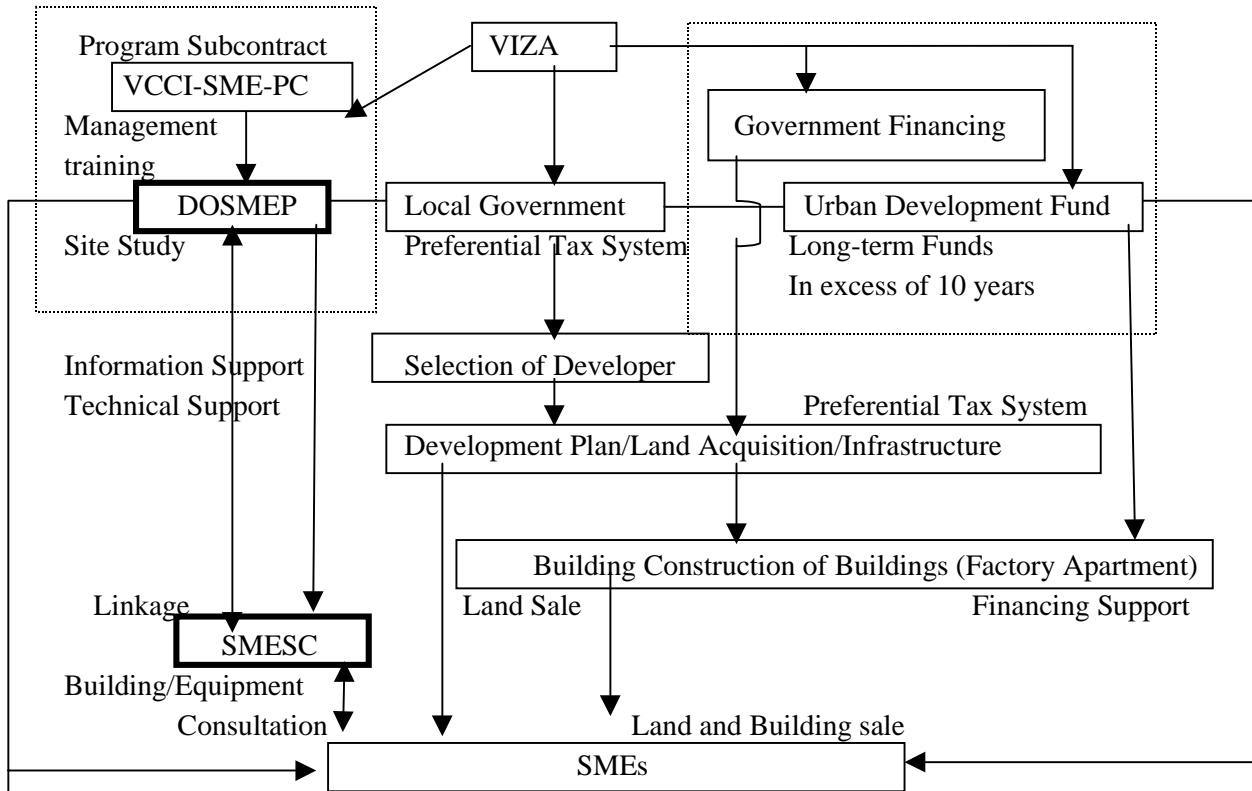
* The government should plan several pilot projects, and create the right conditions for them including a tax system to encourage the relocation of factories, and set up a system to provide funding for land and equipment purchase.

* It is possible for individual medium-standing enterprises to implement relocation, but for the small scale SMEs it could be difficult, and so they can relocate to a factory apartment. The smaller enterprises need to be close to their customers. Thus, by cooperating with each other, they could form a more efficient body similar to a medium-scale enterprise. For example, in the case of enterprises in urban centers such as repair shops where people take their motorcycles to be fixed, the essential functions should be integrated into a service center and this could remain in the urban areas.

* Center for Technical Support should be set up within industrial zones to enhance the competitiveness of the medium size enterprises. This would include support to boost productivity using machinery of the type they are accustomed to using.

The following is a summary of the above points in chart form seen from the perspective of the related competent authorities and their roles.

Figure4- 6 System Diagram Showing the SME Industrial Zone Development Program



Source: JICA Study Team

4.6.4 Export Promotion

The following is an outline of the measures needed to promote the exports of Vietnam's private sector in its entirety, formulated taking the foregoing objective into consideration, and keeping in mind the need to support the growth of SMEs.

Table4- 5 Sequence (Schedule) for Implementation of Measures

	-2005	2006-2010	2011-2020
Relaxation or lifting of regulations imposed on the SMEs such as tariffs and quotas	Quotas awarded entirely on a tend bid basis → Improving efficiency of custom paperwork		
Provision of a one-stop advisory for export promotion and the provision of information on export markets and potential customers	Commencement of information provision →		
Access to export financing	Export Credit Fund → Financing Corporation for SMEs	Import-export Bank→	
Implementation of management consulting services on practical finance, law, tax and exporting	Utilization of foreign experts. → Led by SMESC	Continuous implementation→	
Improvement of quality by setting up product inspection systems	General use of product inspection system →		
Training in international standard accounting and technology	Firm implantation of international standards →	Training human resources	
Research & development and technical support to strengthen export competitiveness such as improvements in product technology and quality	Improvements in quality and technology →	Intensifying research & development	Training human resources in advanced technology →

Source: JICA Study Team

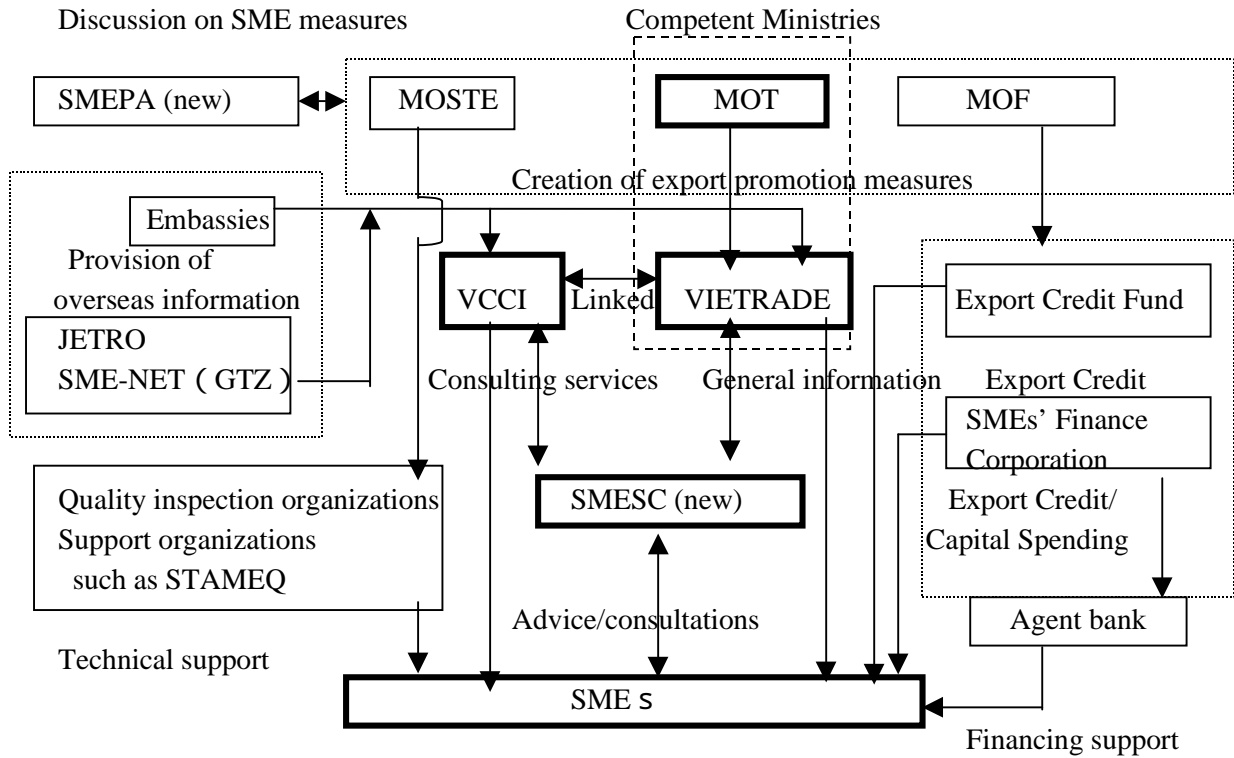
The following measures to promote export are proposed in order to realize support functions centering on information, finance and technology.

Summary of Export Promotion Support Measures

- The keys to achieving promotion of exports include two-way access between the customers and the SMEs and improvements in productivity and quality
- Establishment and implementation of a system to realize export promotion. That means establishing SME Support Centers (SMESCs) as one-stop advisory and support organizations. A system should be put in place enabling SMEs to obtain information on export promotion at the SMESCs on subjects such as seminars, training and exhibitions held by various ministries and related organizations.
- VCCI should be responsible for specific paid services, and VIETRADE should provide general information. At the same time, the SMEs should have free unpaid access to the accumulated information via DOSMEP.
- For the time being, support in concrete form, that is consultations on exporting (introduction of specific types of customers and the standards required by buyers, etc.), should be available to the SMEs at the VCCIs located at eight points nationwide. At that time, it will be necessary to provide support on production control and technology able to meet the conditions of the buyers (delivery time, quality, and price).
- The government should gather information through VIETRADE and provide subsidies to VCCI to strengthen its consultation abilities.
- Creation of a new organization to promote exports at central government level is not necessary. Enhancement of the abilities of the existing bodies, that is VIETRADE and the VCCI is required.
- The Import-Export Bank is oriented towards large-scale fund operations, and it is not immediately necessary for the SMEs to have access to them. For the time being, they should use the funds of the newly established SME financing corporation and the export credit fund.
- In order to ensure that these bodies are rapidly established and to strengthen their activities, that active consideration should be given to establishing a special budget to finance an export strengthening program.

The system shown below would be desirable to promote the measures outlined here.

Figure4- 7 Export Promotion Network



Source: JICA Study Team

4.6.5 Technology / SI Promotion

As one of the immediate measures, the Center for (SI) Technical Support (tentative name) will be established to support the SMEs, by supplying common use services of facilities or inspection tools, training courses regarding production and quality control, plant auditing, and gathering various information. On the other hand, the Center for Promotion of SI Transactions (tentative name) will be established, in order to provide support of trade extensions with foreign enterprises and the SOEs by providing a directory, as an example, including fundamental information to promote various trading. For the middle range time frame, it is to support encouragement of trade between enterprises in earnest, by activating trade with foreign enterprises. The Center for (SI) Technical Support will provide support through advice for high-tech facilities utilization and guidance for financing for equipment installation. For the long range, it is to provide support through training courses or engineer education, which will let the SMEs have their own development capabilities. Basic and comprehensive care for SI technology support will be provided to machinery/parts and electric/electronic industries through the establishment of the Center for SI Technical Support. Specific technology/industry support center should be prepared for other industries such as the garment, pottery, food processing and wooden handicrafts. Specific support measures will be outlined as follows:

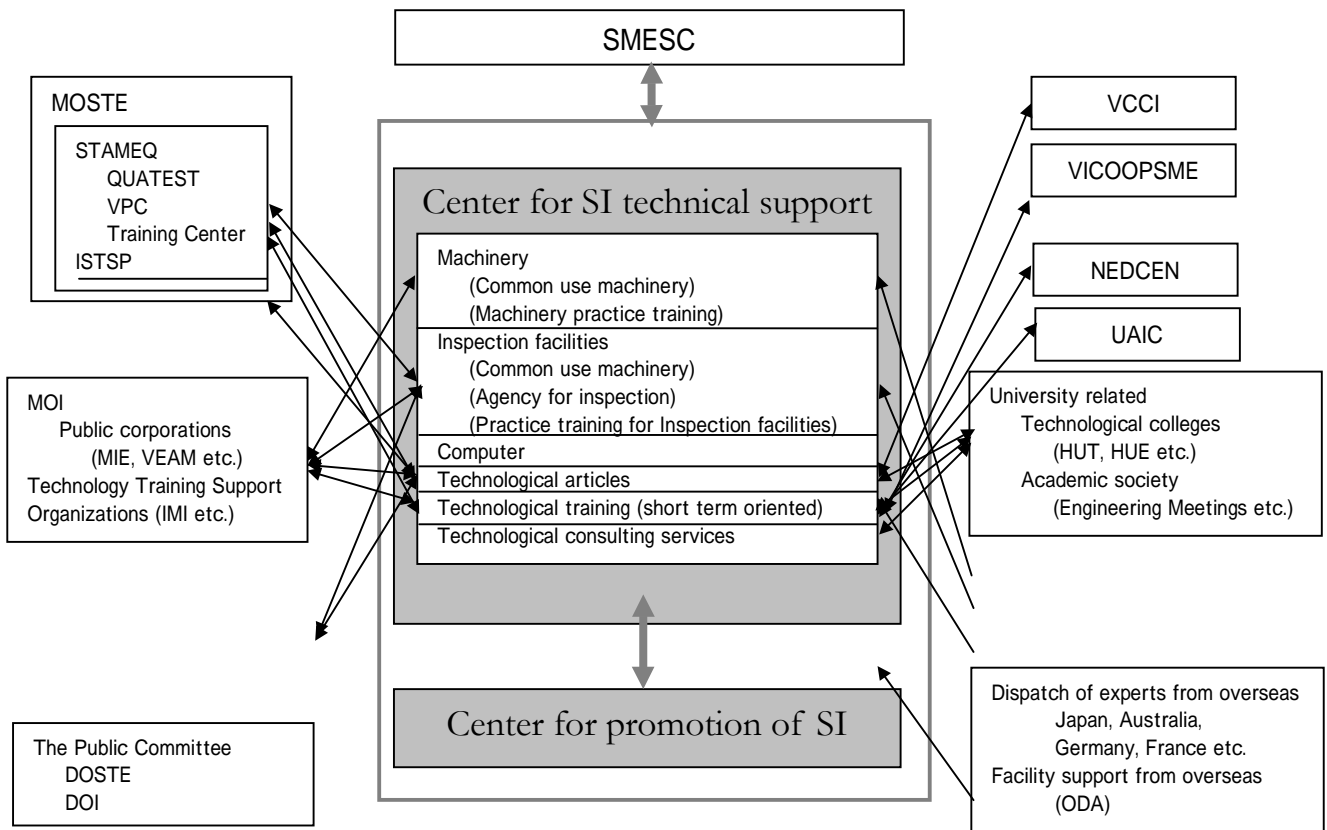
(1) Technology Development Support

Because presently SMEs seldom have opportunities and face needs to develop original product, support is not highly needed for the time being in this area, but will be necessary for the future. Specifically, advice on technology developments or support for technology transfers or research collaborations will be required.

(2) Reinforcement of Production Capacity

Many enterprises cannot utilize their facilities at the maximum level, even if they had some. Training courses or plant auditing will be introduced to improve production management or production and quality control so as to utilize the facilities at their maximum potential. Also, there are many cases, in which enterprises have no skills for high technology processes, nor have any outside support. The Center for (SI) Technical Support will be established, which will allow the enterprises to commonly use advanced facilities, required for high technologies, with a reasonable fee.

Figure4- 8 Functions of Center for (SI) Technical Support and Cooperation with Other Organizations



Source: JICA Study Team

(3) Reinforcement of Quality Control

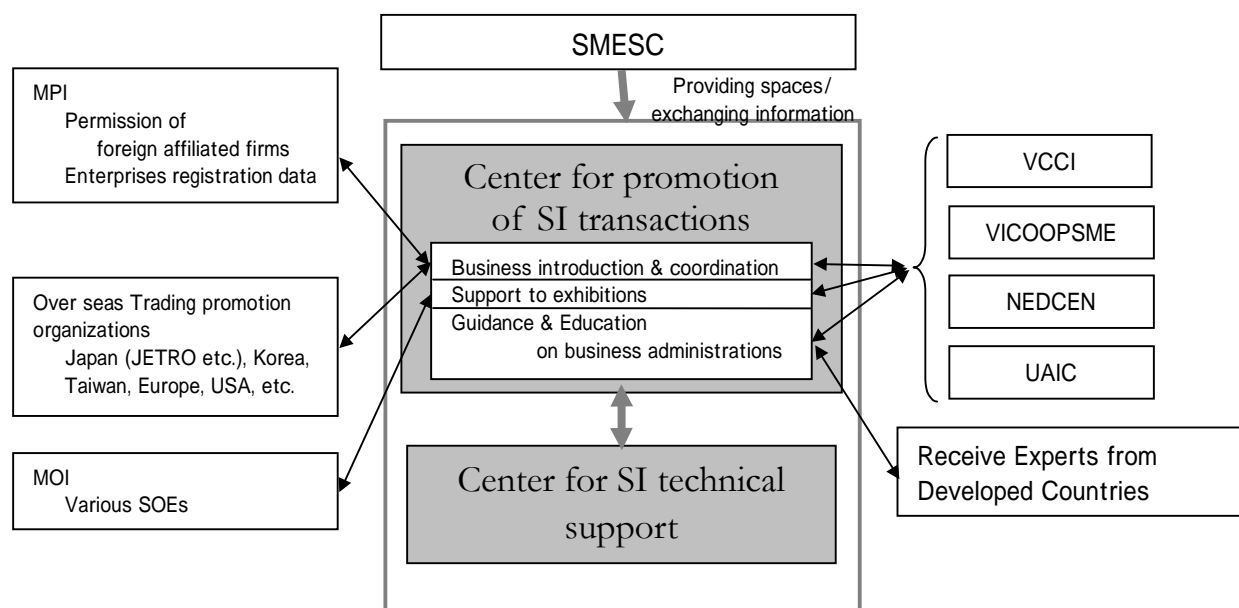
It is said for that overall in Vietnamese industry the products are poor in quality and many enterprises do not realize their quality rating in the industry. It is difficult to improve technical skills, without knowing current technical level. So, this will be one of the important measures.

(4) Activation of business trade

Support for business trade or sales promotions between enterprises, especially driven by SI enterprises, will be implemented, since almost all of domestic enterprises want to have the entire value chain processes in their production line. However, although it is not of critical necessity there is some desire to have trade between enterprises, especially to and from foreign enterprises. Specifically, the Center for promotion of SI transactions will be established to activate this trade. The center will promote both the introduction of business trade and support

this through trade fairs or instructions or advice for business management in corporation with other organizations.

Figure4- 9 Functions of Center for Promotion of SI Transactions and Cooperation with Other Organizations



Source: JICA Study Team

(5) Supply of various information

It is necessary to supply systematically such information that the SMEs are now getting from their personal acquaintances and personal network. Almost all of the enterprises cannot obtain necessary information other than through their personal acquaintances. So, it is necessary to establish a secure system to obtain information easily. Presently, some organizations have training programs for improvement of management capability. Enhancement of these activities will be implemented.

(6) Education of Human Resources

Attitudes on the necessity of education of the human resources of the SMEs are not so strong. Further a critical mind on the development of such education is also not so strong. Such education must proceed in cooperation with industrial organizations regarding quality management or production management. Also, the center for SI Technical Support must promote a succession program to support traditional industrial arts.

Though not discussed here, it is desirable to introduce tax and financial incentives for the

middle and long term, which will provide incentives for research developments or advanced facility installations.

4.6.6 Human Resources Development & Management Advancement Support

Under a market economy system, it is necessary to formulate a comprehensive program, which includes various reform plans such as fostering specialists for education and training, improvement of educational facilities and equipment and their prevailing program. Along with this comprehensive program, the following programs are recommended for introduction.

(1) SME promotion public officers education program

It is a prerequisite for staff working at the counter of government agencies in charge of SMEs as well as local people's committees to have familiarity with SMEs. By accepting any kind of questions and consultation needs, government will be able to locate the problems experienced by SMEs, which will be reflected in their policy formulation. The conventional attitude of public officers was to place private companies under their strict control. Public officers now have to transform their attitude to that of supporting companies. Additionally public officers are requested as a matter of course to have enough knowledge and expertise related to the management of SMEs. However, the knowledge and expertise are not constant as they are changing with the development of economic conditions within the company and surrounding economy, which will force public officers to engage in continuous study. It is desirable that this program be put into practice by such institution like NEDCEN which has a character of working very close to non-state companies and also has experience with the educational programs for governmental workers.

The purpose of this education is to give basic seminars to public officer in an effort to enhance their understanding of SMEs, so that they can serve as policy makers, planners or service provider at one stop advisory desk at SME promotion related organizations or divisions.

(2) Establishment of program to engage in corporate diagnosis and advisory service

The objective of the corporate diagnosis and advisory service is to improve SMEs management practice. By providing corporate diagnosis and advice by designated staff, the attainment of improvement in the form of 1) advanced practice of business management 2) exploration of new business opportunities, and 3) financial assistance is expected. The result will stimulate management capacity enhancement and create a positive cycle that will continue to improve performance. The fruits of these efforts will lead to introduction of a basic administration system for SMEs and the promotion of advanced production control.

During the visits to SMEs by the JICA Study Team, several experts in factory

management observed that the simple effort of cleaning and tidying up of the factory inventory control and change of layout of the factory could help improve their performance. However, severe international business environment is looming over Viet Nam, and corporate management in Viet Nam is lagging behind in terms of administration and technology under the structure of a planned economy. Thus, the introduction of the corporate diagnosis and guidance project is recommended. A project of this kind of form has already been in operation by MPDF with about 50 people in the staff. Experiences accumulated through the activities will be an important asset.

This project consists of three programs, 1) to foster specialists to engage in corporate diagnose and advisory services, 2) to run a corporate diagnosis and advisory services, 3) to promote the program. The promoting body of this project is SMEPA, which actually manage the programs into practice. For the medium term, however, it is desirable for wide and active use of advisers of those NGOs such as VCCI and VICOOPSME to also participate.

- To foster experts who will give corporate diagnosis and advice

Organizations including NEDCEN, and SMEDEC and Training Center under the wing of STAMEQ belonging to MOSTE, and the advisory service of VCCI will be the basis for the experts to conduct corporate diagnosis and advice. NEDCEN, which has a potential to deploy the project nationwide, can act very close to SMEs especially in local areas. STAMEQ has experience in production control including quality control and standardization as well as production technology, and practical experience of product inspection. VCCI is well versed in management technology such as marketing in a market economy. It is recommended that, the above three organizations construct the basis to foster experts who conduct corporate diagnosis and advise, bringing the number of experts to 200 over 2 years starting from the year 2000

Generally, there should be several kinds of experts to conduct corporate diagnosis and advisory services. It is expected that many diagnostic experts in these specialty fields covered by various organizations including the above three will be fostered. For example, NEDCEN specializes in management in general, STAMEQ specializes in manufacturing industry, VCCI has special strength in distribution and commerce. The Guidance Department of SMEPA will supervise the project to bring up diagnostic experts. Instructors are expected to engage in not only education and training, but also to develop diagnostic package, diagnostic tools, as well as databases which will be used for performance reference and standards.

-Diagnosis and advisory activities

At the initial start, a diagnosis and guidance wing will be established within SMEPA, to which related institutions will dispatch staff, and will start experiments in corporate diagnosis and advice services, in tandem with the training of diagnostic experts. During the full-fledged

start of the project, NEDCEN and other institutions mentioned above will engage in diagnostic activities simultaneously. As a stream of services are developed, organizations and experts to carry out services will be introduced by SMEPA by way of the DOSMEP organization to be set up within the local people's committee. After nationwide deployment of the service after the year 2005 as a target, local people's committee will be able to directly select among the local branch of serving institutions. However, candidate corporations in Hanoi and Ho Chi Minh City will be introduced by SMESC to the related institutions right from the beginning of the project.

- Measures to promote corporate diagnosis and advisory services

The purpose of the diagnosis and guidance project is of course to improve the management of individual companies and the achievement of advanced business management. In addition, it examines companies with latent growth potential and actually helps them realize their hidden growth potential. Through this activity, the merit of challenging to management to reform will be fully appreciated by SMEs and activities to effect management improvement is expected to spread widely. The corporate diagnosis and advice project is also imposing a burden on the part of companies who are to be diagnosed because they will be requested to disclose their business data. To make the diagnosis and advice project as the beginning of an upward spiral, coordination with policy finance including SME Finance Corporation as mentioned in Financial Systems Section of this report should be carried out. The very fact that the company was diagnosed and received advice should be used as a reference for creditworthiness under the finance policy.

Aiming at introducing this system in the year of 2002, it is recommended to start its preparation as soon as possible.

(3) Program to foster the management and the administration of SMEs

Along with the project of corporate diagnosis and guidance, management seminars should be held on a regular basis for the management of SMEs..

Here, management seminars are targeting presidents or executives of SMEs, and seminars are given on regular subjects about corporate management in general, finance and accounting, production and quality control. Management instructors as lecturers for the management seminars should also get training, along with training of specialist for diagnose and advice. To make this program broader, it is desirable to supply educational vouchers to the management of SMEs. Regarding a voucher system, the program should be put forward by considering the limited number of educational and training facilities as well as preferential treatment in each

region.

Regarding various systems and programs proposed here, preparation work will have to be started simultaneously with establishment of SMEPA. And the project will have to be carried out with quantitative expansion in scope as projected below.

Table4- 6 SME Related Human Resources Development Plan

	2001	2005	2010
Cumulative number of qualified diagnosis and advisory experts	200	1000	2000
Number of public officers who received basic education On SMEs management and public policies	1000	2500	5000
Number of officers working at one-stop advisory desk	200	650	1000
Management instructors	200	400	1000
Corporate management and administrators education (annual participants)	2000	4000	10000
Estimated number of SMEs (manufacturing)	10000	20000	50000

Source: JICA Study Team