Institutional Environment of the Small and Medium Enterprises

CAO THUY XIEM

ABSTRACT

The research develops a theoretical background for making an analysis of institutional environment to identify factors hindering SME growth in Vietnam. Old institutional economics assumes that institutions can influence individual behavior - individuals act out of duty or awareness of what one is “supposed” to do. New institutional economics adds cognitive influence - individuals act because of conceptions rather than acting based on obligation. Social institutionalism (SI) adopts a multidimensional approach to explain individual behavior. The organizational performance is influenced by external institutional environmental factors and factors at an organizational level. The external institutional factors hindering SME development in Vietnam include economic constraints (limited access to loan, high labor costs), low level of technology, tight competition and high costs of complying formal institutions. At the organizational level, factors hindering SME development are low firm’s flexibility in shifting from informal into formal sector, low firm’s competence and poor organizational strategic orientation. Policies promote SME development should remove above mentioned factors.

Keywords: institutional environment, economic constraints, institutional factors, limited access to loan, tight competition.
INTRODUCTION

The private sector and small and medium enterpries (SMEs) are the driving forces of Vietnam’s economic growth. The number of newly registred private enterprises was 49,203, in 2013, approximately twofold of that in 2003 of 25,653. In 2013, non-state sector employed 6.8 million workers - 59.3 per cent employment in business sector (GSO, 2014; GSO, 2007). Having understood critical role of institutional factors to development of enterpries in general and SMEs in particular, Vietnamese government have issued a number of resolutions and decrees to improve business environment and enhance national competitiveness. Although, obstacles of SMEs - account for 98 per cent of operating businesses - are still there. The aim of this research is to indentify institutional factors hindering development of SMEs in Vietnam.

The research is organized in two parts. The first part of the research develops the theoretical background. The second part of the research presents the research results.

LITERATURE REVIEW

Neoclassical economists conducted behavior analysis of economic actors with assumptions of rationality, perfect knowledge, perfect information, individual preferences and motives formulated entirely from individual cognition. This approach is suitable for generalization of economic behavior. It is not easy to explain real life by applying those simplifying assumptions.

In the late 19th and early 20th century emerged institutional economics. Old institutional economics (OIE) held that institutions can influence individual behavior: individuals maximize their benefits within institutions or act out of duty or awareness of what one is “supposed” to do. The focus of analysis conducted by old institutional economists is formal institutions in comparative perspective.

New institutional economics (NIE) analyzes the influence of institutions on human behavior. Importantly, NIE adds cognitive influence - individuals act because of conceptions rather than acting based on obligation. New perspectives, such as positivism, rational choice theory, and behaviorism, were brought on to analyses politics. The focus of analyzing moved from the surrounding institutions to individuals. NIE posits that institutions operate in an institutional environment which consists of other institutions. Organizations in this environment have the main objective of survival and gaining legitimacy.

Social institutionalism (SI) adopts a multi-dimensional approach to explain the relationship between organizational structures and the social environment in which organizations operate. SI held that culture influences human - in
many circumstances individuals take certain actions because other types of behavior are inconceivable.

Both NIE and IS stress that human behavior is shaped by institutional circumstance (e.g. by legal system, political system, social system, educational system, culture, and so on) and institutions are the outcomes of human behavior.

According to Hussain & Hoque (2002), organizational behavior can be disclosed and researched according to factors belonging to the external and internal environment. Institutional factors perform in different way. Those perform irrespective of an organization are economic and coercive, other factors perform depend on the reaction of an organization are normative and mimetic (Zattoni & Cuomo, 2008; Analoui, 2009; He & Baruch, 2009; Gstraunthaler, 2010). Alternatively, institutional factors perform at two levels - environmental and organizational. If the influence of institutional factors can be analyzed at organizational level that means institutional factors influence organizational systems also.

At the environmental level, economic factors are economic constraints, competition, technological advancement, and coercive factors are accounting standards and financial legislation, socioeconomic-political institutions’ pressures. At the organizational level, mimetic factor is copying best practices from others, normative factors are professionalism/competence; organizational strategic orientation; corporate culture; organizational characteristics.

To survive, an organization has to comply with external pressures because an organization cannot manage institutional factors of the environmental level. The reaction of an organization towards business environment represents institutional factors of organizational level.

**METHODOLOGY**

In order to understand the relationship between the institutional environment and organization behavior, a review of government resolutions and decrees - formal institutions - was conducted to identify what Vietnamese government has done to support enterprises in general and SMEs in particular, and an analysis of SMEs’ reaction towards external environment factors was done using data from a SME survey in 2015 (UNU WIDER, 2016) and secondary materials from websites. Lina Klovienė, (2012) identified the following factors are suitable for analyzing institutional environment - external and internal: economic constrains, technology, competition, socioeconomic political institutions’ pressures, competence, organizational strategic orientation and organizational features. Regarding to external or
environmental level, this research of the institutional environmental influence on SMEs focused on economic constraints (access to loan, labor costs, costs of using infrastructure), technology, competition, and socioeconomic political institutions’ pressures (costs of complying obligations). At the organization level, this research examined organizational features, competence and organizational strategic orientation.

RESULT AND DISCUSSION

External institutional factors
Economic constraints

The economic constrains, the most constraineous factor to the development of SMEs is limited access to loan. According to a SME survey in 2015, the rate of enterprises made new investment slightly improved - 48.7 per cent (compared to 46.7 per cent in 2013). The proportion of micro enterprises making new investment increased while that of small and medium enterprises decreased (Table 1). The largest proportion of finance for a firm’s investment is official loans, and in the next place is a firm’s owned resource. 70 per cent of businesses had no access to official loans and turned towards informal sources.

SMEs’s investment status improved but not as much as expected. The main reasons for that are insufficient demand for firms’ product and restricted access to loan.

The Five-year SME Development Plan 2011- 2015 posed a goal of 35 per cent of total investment belonging to the SME sector. However, there is a gap between the state of SME investment and policy improvement. This due to delayed plan deployment or government has not been able to grasp the needs of SMEs. Generally speaking, poor enforcement practices were pervasive.

Table 1 - New investment

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<tr>
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<th>2013</th>
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<th>2015</th>
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<tbody>
<tr>
<td></td>
<td>Observations</td>
<td>Percentage</td>
<td>Observations</td>
<td>Percentage</td>
</tr>
<tr>
<td>Total</td>
<td>2530</td>
<td>46.7</td>
<td>2628</td>
<td>48.7</td>
</tr>
<tr>
<td>Micro</td>
<td>1812</td>
<td>39.1</td>
<td>1888</td>
<td>42.6</td>
</tr>
<tr>
<td>Small</td>
<td>579</td>
<td>62.9</td>
<td>576</td>
<td>61.5</td>
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<tr>
<td>Medium</td>
<td>139</td>
<td>78.4</td>
<td>164</td>
<td>74.4</td>
</tr>
</tbody>
</table>

Source: UNU-WIDER, SME survey in 2015

In Vietnam, insufficient finance and poor access to loan are chronic illnesses of SMEs. In 2011, 2013 and 2015, enterprises having limited access to loans accounted for 45, 30 and 25 per cent, respectively (SME surveys, UNU-WIDER, 2012, 2014 and 2016). It is observed that the larger the firm size, the higher their investment potential.
The loan access of SMEs tends to decrease. In 2015, 24.6 per cent of responded firms got loans, compared to 25.8 per cent in 2013. However, the number of microenterprises got loans increased while the number of that for small and medium enterprises decreased (Table 2).

Table 2 - Access to loan

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<thead>
<tr>
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<th>2013</th>
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<td>Percentage</td>
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<tr>
<td>Micro</td>
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<td>18,0</td>
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<td>17,3</td>
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<tr>
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<td>579</td>
<td>40,8</td>
<td>576</td>
<td>38,9</td>
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<tr>
<td>Medium</td>
<td>139</td>
<td>64,0</td>
<td>164</td>
<td>57,9</td>
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</table>

Source: SME survey in 2015

Evidence from a SME survey in 2015 shows that causes of hard loan access are requirements set by credit institutions - sophisticated procedures, collateral, description of potential of enterprise, complicated government regulations and so on. Despite the considerable alleviation, it is difficult for firms to complete procedures set by banks in order to get a loan - 30 per cent out of enterprises reported that getting loans was difficult in 2015 (compared to 40 per cent in 2013). The second cause of hard loan access is a lack of collateral - 27 per cent of firms, slightly decreased in comparison to that in 2013. The third cause is firm’s inability to describe its own potential, which significantly increased. In the fourth place are complicated government regulations which increased also. The main determinants of a firm access to loan are firm size, ownership - discrimination exit between state owned and non-state owned firm, geographical location of firms - urban or rural area. Regarding to how the government can help enterprises expand and increase its own profits, the answer of 20 per cent of firms is to provide easier loan and of 17 per cent of firms is to remove more and more bureaucratic requirements.

The second contraineous economic factor to SMEs development is increased labor costs. Firm labor costs include direct and indirect expenses. Direct expenses consist of wage, bonus, lunch, housing and transport allowance. Indirect expenses include of social insurance, welfare services, credit support, food support, periodic health test, costs of dismissal and recruitment. It is clear that firms’ labor costs are influenced by formal institutions, such as regulations on wage, compulsory social welfare and unemployment insurance system.

The firm largest share of labor costs is wage payment. Average nominal wage was VND4.4 million per month, in 2015, higher than the minimum wage of VND3.1 million per month (by 103/2014/ND-CP). Wage deferential is
present in all activities - VND4.5 million for man and VND4.2 million for woman. On average, the real wage in 2013 was VND2.52 million, in 2015 it was VND2.89 million, increased by 15 per cent or an annual growth of 7.5 per cent. A positive relationship between wage and firm size is observed. The proportion of firms paid for social insurance in the category of small enterprise is higher than in the category of micro enterprises. Women-headed enterprises tended to pay higher social and health insurance premium than male-headed ones.

There are no clearly defined sanctions for non-compliance, so the proportion of firms paid for social insurance is extremely low, especially in the non-state sector. There is a relationship between the rate of firms paid for social insurance and the firm size - the smaller the firm size, the lower the rate. The vicious circle could prevail. Low proportion of small enterprises pay for social insurance, low quality of labor used, low ability to pay for social insurance. It is to say, enforcement characteristics of institutional environment impeded enterprises to recruit and maintain their own workforce, especially skilled workers.

Another constraineous factor to development of SMEs is low quality of labor. Most of enterprises have to retrain their employees. This adds to labor cost increase.

Generally speaking, all logistics and transportation activities were done by SMEs themselves. The reason for that is low quality of logistics and transport infrastructure, both locally and nationally, leading to longer transport times and higher transport costs. SMEs’ inefficiency derived from that.

Technology

Innovation takes two forms: introducing new products and improving existing ones. The pace of business launched the new products was 23.8 per cent in 2015 compared to 4 per cent in 2013.

This resulted from the fact that the National Technological Innovation Fund (by Circular 120/2014/TTLT-BTC-BKHCN) was established. The trend of innovation is similar to that of diversification: the larger the firm size, the bigger the proportion of firms making innovation; in the urban areas the number of firms making innovation is less than that in the rural ones, and less firms in the South innovate than in the North.

Both innovation and diversification vary by activities. The proportion of firms innovated and diversified was highest in food processing activity - diversification took place in 15.7 per cent out of firms in 2013, and 25.3 per cent in 2015. 27.8 per cent out of firms introduced new product in 2015, compared to zero per cent in 2013. 19.8 per cent out of firms improved their existing product in 2015, compared to 14.7 per cent in 2013. Lowest
Diversification was the garment activity - 1.1 per cent in 2013 and 3.0 per cent in 2015. Lowest proportion of firms in rubber production introduced new product - 6.3 per cent in 2013 and 2.7 per cent in 2015. The proportion out of firms made improvement of existing product is the garment - 7.5 per cent in 2013 and furniture in 2015 - 7.8 per cent.

**Competition**

88 percent of firms perceived tight competition in their activity. Tighter competition is more prevalent the urban area than in the rural one. In 2015, 83.5 per cent of firms in the rural area thought that they faced competition, at a certain extent, this number in the urban area is 92.6 per cent. The larger the firm size, the tighter the competitive pressure.

Unsold product reflects limited market demand. Firms’ large unsold products were caused by plentiful of products of the same type and no access to good sale channels. This is a sign of tense competition.

SMEs seemed inflexible in foreign markets. In spite of an increase compared to previous surveys, in 2015, just less than 7 per cent out of SMEs exported their product. Internationally accepted standards are rare, the proportion of SMEs had no quality or environmental certificate is high. It is necessary to support for SMEs to participate and maintain their presence in foreign markets (both direct and indirect).

**Increased costs of carrying out obligations**

Enterprises’ activities are regulated by certain rules. The formal regulations are clearly defined in accordance to certain principles and institutions. Enterprises incur formal and informal costs of carrying out their obligations. Formal costs consist of financial and non-financial. Financial costs are taxes and customs fees; non-financial expenses represent lost time or opportunity costs. Informal costs arise from tacit collusion between those carrying out obligations and civil servants. Costs of this type are bribes and incremental costs raised by forced purchase of inputs in informal markets.

There are positive changes in informal institutions. Enterprise income tax has fallen from 25 per cent in 2013 to 20 per cent in 2016. Enterprises may declare taxes online, in 2014, 95 per cent out of firms did so. Firms spent 247 hours per year to pay taxes in 2014, compared to 537 hours in 2013. However, this figure is higher compared to the ASEAN-6 average of 121 hours per year. Clearance at international seaports took 21 days on average. It took 235 hours per year to pay for social insurance, compared to 335 hours in 2013. The time for carrying out administrative procedures for the establishment, reorganization and dissolution of enterprise reduced by 50 per cent,
particularly, for commencement of business 17 days needed. Firms took 70 days to be supplied with electricity. As a result, Vietnam global competitiveness increased from 68/148 to 70/148 (19/NQ-CP, 2016). 985 surveyed businesses were in informal sector in 2013 still there in 2015. In the period 2013-2015, 96 per cent of enterprises moved to the formal sector. This is a consequence of the fact that Law on Investment and Law on Enterprise 2014 has replaced those issued in 2004 - an evidence of reaction of organization to changes in the institutional environment. Recently - March 2018, the National Public Service Portal has been established to provide public services online, so it is to expect lower costs incurred by carrying out obligations.

However, containing factors towards firm development still exist, especially troublesome bureaucratic administrative procedures. 70 per cent of enterprises in the formal sector in 2013 gave bribes and this figure was 97 per cent in 2015.

To avoid losing time, firms gave bribe. In 2013, 44.6 per cent out of firms incurred informal costs and that figure in 2015 was 42.7 (Table 3). The status slightly improved. 58 per cent out of enterprises gave bribes in 2013 did so in 2015 and 30 per cent out of firms did not give bribes in 2013 did in 2015. This represents the fact that a significant proportion of firms aware that it was necessary at that time (Table 4).

<table>
<thead>
<tr>
<th>Table 3 - How many enterprises give bribe?</th>
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<tr>
<td></td>
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<td></td>
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<tr>
<td>Total</td>
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<tr>
<td>By sectors</td>
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<tr>
<td>Enterprises in formal sector</td>
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<tr>
<td>Enterprises in informal sector</td>
</tr>
</tbody>
</table>

Source: SME survey in 2015, UNU WIDER

Main reasons for firms making bribes are "to have access to public services" and "to deal with tax relating problems". In 2013, 28.4 per cent of enterprises reported they gave bribes to have access to public services. In 2015, this figure was 18.75 per cent meaning public administration was improved. In 2013, 17.6 per cent of enterprises reported they gave bribes to deal with tax relating problems. In 2015, this figure was 24.1 per cent showing degraded status. There was an insignificant change in causes of giving bribe as "to win supply contracts for government", "to deal with problems relating to customs" and "to obtain a license and certificate". 35 to 38 per cent of enterprises reported they gave bribe due to other causes, might be to avoid harassment in enforcement practices.
According to a SME survey in 2013 and 2015, giving bribes did not create more jobs in comparison to not doing so.

**Table 4 - Changes in informal costs**

<table>
<thead>
<tr>
<th></th>
<th>No informal costs 2015</th>
<th>Yes informal costs 2015</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Firm s</td>
<td>Percentage</td>
<td>Firm s</td>
</tr>
<tr>
<td>No informal costs</td>
<td>Firms</td>
<td></td>
<td>Firms</td>
</tr>
<tr>
<td>2013</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>810</td>
<td>69.8</td>
<td>351</td>
</tr>
<tr>
<td>Yes informal costs</td>
<td>Firms</td>
<td></td>
<td>Firms</td>
</tr>
<tr>
<td>2013</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>931</td>
<td>41.8</td>
<td>545</td>
</tr>
<tr>
<td><strong>Tổng</strong></td>
<td>Firms</td>
<td></td>
<td>Firms</td>
</tr>
<tr>
<td>1201</td>
<td></td>
<td></td>
<td>896</td>
</tr>
</tbody>
</table>

*Source: SME survey in 2015, UNU WIDER*

Paying informal costs is different between firms exporting and not exporting their product. Giving bribes is common practice among firms that had export, 40 per cent out of those paid informal costs. Of exporting firms that gave bribe, 79.4 per cent did so to deal with customs relating problems. This proved the poor enforcement of formal institutions. The report of SME survey in 2015 shows a remarkable increase of formalization of firms in 2013-2015, which positively relates to a firm growth and insignificantly relates to firm exit, whereas there is no relationship between bribery costs and firm growth or firm exit. So it is to say, giving bribe is a waste of society’s resources. Informal cost burdens to enterprises generated from ambiguous requirements for doing business, lot of which are qualitative without clearly explanation, so bad civil servants could abuse their position for their own personal benefits. Alternatively, the institutional environment is not transparent.

Recognizing the seriousness of the problem, the Vietnam government has instructed ministries to revise all requirements for doing business in order to remove or simplify them. According to report of the Government Office, so far, 55 per cent or 675 out of 1216 requirements were removed. The Ministry of Industry and Trade has done revision three times. The first time, 123 of 443 procedures under the management of the Ministry of Industry and Trade were removed or simplified in December 2016, of which 15 removed and 108 simplified (the solution No 4846 of Ministry of Industry and Trade). The second time, 183 out of 451 procedures at that time were simplified or removed - 134 simplified and 49 removed (Decision 3610a/QĐ-BCT) in 2017. In addition, investment requirements belong to 16 types of activity under the Ministry of Industry and Trade’s management, defined in Law on Investment, were removed or simplified by 55.5 per cent. The third
time, in 2018, according to the decision No 1408, 54 administrative procedures will be removed or simplified (12 removed and 42 simplified) in 10 fields - trade promotion, food safety, export and import, commodity exchange, quality standard, competition management, technical safety, alcohol business, energy, and electricity.

Despite a lot of requirements for doing business has been simplified or removed, their number increased from 443 in 2016 to 451 in 2017 and 541 in 2018. This can be explained that while some requirements were abolished or simplified others were set. This is a worrying sign of the business environment.

**Internal factors**

At the organizational level, factors analyzed in turn are organizational features, competence and organizational strategic orientation.

**Organizational features**

SMEs in the sample belong to all sectors and legal forms: family business, private enterprise, partnership, collective/cooperative, limited liability and holding company. Enterprise dynamics is influenced by a number of factors, such as location, type of activity, ownership and firm size.

On average employment growth was 6.4% in 2013-2015, in contrast to the tendency in 2011-2013. Employment growth varied by ownership, location, sector with controlled firm size. Employment growth in 2013-2015 was 5.2 per cent per annum. This is shown by an increase of fulltime worker - growth rate was 12.3 per cent in 2013 and 12.9 per cent in 2015. New jobs created in small enterprises accounted for 47.5 per cent and in medium enterprises accounted for 53.3 per cent. According to a SME survey in 2015, no shift between firm size categories was observed - 93 per cent out of microenterprises in the 2013 survey were still in this category by 2015, with only a handful of microenterprises moved into medium one. The employment growth of firms in the formal sector was higher than that in the informal sector. In the formal sector, on average, one job was created per firm. The rate of new job creation in firms used 5 workers and up operating in the informal sector decreased. The negative relationship between the new job creation growth and a firm size was observed, both in urban and rural area. Job creation in food processing activity increases as firm size increases, the opposite happens in activities producing product from metal fabrics.

17.1 per cent out of 2419 firms surveyed in 2011 did not operate in 2013. Alternatively, 8.2 per cent out of firms exit per annum. Firm exit in the formal sector is higher than that in the informal sector. In addition, various firm exit possibilities by activities means activity information is important.
Whether a little change of employment and lower firm exit in the informal sector is a good signal?

**Competence**

SMEs made investment mainly to improve productivity rather than improve product quality or introduce new product. By definition, a firm has 2 or more types of product is a diversifying firm. In 2013, 11.1 per cent out of firms had more than one type of product, this figure increased by 0.5 percentage point in 2015. Low rate of firms with diversification is a low competitive and inability to supply different types of product at the same time. The degree of diversification of firms varies by firm size and location - the larger the firms, the higher levels of diversification; firms in urban areas are less diversified than in rural ones; in the North is lower than in the South.

**Organizational strategic orientation**

The above mentioned SMEs’ limitations reflect poor strategic orientation. Diversification and product innovation are ways to get rid of this trap. The sales structure of SMEs reflected a limited vision - 41 per cent out of firms sold their product to local people mainly, 50.9 per cent sold their product to non-state owned enterprises and a handful of firms sold their product to tourists, non-commercial state-owned enterprises, FDI enterprises and export. However, no clear answer was found to the question should firms export their product or not because the revenue and profit per full-time worker in firms without export is higher than that of exporting ones.

Exporting and non-exporting firms have different responses to the business environment. Proportion of exporting firms making innovation in 2013-2015 is higher than that of non-export firms - in 2015, 29.1 per cent introduced new product (compared to 22.8 per cent in 2013), 24 per cent improved existing product (compared to 12.6 per cent) and 16 per cent introduced new process (compared to 4 per cent).

In 2015, the proportion of firms used law consultant services was higher also - 14.4 per cent (compared to 2.5 per cent). This means exporting firms are aware of requirements of the international business environment.

**CONCLUSION**

Enterprises are the driving force for the development of the economy. In Vietnam, 98 percent of operating enterprises are SMEs. Therefore, the role of SMEs is very important for the country’s economic growth. Firms operate in a certain institutional environment. The appropriate institutions facilitate the firm development, otherwise they will become obstacles. In past years, the Vietnamese government has made great efforts in institutional reform aiming at abolition of factors hindering development of enterprises. However, the results were not as good as expected. Institutional reform continues. Basing
on the research results, we can conclude: (1) at the institutional environment level, the institutional factors hindering development of SMEs are limited access to loan, high labor costs, low level of technology, tight competition and high costs of complying formal institutions; (2) At the organizational level, the factors hindering SMEs development are a firm's low flexibility in their shift from informal into formal sector - formalization positively influences employment growth, a firm’s low competence and poor organizational strategic orientation.

**Implications**

To remove obstacles preventing the development of SMEs, policies’ goals should be (1) easy access to loan - simple administrative procedures, losened requirements of collateral, technical assistance from bank staff in describing firm potential or use field inspection instead; (2) productivity increase instead of labor cost reduction; (3) stimulate technological innovation; (4) provide information, support to promote market expansion to reduce competitive pressures; (5) Ensure transparency, effective sanctions against poorly performed or dishonest public servants.

Regarding organizational factors, policy goals should be (1) facilitate the formalization of firms and the shift between firm size categories, (2) provide training for SME leaders to help them in strategic orientation.

**Limitations**

Data from SME survey in 2017 is not available because the SME survey is conducted every two years which makes policy implications not so updated.

**REFERENCES**


https://gso.gov.vn