State Versus Market: The Paradox of Vietnam’s experience with SMEs

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ABSTRACT

Vietnam has been pursuing economic reforms to support the marketization process and the development of SMEs. This paper examines the extent to which Vietnam’s policies effectively support the development of market principles for the growth of SMEs. This paper also assesses issues affecting the sustainability of the measures taken by the government under its Doi Moi policy. The methodology entailed a qualitative interview field approach, applying a conceptual framework of ‘enabling’ and ‘hindering’ factors relating to the evolving relationship between the state and the market, and the impact of the factors on SME development. The findings indicate that in the context of Vietnam’s move towards a market economy, where defective market factors and inadequate institutional support mechanisms are evident, it is vital that the state pursues a more entrepreneurial role. Such a role, with adequate support policies and measures, is required to facilitate the development of SMEs. It is also found that the informal sector provided resources, such as social networks and private credit for the development of SMEs in the early stages of Vietnam’s journey towards a market economy. This informal support infrastructure still plays a key role.

Keywords: Transitional economy; SMEs; state and market; Vietnam.
INTRODUCTION

Transitional economies need to take some specific measures to create conditions to encourage entrepreneurial activities and for small and medium enterprises (SMEs) to find opportunities to grow in different sectors of the economy. In the absence of strong market forces in a transitional economy, the state has to play a decisive role to create those conditions. The experiences of some transitional economies suggest that policies use intangible and tangible resources; clustering and network activities among businesses have played a significant role in creating the critical mass for SME growth and development. In order to attain the critical mass needed to create support infrastructure, the entrepreneurial role of the state is vital in creating that infrastructure and the institutions that are adequately resourced to facilitate the development of SMEs. McIntyre (2002) points out that the development of SMEs is one of the key determinants of successful transition. Obviously the growth of SMEs is vital to the overall economic development of transitional economies. Discussing the relationship between the state and the market in emerging East Asian countries, Petri (1995) points out that a suitable legal and business environment encourages investment and new enterprise development. Petri also suggests that well-devised incentive programs, initiatives and entrepreneurial leadership play a critical role in SME growth. A wide range of specific institutions and policies can help in fulfilling these requirements.

Vietnam has been implementing its national economic renovation program since the 1980s. This economic reform has had a remarkable influence on the country’s business and economic activities. Weeks (1998) argues that the success of economic transition in Vietnam depends on the role played by the state in managing the transition, rather than leaving modifications to the dictates of market. It could be said that Vietnam does enjoy a significant economic advantage, since the government has been able to learn from the experiences of other transitional countries in Asian and Central and Eastern European countries and has the potential to bridge the gap with step-by-step incremental economic transition processes. Vietnam has been pursuing policies to transform itself from a centrally planned economy to a socialist market economy. However, for this transformation to take place successfully there needs to be a policy regime that creates and supports an entrepreneurial culture.

This paper examines the role of state institutions in creating market conditions for SME growth. The adequacy of the policy regime and the effectiveness of the support infrastructure have been discussed to identify the problems of the market development process under the socialist market economy model of Vietnam.
MARKET FACTORS IMPACTING ON SMEs IN VIETNAM

The Socialist Market Economy Model

The Central and Eastern European (CEE) experience suggests that the reduction of government ownership and control in business, business support infrastructure, and financial support, the legal and institutional framework, and cluster and network relationships play a fundamental role in business development (Katz, 1995; Assaf, 1998; Konopielko and Bell, 1997; McIntyre, 2002). However, a small or weak public sector may also hinder the growth of the private sector, as experienced by CEE countries when private enterprises operate in a framework of market-determined prices. In the initial stage of transition, these countries suffered some setbacks when SMEs operated in imperfect markets that lacked institutional support (Katz, 1995). In a similar pattern, the public sector has been playing a key role in strengthening the development of a dynamic private enterprise sector and efficient market in the context of an Asian socialist market economy model. The state and the market have been working together to create sustainable conditions for private sector business development and especially for the development of SMEs. The important factors are as follows:

State Policies for SME Growth

Support policies for SMEs vary from country to country and from developed countries to less developed countries due to differences in business contexts, culture and the level of industrialization. The CEE experience suggests that the conditions outlined above are vital for business development. According to Batra and Mahmood (2003), SMEs in developing countries in East Asia receive support from local governments in the form of microfinance, interventions to increase private sector training, technology development, and market information. China, Malaysia, Indonesia and Thailand benefited from these policy reforms, network relationships, cluster linkage to markets, and the new support infrastructure (Brimble, Oldfield and Monsakul, 2002; Harvie, 2002; Tambunan, 2005; and Harvie, 2002). In Vietnam, policies that provide support are a critical factor for SME growth.

Market Factors

In CEE countries, privatisation was introduced to restructure large State-owned enterprises (SOEs) into SMEs (Gibb and Lyapunov, 1996). McIntyre (2002) recommends a contrasting solution whereby disassembling large firms may not sustain SME growth. In Asia, due to the absence of an adequate support regime, this idea has proved reasonable, since SMEs in China still need large firms in their support. From the experiences of CEE countries, Dallago and McIntyre (2003) state that SMEs are not themselves sufficient for growth without the proper development of institutions and support structures.

Identifying the importance of institutional change for the growth of entrepreneurship, Smallbone (2004) suggests that businesses need to adhere to the following conditions: firstly, a legal
infrastructure that is appropriate to market conditions; secondly, the creation of a legal framework that facilitates the development of entrepreneurship; finally, the creation of commodity, capital and labour markets. Institutions that include regulatory and tax authorities, licensing and registration offices, and private sector institutions, such as banks, accounting firms, other professional bodies and Chambers of Commerce, must provide business support to SMEs (The Expert meeting on good governance for SMEs, 2004).

Social and Cultural Environment

Gibb (1996) suggests that an entrepreneurial culture needs to be nurtured to support SMEs in areas such as values, beliefs, attitudes and behavioural norms. Gibb also argues that a personal network based on social value constitutes an important variable that influences transactions between firms and customers, marketing channels, suppliers, employees, family, regulatory authorities, banks, accountants, and competitors. Ha and Swierczek (2003) found that the performance of SMEs in Vietnam was positively related to entrepreneurial culture. This means that the owners of SMEs are not willing to take risky business decisions and the presence of a risk avoidance attitude is prominent among entrepreneurs.

Business Environment and Support Infrastructure

SMEs need to identify key success factors such as finance, technology transfer, taxation, market promotion, export opportunities, and research and development strategies that determine the conditions for them to overcome difficulties in both their internal and external environments (Petri, 1995; Assaf, 1998).

Wattanapruttipaisan (2002) proposes that competitiveness can be leveraged by factors other than location and natural resources such as: on-going access to global information and knowledge (market standards, marketing opportunities and technology); participation in clusters of firms, networks with suppliers, producers or complementary product distributors and consumers; and on-going learning and improvements in efficiency and flexibility. This network relationship created a new information flow and knowledge base for SMEs that could be the model for the efficiency of resource distribution to SMEs by numerous policy packages from the state and the market.

CONCEPTUAL FRAMEWORK AND RESEARCH METHODOLOGY

Conceptual Framework

The resource base, clustering, networking, and institutional theories referred to by Petri (1995), Assaf (1998), Brimble, Oldfield and Monsakul (2002), Harvie (2002), Tambunan (2005), Ha and Swierczek (2003), and Gibb (1996) provide an understanding of the factors supporting SME development in developing countries. These authors infer that a well-defined support regime from the
state can coordinate with existing market factors to provide policy support, external resources, and institutional infrastructure for the growth of SMEs.

A conceptual framework was applied to examine the evolving relationship between the state and the market and the impact of that relationship on local SMEs (See Figure1). The conceptual framework included enabling or hindering factors associated with (1) the entrepreneurial role of the state through policies, resources and infrastructure, and (2) market factors.

![Figure 1. State and Market Factors impacting on SMEs in Vietnam](image)

**Entrepreneurial role of the state (External resource)**
- Land policy
- Legal & administrative reforms
- Training and development
- Technology & information
- Taxation policy
- Finance and credit policy
- Support institutions
- Trade and export promotion policies

**Market factors (External resource)**
- Business & legal environment (labour, quality of support services & capital market)
- Social and cultural environment
- Supporting infrastructure
- Level of technological development
- Access to global information and knowledge network
- Presence of business clusters and networks with suppliers

- Dominance of SOEs
- Support goes to SOEs

Unsynchronized support from the state

**Plus**

- Inadequate support from market

**Hindering Factors**

- Negative social attitude
- Inadequate market conditions

Growth of SMEs depends on relationships between state and market resource

**Research Methodology**

This paper uses qualitative data drawn from a number of semi-structured interviews held in Hochiminh City, Vietnam. In order to identify key themes in this data, a content analytic approach was taken. For the purposes of reliability and subjectivity in examining the effectiveness of SME-supporting policies in Vietnam, three groups were selected randomly from public telephone directory books. These groups comprised: six private manufacturers of food and beverages in Hochiminh City; a group of five economic experts, researchers, and government officers working closely with SMEs; and a group of six supporting business agencies whose directors are currently involved in business associations or are running businesses providing consulting services to SMEs. Seventeen respondents
were selected randomly and interviewed in June 2006. Semi-structured interviews were conducted mainly in Hochiminh City. Based on the conceptual model, a group-comprehensive questionnaire was developed to address the overall research issue of identification of the effectiveness of SME-related policies. Identified issues were analysed through applying NVivo-assisted themed qualitative analysis methods.

MAJOR FINDINGS

The findings clearly show a significant prevalence of hindering factors as opposed to enabling factors in relation to SME support. Collectively these factors are discussed in relation to the potential entrepreneurial role of the state. The factors encompass policies, resources and infrastructure in areas of taxation and finance, land, training and development, supporting institutions, technology, legal and administrative aspects, trade and export promotion.

Taxation and Financial Policies

A shortage of information about tax incentive policies, including difficulties and hidden costs in the application procedure for tax incentives and unclear tax incentive policies deterred SMEs from applying for them. Taxation officers appear to have strong power to enforce the tax rates, and this is creating tax return and tax incentive application difficulties for SMEs. Hidden costs and delays in application processing for tax incentives and tax-free arrangements cause difficulties for both tax payers and tax collectors. An inconsistently imposed VAT rate also indirectly encourages corruption and tax evasion.

Problems with financial and credit policies included: discrimination against SMEs; corruption; strict application procedures; unreasonable credit policy; inadequate land laws concerning land use rights; a shortage of government monitoring; vague roles for supporting agencies in helping SMEs to overcome financial constraints; a lack of information about credit policy; and the lack of credit insurance funds to act as guarantors for SMEs to access credit. In addition, while SOEs may have longer terms and lower interest rates for credit with the need for mortgages, thanks to their managerial governing bodies’ guarantees, SMEs are not able to access these advantages.

Land Policy

It seems that SMEs do not receive any noticeable land policy aid and have to “swim alone in the ocean”. Despite the fact that supporting policy is in place, SMEs do not know where to ask for assistance. Other hindering factors include: a lack of information about land issues such as resources and industrial zones, high rental fees and bureaucratic procedures involved in rent application processes. These factors and other strict requirements in industrial zones such as discrimination against SMEs in accessing land resources and a lengthy, bureaucratic application procedure for land rental have resulted in SME despondency about entering industrial processing parks. While spacious
land is made available for SOEs, SMEs are restricted to their own limited land or they must rent it from SOEs or elsewhere.

Classification of land use for the assessment of rental prices for land in industrial zones and other public resources is now based on the legal status of the occupant, not on the purpose for using the land; therefore rental prices may differ from business to business, as in the case of SMEs compared with SOEs. This inadequate policy reveals unfair treatment amongst different business sectors.

**Training and Development for Managerial Skills Development**

The findings indicate that some government officers’ inadaptability to a market-oriented economy has created annoyance and difficulties for SMEs. According to interviewees, the insufficient skills and knowledge of executive officers has actually discouraged them from working with SMEs effectively and actively. Surprisingly, all respondents claimed that the roles of these supporting agencies is still not strong in providing a high quality of advisory and training programs for SMEs. Training programs are not practically focussed and are too general.

**Supporting Institutions**

There are shortages of good technical advisors and information. One respondent reported difficulty in seeking qualified information and does not know where to seek advice. It seems that supporting agencies have failed to meet the demands of SMEs. Respondents have doubts about the roles of supporting agencies and the quality of technological consulting services. Information provided is too general and there is a shortage of necessary information about incentive policies and legal regimes available for SMEs.

According to the findings, a common SME problem is the lack of formal linkages among businesses, since most of the cooperation is through informal relationships. This has led to the absence of a leap-frog approach for entrepreneurial development through which cooperation among potential businesses for production, sharing information, supply chain and outbound value chain activities could evolve. In the absence of such an entrepreneurial culture, SMEs do not know where to seek advice and where there might be opportunities for cooperation. As a result, SMEs find it risky to engage in international businesses with foreign partners. As claimed by respondents, the weak and unsynchronized role of supporting institutions in facilitating networking and cooperation also could be the reason for the slow growth of SMES. On the other hand, the findings also indicate that there is lack of cooperation among supporting institutions.

**Technology Support**

A number of common technologically-related issues were referred to by respondents, such as legal barriers and an ineffective policy regime for property rights; patents and trademarks; technological transfer; and importation of used equipment. Also, there was a lack of formal network linkages and technological cooperation among technological research institutions, between SMEs and
supporting institutions, and with other firms. The shortage of funds for investment and for technological development, and the existence of an ineffective legal framework have prevented SMEs and research institutions from cooperating with each other. Hence the findings indicate that there is evidence of a deficient overall national technological research and development strategy.

**Legal Framework and Administrative Reforms**

Respondents stated that there were too many unnecessary licenses, problems of management overlap and regulation barriers, particularly when businesses apply for a business license, tax file number or business seal. Several respondents complained that they still needed to obtain numerous ‘unnecessary’ licences and certificates from different local authorities and management offices that are to them clearly costly. The findings also indicate that the gap between the formulation of rules and the implementation of those rules is significant. The weak role of law enforcement organizations in supporting SMEs in resolving commercial disputes discouraged potential SMEs. A deficiency in the current business laws also added more confusion and uncertainty. The findings also reveal a high tendency in SMEs not to declare bankrupt. Instead they try to solve their problems by using the informal social network. This arises from the fact that business failures may be seen by economic police as due to inefficiency of the SMEs, which may result in criminalization and punishment.

Instability of business-related laws may impede the development of private sector. There are too many replicated and contradictory regulations, circulated letters and decrees from the governments and related managerial authorities that can be applied to a single business issue. Each local authority also has different legal documents and regulations, with many weak and unclear points that can be understood differently and may create confusion for management authorities due to a lack of valuable information and legal knowledge. Furthermore, business inspection procedures are sometimes inconsistent and not compliant with the law.

The findings reveal three major issues in relation to public administrative reform and bureaucracy. These are: corruption and red tape, business inspection problems, and problems of overlap in management. Bureaucracy exists everywhere and in every single supporting policy from tax, credit, land, technology, supporting institutions to training, trade, and legal matters. It could be said that bureaucratic control over effective business operations is actually a chronic disease. This state of affairs has generated significant and unofficial expenses for SMEs. This was an undefined hidden tax on SMEs activities.

**Trade and Export Promotion Policy**

There is strong respondent evidence that the tariff incentive policy is not clear and seems not aimed at SMEs. SMEs are still facing many hurdles in relation to tariff barriers. For example, the tax rate on used equipment is normally based on custom officers’ whims, given that the tariff criteria for quality assessment are not clear.
There is evidence, too, that export promotional funds and incentives are not available to SMEs. Subsidy policies are offered to SOEs as large exporters. Furthermore, import and export quotas are not easily obtained. This is due to the bureaucratic administrative regime and difficulties in the import-export licensing system that have prohibited SMEs from doing business directly. As a result they are restricted to operating as subcontractors for larger firms and SOEs.

Empirical studies and contribution of this study

Our research findings are supported by evidence from numerous studies, reports, and secondary data such as James and Chuong (1997), McMillan and Woodruff (1999), Vu (2001), Nguyen, Bui, Han, Hoang, and Nguyen (2001), Le and Ngo (2002), Ho, Do and Chu (2002), Pham (2002), Do, Ngo, Tran, Do, Vu and Le (2004), GSO (2004), and Trang, Le, To, Bui, Nguyen, Nguyen, Do, Tran, Chuong, and Hoang (2006). The results of our study clearly point out that after more than 10 years on this journey towards a market socialist economy (since the studies of James and Chuong and McMillan and Woodruff on Vietnamese SMEs were published in 1997 and 1999, respectively), Vietnam has not yet successfully created sustainable market conditions in which SMEs can flourish. An alarming trend is that informal financial support infrastructure and social business network relationships still play a key role in the growth of SMEs in Vietnam. In addition, the findings highlight that there is significant gap between the formulation and implementation of policy support for SMEs. Furthermore, the SME sector has not yet been recognized by the government and society as one of the key driving forces for the development of the market economy in Vietnam.

DISCUSSION AND CONCLUSION

Poor Financial and Capital Market in Vietnam

The results of our study indicate that SMEs in Vietnam are currently facing significant difficulties in accessing formal credit and they have to rely heavily on informal credit. This is consistent with the statistical data from GSO (2004) that, although credit capital is too low, more than half of the credit is reserved for SOEs. The results from our study also show that while SMEs have almost no access to long-term credit, or even to short-term credit in domestic formal credit funds, they also have nearly no access to international formal credit. Similarly, Pham (2002) observes that credit for SMEs from venture capital and foreign funds is very small.

Low Level of Technological Development

*Gap between supply and demand for technology infrastructure*

As stated by Le (2006), an inadequate technological market or weaknesses of technological support services are significant barriers. The technological market has failed to meet the demands for technological research development and transfer. The author also reveals that there is no real technological support for SMEs, since only state-owned technological research institutions and state-
owned technological support services are operating in Vietnam, and they support large SOEs. This is consistent with our research findings.

**No rules and policies for regulating and defining the methods of technology transfer to support SMEs**

This observation is consistent with our research results that supporting technological development activities are too underdeveloped to assist SME growth. On the other hand, those support policies seem to pay more attention to SOEs’ technological research and development, rather than supporting and facilitating the sustainability and growth of SMEs in private sector.

**Inadequate Business and Legal Environment**

**Market support factors: land, legal framework, labour**

According to the vnexpress.net (as at 6 Dec 2006), the Vietnamese growth competitiveness index (GCI) has dropped to a rank of 104 in a list of 175 countries. Despite the fact that Vietnam is one of the countries that have undertaken notable reforms in public administrations, and gained some positive improvements in the business environment, these achievements are not enough to sustain economic development as well as enhance the competitiveness of the economy. From our research findings, there is clear evidence that the existence of some inadequate business factors has obstructed the development of a business environment in Vietnam. Basic business environmental factors are not adequate for supporting SMEs. These business factors include: A poor level of technology development, unskilled labour, insufficient capital for business activities, poor land management, and inadequate quality of business support services for technology and information.

**Poor quality of support services for SMEs**

It could be said that due to many defective market factors, the current unfavourable business environment does not allow SMEs to utilize their creativity and undertaken further business expansion due to a lack of information about the legal and business environment.

Moreover, the results of our study indicate that SMEs are neglected by consulting firms. As a result, they tend to seek guidance from unofficial sources or they rely on their hired advisors for market information. Hence there is a gap between SMEs’ needs and the services available for SMEs.

**Poor Support Infrastructure**

Our study reveals that the monopoly of SOEs in several key industries has led to created unreasonable costs, such as high internet and telecommunication fees, utilities fees and transportation fees for SMEs. As a result, business expenses in Vietnam are higher than in other regional countries. These expenses include land rental and business premises rental fees and other business expenses. According to Ho (2002), export credit funds can only satisfy 26% of the real demands. Hence only a limited number of SMEs and other business firms can access such funds.
Social and Cultural Environment

**Discrimination among business sectors**

The research findings describe SMEs’ vital roles are not widely acknowledged by the government and Vietnamese society. This is agreed by Le (2006) and Pham (2002). On the other hand, SMEs have tended to be viewed negatively by labourers and the public as a high-risk policy that would generate insecurity in the job market. As a result, it is very tough for SMEs to attract qualified labour and access adequate support such as credit, land, and other external resources. Negative social perceptions towards the roles of SMEs would have a significant influence on the development of this private business sector and discourage SMEs from business development in many ways. Although the current legal regimes do ensure fairness of competition between the public and private business sectors, so-called “unwritten laws” of discrimination against SMEs still exist strongly in society. Operating in such unfavourable environment, together with defective supporting institutional developments, inadequate regulatory frameworks and the SMEs’ poor internal resources, it is obvious that SMEs are struggling to survive and develop.

**Strong uncertainty avoidance and attitudes of mistrust**

Our findings show that strong uncertainty avoidance and attitudes of mistrust exist among SMEs and other business entities. Having no reliable information about business opportunities for cooperation, poor internal resources, and social discrimination against them may also deter SMEs from seeking the opportunity to establish strategic alliances, business cooperation with other firms and financial supporting institutions and to achieve better performance. This finding is consistent with the findings from Nguyen (2006) and Ha and Swierczek (2003).

**Presence of business clusters and networks**

According to the results of our study, there are no strong linkages between SMEs and other supporting agencies. As stated by a respondent, “Linkages between academic and research institutions, universities, supporting organizations, and SMEs are still questionable”. SMEs and those institutions tend not to seek cooperation because of a lack of mutual trust between them. SMEs still consider that they are self-contained firms, so that they prefer not to form any clusters or to develop linkages and networks.

Numerous studies, such as McMillan and Woodruff (1999), Nguyen (2005), Nguyen et al. (2005), and Nguyen (2006), indicate that trust is an important factor for cluster and network development which may help to facilitate the development of necessary supporting infrastructure. According to the VNCI project and building Vietnamese competitiveness (VNCI-1, 2003, p.2), “Efforts on building commercial collaboration among cluster members were limited. As a result, the foundation for trust and cooperation among cluster member were not significant enhanced. The
effectiveness of forming a broad partnership with key cluster champions, including association leaders, local governments, VCCI, universities and other donor is low.”

Access to information and global networks for cooperation

Our research findings reveal that most of the information for SMEs is from informal sources. This is consistent with Webster and Taussig (1999), Harvie (2001), Ho et al. (2002), Vu (2001), and Pham (2002). According to a respondent in our study, “information about market, opportunity for SMEs, the importance of strategic plan and trade policies are not widely revealed to SMEs by the government and Hochiminh City’s authorities. SMEs have limited access to market information and information.”

Harvie (2001) observes that most information is obtained through the media or by personal contacts of firms, and not through formal channels. Only the more dynamic SMEs tend to get in touch with formal organizations like the SMEs club, the VCCI and the various trade associations for information. As a result, SMEs may face problems of missing out on business opportunities and cooperation or being deceived by their overseas partners due to the lack of reliable information.

In the context of an emerging state and market relationship where large SOEs are still dominant, SMEs in Vietnam need to develop networked relationships and operate within a semi-cluster environment in order to form the critical mass to attract the attention of important policy actors. At the same time, a legal framework and adequate business laws need to be put into practice so that support institutions can work in a more coordinated manner to create a sustainable market framework for SME growth. Vietnam is not in a position to create large internationally competitive business enterprises. To make proper use of its comparative advantages Vietnam needs to develop the state and SME relationship and devise market practices around SME activities to build a road to a socialist market economy. Efficient, competent and innovative SMES will pave the way for large domestic and international companies to invest in the sectors in which Vietnam has competitive advantage.
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