

# Challenges of Small and Medium-Sized Enterprises (SMEs) In Vietnam during the Process of Integration into the ASEAN Economic Community (AEC)

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## Abstract

*This paper analyzes the economic obstacles faced by small and medium sized enterprises (SMEs) in Vietnam during the process of integration into ASEAN Economic Community (AEC). It also examines the level of awareness of those obstacles within SMEs and the preparation they made, if any, to overcome those obstacles. To achieve the research objectives, quantitative methods are used. With surveyed data that covered 2,575 SMEs in Vietnam from the Central Institute of Economic Management (CIEM) and the data from the Asian Kenan Institute (OSMEP), the results showed that Vietnamese SMEs are facing major obstacles, such as: (1) intense competition from domestic as well as foreign businesses (2) difficulty in consumer markets, (3) lack of capital, and (4) limited understanding of relevant laws. Lastly, the study provides some suggestions to help Vietnamese SMEs overcome these obstacles and prepare to actively integrate into regional markets.*

**Keywords:** *Integration, Asean Economic Community (AEC), Vietnamese SMEs*

## 1. Introduction

SMEs play a vital role in the community of Asean countries, accounting for 89-99% of all enterprises in the Member States, creating 52-97% of employment, contributing 23-58% of GDP, contributing 10 - 30% of total exports (OECD, 2012). SME development is one of three important missions of the AEC. However, as reported by the OECD (2012) the primary difficulties faced by SMEs in Asean countries are limitation in accessing to the capital and technology, and highly competitive markets, in addition, the knowledge of small entrepreneurs not meet the requirements of integration. In this situation, many policies were

proposed to support SMEs, but their effectiveness is not high. In the ASEAN Vision to 2020 and the Hanoi Action Plan, ASEAN countries have identified the goals of becoming an integrated economic community with free movement of goods, services and investment. An important aspect of ASEAN economic cooperation is to promote the role and the development of SMEs, and to improve the competitiveness of these enterprises in the regional market as well as in the world. The integration into AEC not only brings opportunities but also creates great challenges for SMEs, in particular SMEs in the developing countries. With the small scale, high production costs, lack of production experience, lack of capital and technology, insufficient market information (Cuong, Sang and Anh, 2008), SMEs in Vietnam need to understand their obstacles and be fully aware of the strategy to reach regional market and sustainable integration into AEC.

## 2. Literature Review

SMEs often faced with three basic limitations: (1) knowledge and skills of employees (Clarke and Gibson, 1998; Ntsika, 2001); (2) lack of management capabilities (Megginson, Byrd and Megginson, 2003; Kuratko and Welsch, 2004; Rwigema and Venter, 2004) and (3) access to markets, restrictions on capital and market shares (Ntsika, 2001).

Once taking part in international integration, wide - opened market also means the competition is more fierce, resulting in three cases: (1) having ability to compete internationally, benefiting from integration, (2) weak integrating ability, should improve the production capacity to meet international standards, reforms in terms of personnel to be able to survive amid fierce competition; Samad (2007) gave an additional case, that is (3) the corporate sponsored by the State are not affected so much by the integration process.

Many previous studies have showed that economic integration brings both opportunities and challenges for SMEs (Hirschman, 1958; Rugman 1997; OECD, 2000; Macmillan, 2008; Oum and Narjoko, 2010; Rahman and Ramos, 2010; Parida, 2012; Spithoven, 2013). However, because of limited capacity, it is so hard for SMEs to take advantage from the integration process. So they just tend to concentrate on coping with the major challenges during the integration process. It is a fiercely competitive environment, due to the technical requirements and high quality standards of oversea manufacturers as well as importers in production networks. Due to the issues related to macroeconomic policy such as tax policy, technical barriers and differences in business environment (Oum and Narjoko, 2010). Since then, These issues reveal the weaknesses of SMEs in understanding the law as well as catching up with the requirements and regulations of foreign markets. In general, SMEs suffer from a lack of management skills and techniques to achieve high efficiency (Rahman and Ramos, 2010).

In addition, limitations in financial resources is one of the major barriers to integration for SMEs (Oum and Narjoko, 2010; Macmillan, 2008). Capital restrictions make it difficult for them to invest in infrastructure, expansion of production, or enhancing export (Rundh, 2007; Zhang, Sarker, 2008; Wengel and Rodriguez, 2006). Furthermore, this has decisive effect on research and development (R&D) activities. Also, this limits the creativity of the businesses, causes them to fail to gain knowledge about internationalization and reduces the level of

international transactions (Macmillan, 2008).

In addition to subjective obstacles, SMEs are facing objective difficulties such as administrative procedures, technical barriers, tariff barriers, and differences in culture and business environment (OECD, 2009). To overcome these obstacles, SMEs need not only financial but also technical support from the government. Besides, these enterprises need some improvement in administrative procedures or policies that give encouragement and the priority to them.

Due to lack of collateral, fragility management and financial systems, and uncertain profitability, SMEs find it difficult to access bank loans (Shinozaki, 2012). To remove this bottleneck, the government should both develop many credit guarantee programs for SMEs and give the low interest credit package to help these enterprises reduce financial costs, increase in investment in production. Besides, the government needs to diversify its information sources through oversea missions to establish an integration information system for improving trading promotion program of the government and strengthening the quality of human resources by professional training systems; The result is improving the transparency of the business environment (Oum and Narjoko, 2010). Therefore, carrying out the research into existing obstacles and perceptions of SMEs in the integration process will help these businesses to prepare carefully to reduce negative effects of integration.

### **3. Data and Methodology**

This research used quantitative methods to assess the current economic constraints of SMEs in Vietnam as well as the awareness and preparation of these enterprises for integration process into AEC. To assess current difficulties of SMEs in Vietnam, the paper used data of SMEs surveyed by the Central Institute of Economic Management (CIEM). The survey conducted in-depth interviews with 2,575 SMEs which concentrated on four provinces in Vietnam including Ho Chi Minh City (636 companies), Nghe a province (358 companies), Ha Tay province (345) and Hanoi capital (282 companies). The dataset covers many different aspects of a business. However, within the domain of this article, the author just focuses on economic constraints of SMEs in the integration process. These enterprises have problems during development with three main obstacles, these are: (1) lack of capital (628 companies), (2) reduced orders (553 companies), (3) unfair competition (445 companies).

Besides, the majority of SMEs in Vietnam (2258 in total 2,575 surveyed enterprises) are facing with fierce competition in the market, and 1,749 businesses have many difficulties because of the economic crisis. To measure the awareness and preparation of SMEs in Vietnam to integrate into AEC, the author used the surveyed data conducted by OSMEP in 2009. This dataset is about important information of 93 SMEs in 10 ASEAN countries, such as the general information of the businesses, the operating and financial obstacles of the businesses, as well as supporting activities for SMEs to expand these businesses in AEC.

#### 4. Obstacles to Economic Growth of SMEs in Vietnam

##### 4.1. Limitation of SMEs in Vietnam

- Little understanding of laws, regulations and assistance from the government.

SMEs still confront difficulties in bureaucratic procedures, led by the business registration procedure (69.27%), and followed by those of fire safety certificate (27.84%) and social insurance (23.87%), with the focused distribution in four big cities of Vietnam: Ho Chi Minh, Ha Noi, Ha Tay and Hai Phong. However, the waiting time for business registration in Lam Dong province is the longest with the average of roundly 23.77 days, while Ho Chi Minh, Ha Noi and Ha Tay respectively take 23.17, 22.71 and 21.28 days, higher than the common average level (23.17 days).

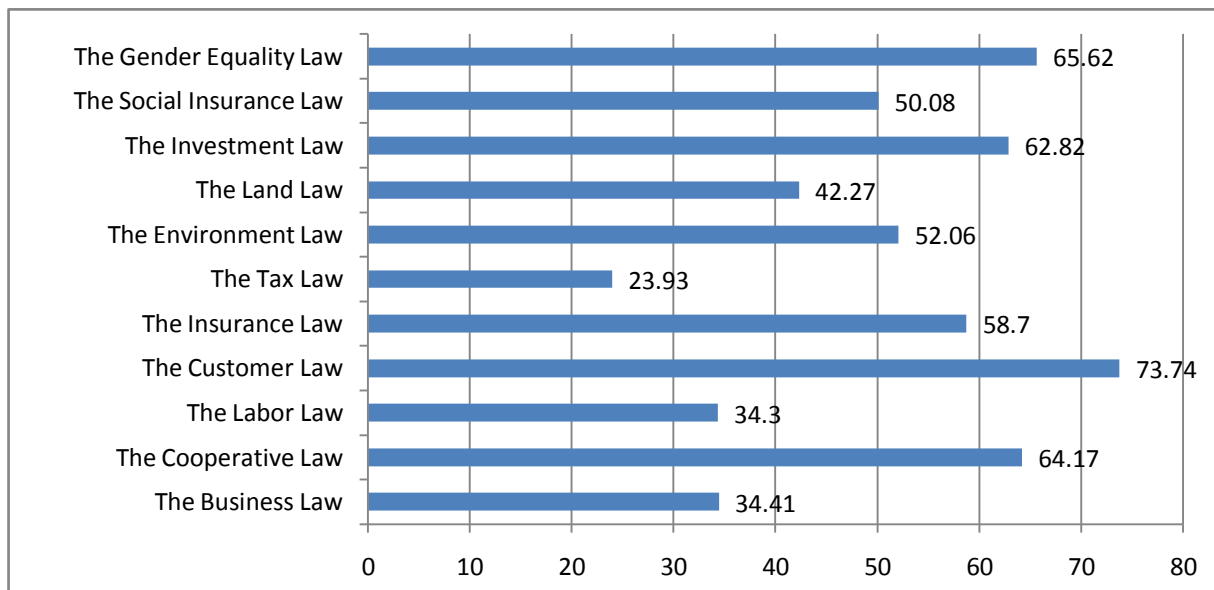


Figure 1. The awareness of the SMEs about the laws and regulations of the government (Unit:%). (Source: Author's estimation based on data of SMEs in 2013 (n=2575))

Figure 1 shows that the awareness of the SMEs about the laws as well as regulations of the government is quite limited; generally, above 50% of Vietnamese enterprises do not know or do not understand clearly the legal documents issued by the state. In details, 73.74% of them have a very limited insight in terms of the customer law, whilst the figures for gender equality, cooperative and investment laws are 65.62%, 64.17% and 62.82% in turn. All the aforementioned problems result in a great number of commercial business disputes which have been increasing exponentially and occupying a high proportion in dispute settlement under judicial agencies.

According to the statistics of the Hanoi People's Court (the capital of Vietnam), the number of trade disputing cases handled annually accounts for one third of total cases in the Hanoi Law Court, and one quarter for that of Ho Chi Minh City (NCSEIF, 2015). Moreover, while entering foreign markets, the Vietnamese SMEs frequently face up with trading disputes, lawsuits or losing trademark copyrights; additionally, they are also brought to court and imposed with anti-dumping laws. In many cases, these enterprises confront scams in information evaluation, legal status and finance status due to the lack of information about

foreign partners as well as their representatives, affecting their market-entering capacity, prestige and competitive edge.

Besides, most of the Vietnamese SMEs are given insignificant support from the authority; specifically, merely 15.08% of them receive assistance in finance, technique and other aspects. Nevertheless, in order to gain these aids, 28.05% of SMEs in Vietnam have to spend unofficial expenses, especially regarding receiving preferential loans, or national programs related to commercial promotion, technology and ISO quality.

Therefore, based on the companies' assessments, 19.15% of them assert that in order to expand production as well as increase profit, the most important thing is the support of credit access, followed by that of administrative procedures (15.84%) and issuing preferential policies for the private sector (12.74%) provided by the officials. It implies the fact that on the purpose of ensuring their rights and minimize trade disputes, Vietnamese SMEs have to understand clearly and comply strictly the governmental laws and regulations. In addition, simplizing the administrative procedures as well as enhancing the measures of financial grants and supporting policies for the SMEs have a practical significance, contributing to ensuring their effective development.

- Obstacles to consumption markets

One of the difficulties of the SMEs is ensuring and developing the output markets in the integration process. Thanks to economic hurdles, the CPI (Consumer Price Index) decreases, many companies declare bankruptcy, employees' income reduces leading to the consirable deduction of the purchasing power; on the contrary, exports still increase rapidly, meaning that after the recovery of export market, the enterprises no longer pay much attention to the domestic one as they did in the 2009-2010 period. It partly demonstrates the shortage of concern about the home market as the absence of the consumption support programs (GSO, 2011, 2012, 2013). This situation also happens to the Vietnamese SMEs. The statistical results show that 37.83% of merchandise of SMEs is backlogged and cannot reach consumers. The most essential reason, making up 70.4%, is that there are many similar products in the market; whereas, the other reason taking 13.77% is the inability to access to sales channels (Figure 2).

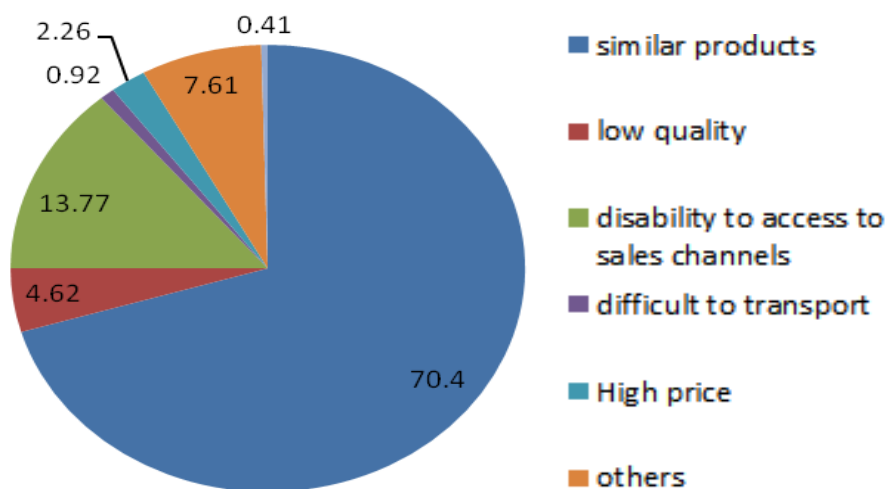


Figure 2. Reasons why merchandise is backlogged and cannot reach consumers (Unit: %). (Source: Author's estimation based on data of SMEs in 2013 (n=2575)).

To solve the above problems, there are many mentioned options such as: (1) manufacturing new products, (2) improving products and (3) applying new processes. Yet, most companies choose the option of improving products (429 companies, making up 16.66%) using such methods as following customers' requirements (56.18%) and competitive problem-solving (30.54%).

It can be seen as a successful strategy of the enterprises when the assessment results indicate that 73.75% of the entities succeed in improving products, motivating 613 businesses develop their new items or new production lines in the future. But the most important difficulty that all the businesses have to face is the lack of capital (representing 48.86%) and access to output market (23.62%).

Meanwhile, the SMEs in Vietnam are usually prone to face obstacles in developmental progress (accounting for 82.91%) mainly focusing on four large areas including: (1) Ho Chi Minh City, (2) Nghe An, (3) Ha Tay and (4) Ha Noi. The biggest challenge is the lack of capital (29.43%), primarily happening in Ho Chi Minh City, Nghe An and Ha Noi. In addition, 25.91% are facing difficulties due to limited demands for goods and services that the enterprises supply; thus, the number of orders falls, mainly in Ho Chi Minh City, Hai Phong and Ha Tay. Too much competition is also a major obstacle to the SMEs, especially in Ho Chi Minh City, Nghe An and Ha Tay. This requires not only the efforts and investments of the enterprises, but also support from the government and business associations so as to figure out the inherent difficulties of the SMEs in Vietnam.

- Highly competitive environment.

According to the evaluation of the 2575 SMEs in Vietnam, 72.41% of the enterprises believe that their competitive capacity has improved compared to that of two years ago. Nevertheless, the economic integration contributes to the fact that 87.69% of the SMEs are competed more intensively, especially in the regions of Ho Chi Minh City, Nghe An, Ha Tay and Hai Phong.

The levels of competition are different among business forms; in detail, 24.07% of the companies are competed intensively with the foreign ones, 24.7% of them are in experiencing competitive pressure from non-state businesses. The breakdown of companies under moderate level of competition also focuses on these two businesses types. It means that with particular small and medium business sizes, the main competitors are domestic and foreign private enterprises.

Table 1. The levels of competition of SMEs in Vietnam (Unit: %)

Levels	Competition with State-run businesses	Competition with Private Domestic businesses	Competition with Foreign businesses	Competition with unregistered businesses	Competition Due to Illegally Imported goods	Competitive Pressure from Other Sources
intensive	6.02	24.07	24.7	7.3	7.88	5.93
moderate	26.99	40.71	48.74	17.08	13	16.46
slight	22.65	15.27	15.85	17.35	15	17.74
uncompetitive	44.25	19.87	10.09	58.1	64	59.6

Source: Author's estimation based on data of SMEs in 2013 (n=2575)

- Being negatively affected by the economic crisis.

Many previous studies indicate that the global economic crisis brought not only advantages but also disadvantages to the SMEs. In Vietnam, 67.92% of the SMEs believe that the crisis affects the companies positively, in which only 8.35% of them assert that the phenomenon has positive impacts due to three main reasons: (1) the input materials cost cheaper, (2) weaker competitors do not have enough competitive capacity and (3) there are more skilled labors.

However, the effects of economic crisis on small countries like Vietnam mainly cause barriers; indeed, 40.19% of the enterprises suppose that influences are just temporary while 29.56% believe in the presence of long-run impacts. Thus, the enhancement of competitive abilities along with solving the economic obstacles is meaningful to developmental process of the companies in short-term; besides, it also optimizes strategies which help the businesses overcome the economic recession and integrate into the regional and global economies.

#### 4.2. Awareness and preparation of SMEs in the integration process into AEC.

- Forecasting the influence of AEC to SMEs in ASEAN:

According to Asia Kenan Institute (2010), 75% of ASEAN SMEs (out of the total of 93 surveyed businesses) believed that the establishment of AEC will positively impact on their business. However, every member of ASEAN countries has different points of view. Some countries, such as Cambodia, Myanmar, Singapore and Vietnam believe that joining AEC will bring good effects on their economies while other countries such as Brunei, Malaysia, Philippines and Thailand concern negative impacts of this integration.

Besides, BCG (2014) found that AEC will bring benefits for not only regional but also multinational companies. In the competitive environment of AEC, over 50% SMEs in Vietnam believe that they would lose altogether compared with the remaining businesses.

In general, being aware of the opportunities and challenges of the integration into AEC of SMEs in Vietnam is limited. The result of investigation conducted by ISEAS in 2013 showed that 76% of businesses in Vietnam do not know about AEC, 94% of these businesses do not know about the AEC Scorecard, and especially 63% of these businesses believe that AEC will bring no influence or very little impact on their business. This is the largest proportions among the ASEAN countries. This gives SMEs much troubles to take advantage of opportunities as well as face unforeseen challenges when joining the AEC.

- Preparation of SMEs:

The result of investigation conducted by Asia Kenan Institute (2010) showed that the ways SMEs prepare for joining AEC are quite similar among ASEAN countries. There are 18% of businesses who believed that they should study and understand the agreements and limitations of AEC, while 13% of businesses were interested in increasing their competitive capacity through some activities such as creating brand values the international market, developing human resource, and building alliance network with other companies in the region.

However, most countries in the region assert that to prepare for joining AEC, enterprises should incorporate 8 following ways, these are: (1) studying and understanding the agreements and limitations of AEC, (2) increasing competitive capacity of companies, (3) applying marketing strategies focusing on foreign buyers, (4) improving machinery and using new technologies, (5) promoting R & D, (6) developing human resource, (7) building alliance network with other companies in the region and (8) finding new business opportunities. Also, similar to SMEs in Brunei, Laos and Cambodia, according to the Vietnamese SMEs' assessment, building and developing human resource are the most important factors for sustainable economic integration; whereas SMEs in Thailand overestimate the importance of promoting marketing capabilities. To prepare for integration into AEC, there are 31% of enterprises using internal funds, nearly similar to the number of businesses using financial support from the programs of the government (32%). This ratio is rather high in some countries such as Cambodia, Brunei, Malaysia and Myanmar. Moreover, SMEs need to be supported information of many areas to help them to run businesses and enhance competitive capacities in the region. Some information they require is export and customs procedures, financial supporting policies, market expansion, infrastructure developing policies especially in the field of logistics, and international trading.

Vietnam is actively making its commitments with AEC to be on the way joining to this community. However, communication is not effective enough to give right perception to SMEs and help them to prepare effectively for integration. That requires great investment and tremendous support from the Vietnamese government to help SMEs to integrate proactively.

## 5. Conclusions and Recommendations

The basic economic obstacles of SMEs in Vietnam are the competitive pressure from domestic and foreign private enterprises; competitive markets strong effects from the recent global economic crisis and little understanding of laws and regulations. Furthermore, with little understanding of common law of AEC and fierce competition, Vietnamese SMEs should



have suitable policies to actively take opportunities and overcome challenges of the integration into AEC. Also, to take part in the AEC effectively, SMEs need more significant support for administrative procedures, credit access, as well as improving investment and business environment from the authorities. This is necessary in order to improve their competitive capacity and for SMEs to be ready to integrate into the regional market. Additionally, Vietnamese SMEs need to use flexible marketing solutions to expand markets and reduce backlogged inventory. Moreover, these enterprises need to understand and comply with the laws and rules of Asean countries by linking with other enterprises in other countries in the region.

With the goal of generalizing the economic obstacles, analyzing the awareness and preparation of SMEs in Vietnam during the process of integrating into the AEC, the study still have some certain limitations such as: (1) using the secondary data, so we cannot generalize all the difficulties of Vietnamese SMEs in recent times (especially in 2014 and 2015); limited information in the dataset. (2) Analysis based on descriptive statistics. Results of the study can be enriched by updating the current difficulties of SMEs in Vietnam, dividing SMEs into various groups (depending on industry, size, type) or adding other models rather than using only descriptive statistics.

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