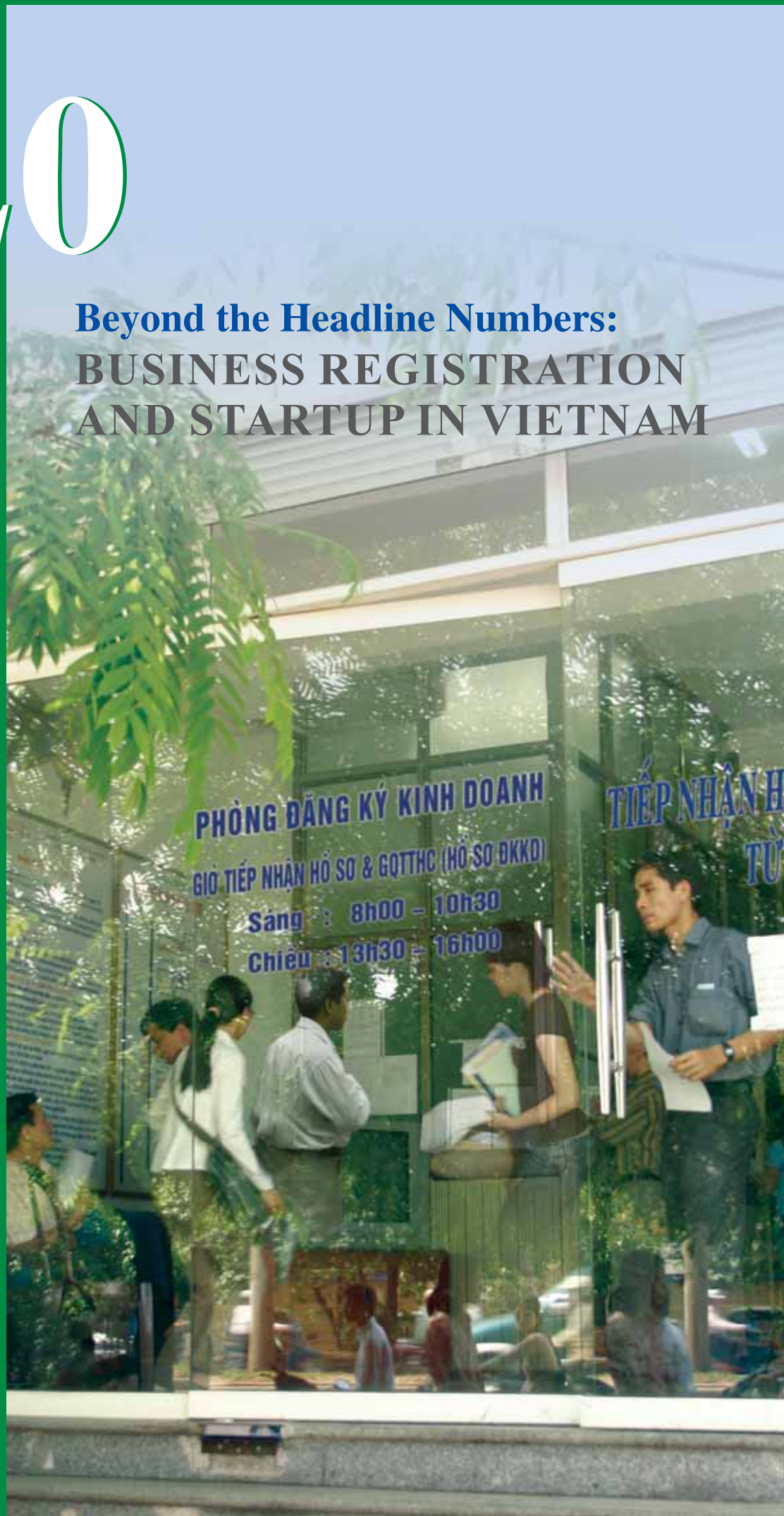


# Number 20

## Beyond the Headline Numbers: BUSINESS REGISTRATION AND STARTUP IN VIETNAM



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May 2005



Mekong Private Sector Development Facility

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## ACKNOWLEDGEMENTS

This research project and the report that emanates from it have been the result of collaborative teamwork among staff members, partners and consultants of the Mekong Private Sector Development Facility (MPDF).

The final report was written primarily by Nick Freeman, Nguyen Van Lan and Nguyen Hanh Nam of MPDF. Trang Nguyen (MPDF) and Amanda Carlier (World Bank) initiated and conceptualized this project, and provided guidance on the methodological approach of the research. Trang Nguyen was also responsible for oversight of the project.

Tran Thanh Son (World Bank) played a crucial role in sample identification and generation. Nguyen Hanh Nam, Le Bich Hanh and Duong Thanh Trung (MPDF) were actively involved in the interviews with business owners. Duong Thanh Trung also collated and processed much of the data. Dao Thi Lien (MPDF) and Tran Thi Ngoc Dung (World Bank) were extremely helpful in arranging interviews and logistics. Nguyen Quynh Trang (consultant) interviewed business owners, and Phan Thi Thuy Chi and Nguyen Thu Huyen (consultants) carried out site visits and investigations to confirm the existence of firms. Catherine McKinley edited the final report.

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All errors and omissions are the responsibility of the authors only.

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## EXECUTIVE SUMMARY

It is widely perceived that the private sector in Vietnam has thrived since the promulgation of the Enterprise Law in 2000. This perception stems in large part from reports that the company registration process has become much easier, and from the six-figure headline numbers often cited for new business registrations over the last four years. If these figures are used as a proxy indicator for business vibrancy, then the private sector would indeed appear to be a picture of good health.

However, some evidence suggests that the private sector may not be quite as healthy and robust as the headline numbers imply. In particular, the registration numbers are being inflated to some degree by such factors as: single businesses enacting multiple or rolling company registrations; little or no tracking of business closures; and the presence of so-called “ghost companies” (companies which exist only in name but have not begun operations or exist mainly to buy VAT invoices and on-sell them). The headline numbers also do not provide any information on the extent to which existing firms are growing, or not, and the degree to which new companies are successfully maturing into more robust corporate entities. Consequently, tallying the number of new company registration certificates being issued might be one measure of private sector health but it only gives a one-dimensional snapshot of a multi-dimensional phenomenon.

In this context, The Mekong Private Sector Development Facility and the World Bank office in Vietnam decided to initiate a study of the business registration and formation process in Vietnam. The primary goals of the research are to: better understand the process that new firms go through when registering; see how companies are faring after registration; and thereby get a more nuanced picture of what actually lies behind and beyond the oft-recounted headline numbers. The methodological approach used for this study is detailed in Chapter two. The key findings are outlined in this executive summary and discussed in more detail in Chapters three to five. Chapter six provides some concluding remarks.

## FINDINGS

### ➤ BUSINESS REGISTRATION DATABASES ARE WEAK

The headline numbers should be used with care, as the existing databases for business registration are weak. Business registration figures provided by the National Business Information Center (NBIC) on new company formations were used as a starting point for sample identification in this study. We found that although they fairly accurately depict the pace at which new firms are being officially registered (and in some cases, re-registered), they do not necessarily serve as a good indicator of the size - or pace of

growth - of the corporate sector in Vietnam. The General Statistics Office's (GSO) annual figures for operational firms are roughly 40% smaller than those provided by the NBIC for business registrations. This margin of difference stems not only from the different data collection process used, but also from the fact that they are measuring different phenomenon: business registrations in the case of the NBIC's headline numbers, and business operations in the case of the GSO's headline numbers.

Our sample survey of 300 firms registered by the NBIC in the three years between January 2000 and December 2002 found that 73.7% were definitely or probably operational, 13.7% were definitely or most probably closed or non-operational, and 15.7% remained of unclear operational status, despite our concerted efforts to locate them. The survey also unearthed only 14 companies (just 5% of the total sample) that had officially ceased operations. Of these, just three (or 1% of the sample) had completed the formal company cessation procedures. This suggests that the process of formal cessation of a business is difficult and/or the incentives for doing so are not adequate. International experience clearly shows that more than 5% of new business ventures will be unsuccessful and ultimately close as part of the inevitable corporate sector life cycle. Company closures are part of the dynamic process by which successful businesses burgeon and unsuccessful businesses ultimately expire.

A number of weaknesses currently exist in the NBIC database itself, most notably with regard to the quality of data on each company that is initially inputted and then maintained. We found that 39% of companies in our sample were at addresses other than those cited in the NBIC database, often having relocated since registration.

#### ➤ **MOST RECENTLY REGISTERED FIRMS ARE NOT NEW**

Though high company registration numbers are an encouraging sign of private sector development, they should not be used as a proxy indicator for the overall health of the private sector. Among surveyed firms, 16% were registered prior to the enactment of the Enterprise Law in January 2000 and subsequently re-registered. In the same vein, roughly 45% of firms that we interviewed were originally informal entities (household businesses) that had decided to formalize their company under the Enterprise Law. Just 32% of firms interviewed could be genuinely regarded as new start-up ventures by entrepreneurs, founded since the enactment of the Enterprise Law. This tells us that:

#### ➤ **COMMENCING BUSINESS OPERATIONS REMAINS BURDENSOME**

Our survey found that, on average, it took firms in our sample around 50 days (or around 23 days for those using a service provider) to complete the whole registration and formation process, from applying for a registration certificate, through to being issued their first "red invoice" book for VAT purposes. This is notably longer than the figures often cited for initial business registration in Vietnam, which tend to simply focus on the actual certificate approval process rather than the business formation process as a whole.

Attaining the first red invoice VAT book appeared to be the most burdensome part of the business formation process.

Notwithstanding recent commendable advances, the time it takes to register a new company in Vietnam is still relatively long by international standards. The current procedures could be simplified so as to allow firms to simultaneously register for the company seal, tax code and purchase invoices and thereby shorten the whole registration period. Well-codified and simplified procedures could also help reduce the prevalence of “unofficial fees” that are often paid during the business registration process. These findings are consistent with those of the World Bank Group’s recently released “Doing Business 2005 - Removing Obstacles to Growth” report<sup>1</sup>.

➤ **POST-REGISTRATION ISSUES (LAND, CAPITAL, PUBLIC ADMINISTRATION) ARE STILL BARRIERS TO GROWTH**

The study also attempts to identify regulatory obstacles that are inadvertently constraining private sector dynamism and to propose ways Vietnam might seek to improve its regulatory environment in order to support a more vigorous and vibrant private sector. Of the 47 firms we interviewed, the majority reported they were profitable but roughly half had found the experience of operating a firm to be more difficult than initially anticipated. Nonetheless, roughly 90% had continued with some kind of business since starting up. Just 10% had made major changes to their business line.

Problems finding adequate land or premises was cited by a quarter of companies interviewed as being the most difficult part of the start-up process. Less than 10% of firms were currently situated on their own land, with the majority either located on rented premises or using private property owned by the company’s founders. Roughly 11% of firms interviewed were renting land or premises from State-owned enterprises.

Our survey results suggest that finding sufficient investment capital continues to be a major challenge facing private firms, both during the start-up phase and subsequent operations. The majority of firms interviewed were unable to borrow from banks and they believed that their limited access to formal credit was hindering their growth prospects. The main obstacle appeared to be a lack of suitable physical assets to provide as loan collateral.

The administration of the tax system, particularly with regard to the issuance of red invoice VAT books, was depicted as being cumbersome and time-consuming by a number of companies interviewed in this survey. In the case of corporate income tax, some companies reported that tax officers imposed a tax rate that they deemed to be reasonable but not necessarily based on the figures provided in the company’s accounts (which tax officers have a tendency to distrust). According to some firms interviewed, declaring an operating loss was not an option. Firms also said that there was an expectation among tax collectors that a company’s profits - and therefore the corporate income tax paid - should increase incrementally each year.

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1 “Doing Business 2005 - Removing Obstacles to Growth.” World Bank, International Finance Corporation and Oxford University Press, Washington DC 2005.



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## CHAPTER I

### BUSINESS REGISTRATION: CONTEXT AND PROJECT RATIONALE

It is widely perceived that the private sector in Vietnam has thrived since the promulgation of the Enterprise Law in January 2000. This perception stems in large part from reports that the company registration process has become much easier, and from the six-figure headline numbers often cited for new business registrations over the last four years. Indeed, the latest available headline numbers for new business registrations are commonly cited in reports as supporting evidence that the economic reform and the business liberalization process in Vietnam are both active and bearing real fruit.

#### 1.1 HOW REPRESENTATIVE ARE THE NUMBERS?

According to a Vietnamese government report, the average time taken to register a private business has contracted markedly, from 99 days prior to the Enterprise Law to 10 days in May 2003. The costs of registering a new business have also declined considerably<sup>2</sup>. The World Bank's "Doing Business 2005" reports a considerably higher number - an average of 56 days to register a business. Nevertheless, there is no doubt that over time it has become easier, quicker and cheaper to register a company; as a result, more local entrepreneurs are formally registering their existing or planned businesses. Indeed, the growth in private company registration numbers is commonly cited as an important proxy indicator that the ongoing economic reform and business liberalization process in Vietnam is alive and well and bearing tangible fruit. From these seeds of new company registrations should subsequently flower a more vibrant and robust private sector in Vietnam, if provided with the right environmental conditions for healthy growth.

However, some evidence suggests that the private sector may not be quite as healthy and robust as the headline numbers might at first imply, and that official statistics on company registrations in Vietnam are not capturing the complete picture. In particular, the headline numbers are probably being inflated to some degree by such factors as single businesses enacting multiple or repeated company registrations and the presence of ghost companies. Consequently, tallying the number of new company registration certificates being issued might be one measure of private sector health, but it gives only a one-dimensional snapshot of a multi-dimensional phenomenon. Indeed, it would probably be too much to expect that relatively new registration systems, put in place to record such a rapidly moving phenomenon as new company registrations, could provide a wholly accurate profile. Rather like a camera snapshot of a fast-moving vehicle, it is likely that

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2 See "Report on Three Year's Implementation of the Enterprise Law", Task Force for the Enterprise Law's Enforcement, May 2003.

the photograph that is developed will be somewhat blurred and depict an event that has since passed.

Although new company registrations in Vietnam are probably being recorded relatively well, the closure of effectively defunct companies is far less well measured. Yet business closures are inevitable and are as much a part of the private sector growth story as are new business registrations. In any country with a vibrant private sector, not only are business closures to be expected, they are an integral part of the dynamic process that occurs when firms - and the corporate sector as a whole - react to multiple and continual changes in the external environment (e.g. new market opportunities and business conditions). This is part of the corporate sector life cycle and is well recognized around the world. As recently stated by the Singapore government, “...businesses are continually entering and exiting the economy... This chain of formation and cessation is a common process of business activity”<sup>3</sup>.

## 1.2 LOOKING BEYOND THE NUMBERS

In this context, MPDF and the World Bank decided to initiate a study of the business registration process in Vietnam in order to: better understand the process that companies go through when registering; see how companies are faring after registration; and thereby get a more detailed picture of what actually lies behind and beyond the headline numbers. An increase in company registrations is a good sign in itself but does not automatically mean that the overall size and output of the private corporate sector in Vietnam is growing at a similar pace. For example, existing companies may be fragmenting into new, smaller ones in order to take advantage of fiscal incentives currently offered to new companies. Such actions would cause an illusory inflation of the official statistics for company registrations without necessarily having an impact on total output, jobs, capital invested, etc.

Furthermore, although the actual business registration exercise itself may have become easier since 2000, the regulatory process of setting up a new business entails much more than just registering the firm. This study considers whether these additional procedures, such as tax code registration and acquiring necessary operating licenses, have improved in tandem with the business registration process. Finally, we look at obstacles that newly registered companies might face in the early years of operation, including accessing finance and land, etc.

It is important to emphasize that this research project is not intended to discredit the official statistics for company registrations. Rather, it aims to provide additional insights and therefore bring more meaning to the numbers that are so often cited in the media and elsewhere as a proxy for the health of the private sector. Virtually all recent studies on the private sector seem to indicate that, overall, it has indeed become easier to set up and

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3 Quote taken from the “Statistics Singapore Newsletter”, September 2003, p. 17.

register a new private company in Vietnam. But this improvement is relative to the past in Vietnam and not necessarily relative to other countries in Asia. Ideally, Vietnam should seek not only to improve on its past performance but also on the performance of its regional peers and rivals.

By better understanding what is really occurring behind and beyond the headline numbers, we can hopefully identify the kinds of policy measures that will allow Vietnam to: build on past progress; improve the implementation of the Enterprise Law; inform ongoing discussions about revising this law; and thereby support the private sector in the next stage of its development.

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## CHAPTER II

### METHODOLOGICAL APPROACH

Due to time, logistical and cost constraints, it was not feasible to conduct a nationwide survey of registered companies in Vietnam. Therefore, a random sample of 300 registered companies was chosen for this survey, all of which were registered in Hanoi or the four surrounding provinces of Bac Ninh, Vinh Phuc, Hung Yen and Ha Tay. For this, we used the company registration statistics contained in the NBIC database, primarily because it was easy to access and contained a sufficient degree of detail on each company<sup>4</sup>.

The NBIC database was developed and is maintained by the government agency with principal authority over all company registrations: the Ministry of Planning & Investment and its various Department of Planning & Investment (DPI) offices around the country. It is one of the more robust sources of information currently available, notwithstanding the weaknesses discussed in this report.

#### 2.1 SELECTION CRITERIA

The precise selection of companies for the random sample was weighted according to three sets of criteria:

- One hundred companies from each of the years 2000, 2001 and 2002 (the three full years since the enactment of the Enterprise Law on January 1st, 2000);
- Companies registered in the five locations, weighted in proportion to the aggregate number of company registrations in these locations<sup>5</sup>; and
- Weighted in proportion to the aggregate number of company registrations for the three different types of formal private companies in Vietnam (private, limited liability and joint stock).

It is recognized that this sample of 300 companies located in and around Hanoi has its limitations and any national extrapolation of the survey results should be done with some care. Three hundred companies is a relatively small proportion (around 4% or less) of the total number of private companies to register in the three years from 2000 to 2002 and therefore cannot be deemed a statistically significant sample for Vietnam's private sector as a whole. Equally important, the 300 companies selected for study are all located within one region of Vietnam and therefore the sample cannot claim to fully capture the experience of private companies across the whole of Vietnam. For example, a similar

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4 The NBIC database can be readily accessed on the internet at [www.business.gov.vn](http://www.business.gov.vn).

5 Of the 300 companies, 6 were located in Vinh Phuc, 6 in Hung Yen, 9 in Bac Ninh, 42 in Ha Tay, and 237 in Hanoi. See Table 8 in the appendix for a more detailed breakdown by company type and year of business registration.

sample of companies located in some of the southern cities and provinces may have resulted in different findings. Recent research has shown that considerable differences in the business environment can exist from province to province in Vietnam<sup>6</sup>, and this survey cannot claim to capture this reality.

## 2.2 FINDING OPERATIONAL COMPANIES

The data collection process essentially comprised two distinct phases. Having identified the representative sample of 300 private sector companies officially registered between January 2000 and December 2002 in Hanoi and four surrounding provinces, Phase One entailed evaluating which of these firms were: i) currently operational; ii) non-operational, or; iii) their operational status was unclear. This evaluation process consisted of a graduated sequence of different checks:

- Using the company details provided on the NBIC database for each of the 300 companies chosen for inclusion in the sample, companies were called on the telephone and phone numbers were checked with the telephone directory service;
- The main details of the company, as provided by the NBIC database, were verified and/or updated to meet further research needs in phases One and Two of the survey;
- Companies that were confirmed as operational were set aside for Phase Two;
- For those companies that appeared to be non-operational, or their operational status remained unclear, two further checks were then conducted on this sub-sample;
- The first of these was a site visit to the address given on the NBIC database as the location for the company to gain further information on the status of the company<sup>7</sup>;
- The second was a check to see if the company had been issued a tax code by the tax authorities<sup>8</sup>;
- Companies that were identified as being operational at this stage were also set aside for Phase Two;
- This left Phase One with a sub-sample of companies that were confirmed as non-operational or with unclear operational status.

## 2.3 DATA COLLECTION

Phase Two of the research project entailed a much closer study of those companies in the sample that were identified in Phase One as being currently operational. This was conducted through detailed interviews with the managers and/or owners of 47 companies

6 See Malesky Edmund, "Entrepreneurs on the Periphery: A Study of Private Sector Development Beyond the High Performing Cities and Provinces of Vietnam." MPDF Private Sector Discussion Paper No. 18, November 2004.

7 If the company was not evident at the address given, the site visit included a brief check of the immediate area and asking people in the vicinity if they had any knowledge of the firm.

8 As the next stage in the business start-up process after company registration, the absence of a tax code for a company would strongly suggest - but not absolutely confirm - that the company failed to commence actual operations.

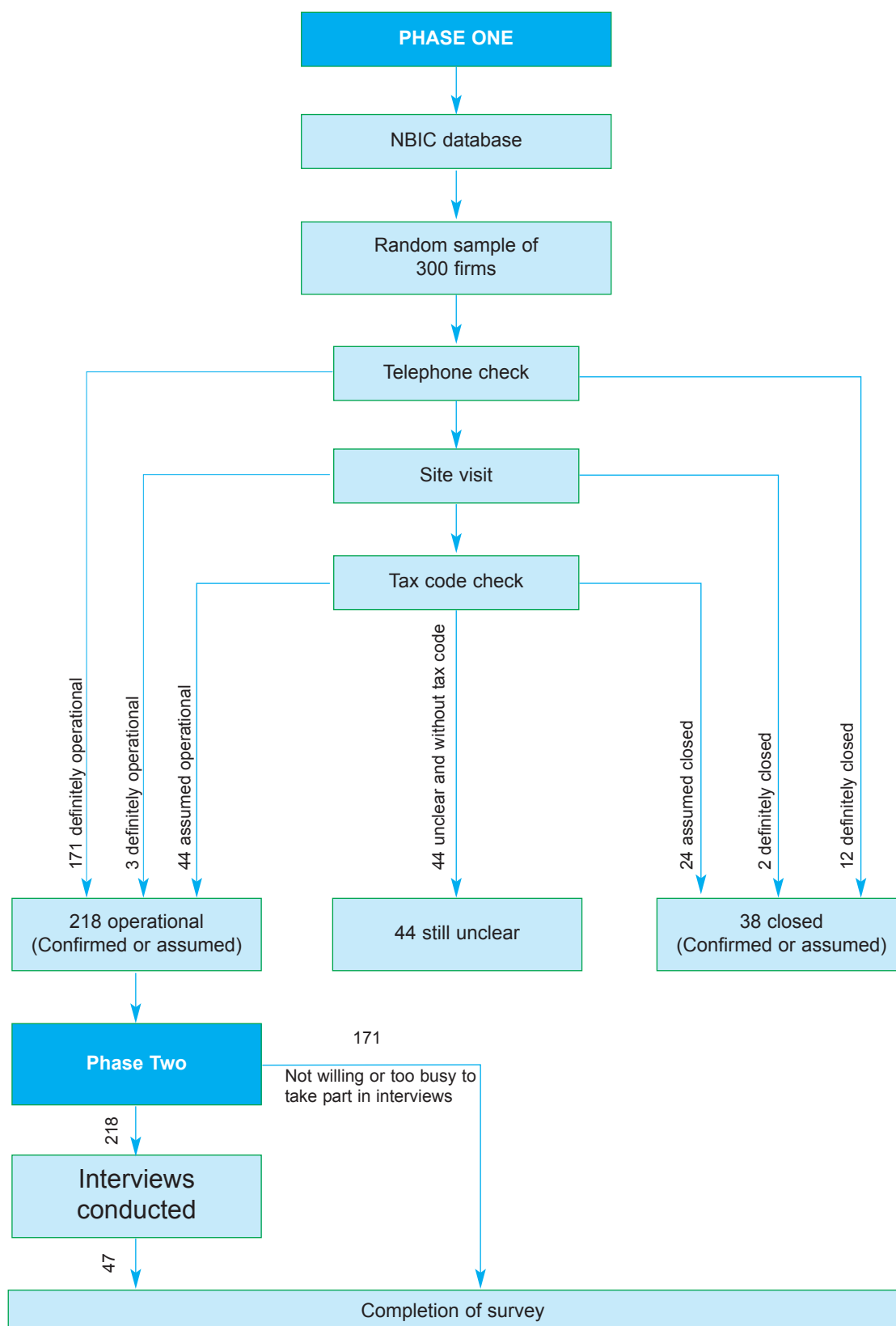
willing to discuss their business activities. The research tool used was a structured questionnaire containing over 50 questions (both open and closed) that sought to learn more about:

- The origins of the company;
- The registration process the company underwent (including obtaining a tax code and the red invoice book);
- The company's initial start-up phase;
- The company's current operations;
- Specific issues relating to land; and
- The future outlook of the company.

In total, 47 companies - 16% of the total survey sample and 22% of those confirmed as being operational in Phase One - were interviewed. The principal results from Phase Two are provided in chapters Four and Five of this report.

Ideally, a random selection would have provided the optimum picture of all the 300 companies surveyed. However, we were unable to do this because many firms were not willing to be interviewed. This places some limits on the interpretation of the findings. For example, poor performing companies - such as those making a substantial loss or on the verge of closing down - are more likely to decline a request for an interview, despite the fact that their experiences and comments are equally valid and interesting for a study of this kind. However, this potential sampling bias was not deemed to be a major concern as the main purpose of the interviews in Phase Two was to provide some real examples of the kinds of problems and challenges facing local companies during and after their initial registration process.

The majority of the interviewees (roughly 85%) held the post of managing director. Roughly 10% were deputy-managing directors, and just 5% of company interviews were conducted with middle managers (e.g. chief accountant or production manager). In some cases, both the managing director and one of his/her deputies were present at the interview. In most cases, the managing director was also the principal owner of the company. Given the high positions of the interviewees in their company, we believe we have captured an accurate picture of the most pressing problems and challenges facing each firm.

**Figure 1: The survey process**

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## CHAPTER III

### RESEARCH FINDINGS: THE HEADLINE NUMBERS

As noted earlier, it is widely recognized that the number of private companies officially registered in Vietnam has increased considerably in recent years as the various barriers to entry have lessened. According to a senior expert from the Central Institute of Economic Management (CIEM), about 114,000 local companies registered their businesses in the four-year period between 2000 and 2004, compared to 45,000 in the eight-year period from 1991 to 1999<sup>9</sup>; bringing the total number of registered enterprises in Vietnam to about 150,000. However, it should be recognized that the rapid growth in new business registrations in Vietnam since 2000 stems from a low base, as one would expect in a transitional economy where State-owned enterprises dominated the formal corporate sector until the 1990s. Relative to most other countries in Asia, the number of private firms and the scale of private sector activity in Vietnam is still comparatively small when measured as a proportion of population, industrial output, or total GDP.

Precise statistics on the number of formal companies (excluding informal and household enterprises) operating in Vietnam tends to vary<sup>10</sup>. At present, two organizations in Vietnam independently report data on company formation and operation: i) the General Statistics Office (GSO); and ii) the National Business Information Center (NBIC) at the Ministry of Planning & Investment. Although some other agencies and organizations conduct occasional surveys of their own to derive company data, the GSO and NBIC are the principal regular sources of this kind of company information. We look at each of these in turn, before turning to our survey findings.

#### 3.1 GENERAL STATISTICS OFFICE

According to the latest available GSO statistics, the number of companies operating in Vietnam at the end of 2002 was just over 62,900; roughly a two-fold increase since the enactment of the Enterprise Law in January 2000<sup>11</sup>. In terms of company registrations, the GSO calculates that private firms account for roughly 93% of the total corporate sector in Vietnam (including state-owned enterprises and foreign-invested projects); up from around 83% before the Enterprise Law. Although the GSO's official statistics for companies operating at the end of 2003 were not available at the time of writing, it is expected that the number will be somewhere around the 75,000 mark.

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9 Nguyen Dinh Cung, "Some Experiences in Drafting the Enterprise Law in Vietnam", paper and presentation to MPDF and Drafting Committee of the Lao Business Law, December 2004.

10 In addition to the formal companies, there were an estimated further 650,000 or so informal companies operating (without tax codes) in Vietnam in 2002, according to GSO estimates.

11 According to the GSO, there were 33,393 local private companies with tax codes at the end of 1999.



The GSO compiles its figures annually, as part of a national survey of all formal firms operating in the country<sup>12</sup>. Until 2004, the primary source of reference data used by the GSO was tax codes issued by the tax department to each company. These codes are sent to the local GSO offices (called DSOs) in each province and district, and GSO officers refer to these when counting the number of companies actually in operation. Companies that have closed down or are non-operational are excluded. Equally, any companies found to be operating but not included in the tax code list are included in the tally. More recently, the GSO has also referred to the new company registration data provided by the NBIC.

The GSO recognizes a number of potential weaknesses with this counting procedure, including: i) the danger of double-recording companies that are issued with a new tax code when they change their legal status; ii) the fact that some enterprises do not pay tax and therefore have not been issued with a tax code (e.g. cooperatives transferring into a formal enterprise); iii) the fact that small firms may delay getting a tax code although they are effectively operational; and iv) challenges that DSO officers face in accounting for all companies, some of which may be hard to find or confirm as operational. In terms of the latter, the GSO believes that less than 4% of all companies - most of which tend to be very small firms with just a handful of employees - are missed in this way, and so the figures they provide on the number of companies operational in Vietnam are relatively accurate (within about 3,000 firms).

### 3.2 NATIONAL BUSINESS INFORMATION CENTER

The National Business Information Center (NBIC) should be particularly well placed to collect, collate and disseminate information on company registrations in Vietnam. Situated within MPI's relatively new Agency for Small and Medium Enterprise Development (ASMED), the NBIC seeks to maintain a national database on company registrations. The information for this database is provided by the various DPI offices across the country. It is to the DPI offices that people submit their applications for company registration and from which they receive a business registration license. The national figures for end-2003 suggest that there were 83,490 firms registered in the NBIC database and a further 14,400 or so were registered nationally in the first five months of 2004.

The NBIC's process for collecting data is markedly different from that of the GSO. Most importantly, the NBIC is recording new company registrations, conducted at the provincial and municipal DPI offices, and not measuring actual companies in operation. These company registration figures are pooled nationally by the NBIC in Hanoi. For 11 DPI offices, this information is passed to the NBIC electronically, using the NBIN network spanning Hanoi, Hai Phong, Thai Binh, Hai Duong, Phu Tho, Thai Nguyen, Nghe An, Da Nang, Ba Ria-Vung Tau, Dong Nai and Ho Chi Minh City. There are plans

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<sup>12</sup> An effort is made to literally count all firms and no sampling or extrapolation techniques are used by the GSO in the annual survey. Household enterprises are not included in this annual exercise, although they are included in the five-yearly census exercise, where sampling and extrapolation techniques are used.

to extend NBIN to encompass all of the DPIs in Vietnam but this has yet to happen. DPI offices not connected to NBIN send their new registration figures to the NBIC - by fax or post - each month where they are inputted manually into the database. However, some DPI offices submit these figures late, making extrapolation from NBIC figures difficult. Six of the 64 DPI offices had not made any submission in the first four months of 2004 when we met with NBIC in mid-2004. It is believed that some DPI offices lack sufficient resources and manpower to conduct their work as efficiently as desired by the NBIC. As their principal task is to issue business registration certificates to eligible applicants, other less important tasks can sometimes get overlooked.

Perhaps the main weakness of the NBIC system is that the figures can be unintentionally misinterpreted as being indicative of the number of companies actually operating. But not all companies that initially register subsequently become active, as circumstances change and business plans are cancelled or suspended. An inability to acquire the necessary financing, a change in market conditions or business regulations, the cancellation of an anticipated contract: these are all examples of events that could result in a company proceeding no further than the initial registration process. As the second phase of this study shows, the tax code application and approval process tends to be a more difficult exercise for new companies than the initial registration process and a proportion of firms fail to pass this hurdle.

As with the GSO's data collection process, there is also the problem of double-counting some companies that re-register when changing their legal status or ownership structure. And partly as an indirect consequence of various factors - including the current investment incentive regime for some start-up companies - there is a tendency for some existing companies to register new "satellite" firms when expanding or diversifying their business operations rather than keeping the expansion within a single registered entity. Branch offices of existing companies established in different locations also tend to get counted as new firms. Add to this the formal registration of companies that had previously been informal household enterprises and it is clear that the NBIC figures provide an inflated picture of start-up ventures, and that the demographic profile of Vietnamese firms is not quite as youthful as the headline numbers would suggest. In particular, a substantial proportion of supposedly new companies, having registered since the enactment of the Enterprise Law in 2000, are not new at all.

Also, the NBIC data does not strictly account for companies that close down, or simply cease to operate (e.g. go into a state of hibernation until market conditions improve). So while the welcome "births" of new companies are being recorded, the inevitable "deaths" of others are not. As a result, the figures provided by the NBIC should be used with care: they accurately indicate the pace at which new firms are being registered but they do not accurately indicate the size or growth of the corporate sector in Vietnam. This is an important distinction that must be emphasized.

Table 1 below seeks to provide a comparison of the two sources of headline numbers on company formation in Vietnam. This is followed by Table 2, which provides recent GSO and NBIC figures. As shown, the difference between the two is gradually widening, with the GSO figures roughly 40% smaller than those provided by the NBIC. This margin of difference stems not only from the different procedures used but also from the fact that the two organizations measure different phenomenon: business registrations in the case of the NBIC and business operations in the case of the GSO. This important distinction should be always borne in mind.

**Table 1: Comparison of two main statistical sources on local companies in Vietnam**

	GSO	NBIC
<i>Principal Difference</i>	Measures the number of companies in operation.	Measures the number of new company registrations.
<i>Description</i>	Part of annual survey exercise.	Dedicated database on national company registrations
<i>Principal Source of Data</i>	Collated annual survey of companies operating in Vietnam.	Collated details of company registrations made at all DPI offices in Vietnam.
<i>Frequency of Data Collection</i>	Annually.	Real time for 11 provinces/ municipalities, and (should be) monthly for all other provinces/ municipalities.
<i>Principal Strengths</i>	Records all companies shown to be operational, and does this relatively accurately.	Records all new company registrations, and does this relatively promptly.
<i>Principal Weaknesses</i>	<ol style="list-style-type: none"> <li>1. The survey is conducted only annually and year-end results are not published until some considerable time later.</li> <li>2. Some small companies that are operational but not readily contactable by local GSO officers are likely to be overlooked.</li> <li>3. Companies eligible for a tax holiday will not have a tax code and may therefore be overlooked.</li> <li>4. As companies change their legal status, they may be issued a new tax code and run the risk of being counted twice. Similarly, companies with multiple branch offices may have multiple tax codes.</li> </ol>	<ol style="list-style-type: none"> <li>1. Not all company registrations result in operational firms.</li> <li>2. No systematic recording is made by DPI offices (and therefore transferred to the NBIC) of companies that close down or become non-operational.</li> <li>3. Only 11 DPI offices are directly linked to the NBIC network itself, with other offices submitting their new registrations manually. Some submissions are significantly delayed.</li> <li>4. As companies change their legal status, they are likely to re-register at the DPI offices, but these re-registrations are counted in the same way as new registrations.</li> </ol>
<i>Latest Data on Company Registrations</i>	End-2002: 62,908 companies operating. End-2003: 72,016 companies operating.	End-2003: 128,490 companies registered.

**Table 2: GSO and NBIC data compared (2000-2003)**

	End-2000	End-2001	End-2002	End-2003
NBIC Data on New Company Registrations*	59,413	80,453	101,988	128,490
GSO Data on Companies Operating	42,288	51,680	62,908	72,012
GSO Figures as % of NBIC Figures	71%	64%	62%	58%

\* These figures comprise company registrations since January 1<sup>st</sup>, 2000.

### 3.3 SURVEY RESULTS FROM PHASE ONE

How do these official headline numbers compare with the results from our survey sample of 300 firms? In the first stage of the checking process - using telephone calls and telephone directory services - we found that:

- Fifty-seven percent of the companies in our sample (171 firms) were clearly operational;
- Just 4% (12 firms) of the companies appeared to be formally closed; and
- The operational status of the remaining 39% (117 firms) was unclear.

We noted some marked differences between different locations. In Hung Yen province, for example, all of the sampled companies were clearly operational, compared to just 44% in Bac Ninh and none in Ha Tay (where 57% initially appeared to be non-operational). The sub-samples in these locations are much too small to make any strong assertions or conclusions here, but the distinct provincial variations would suggest that differences exist in the way provincial DPI offices register and/or monitor private companies under their remit. (If so, this would be congruent with other recent research that emphasizes the distinct differences that can exist in the regulatory and business environments of different provinces and municipalities.)

After the surveys, we conducted site visits to the 129 companies (43% of the sample) that initially appeared to be either non-operational or without clear operational status<sup>13</sup>. These site visits resulted in:

- The number of confirmed operational companies increasing significantly to 73% of the total sample (from 171 to 218);
- The number of confirmed closed companies also increasing slightly, from 12 to 14, or slightly less than 5% of the sample. All but one of these were in Hanoi; and
- The operational status of the remaining 22% (68 companies) remaining unclear even after visits to the address recorded in the NBIC database.

13 A further eight companies were also included for site visits when it was found that they appeared to be operational, even though the NBIC database stated they were formally closed.

Simultaneous with the site visits was an attempt to see which of the 300 companies had been issued with tax codes, as these are the next regulatory stage in the process of commencing business operations. Although the accuracy of this tax code check was not wholly robust, it seemed to suggest that around 14% of the total sample of 300 companies (42 firms) had not been issued with a tax code. If correct, this suggests - but does not wholly confirm - that these companies failed to advance beyond the initial registration process and therefore did not become operational. Of the 111 companies whose operational status remained unclear, 24 did not appear to have been issued a tax code and we therefore assumed that they were indeed non-operational.

Of the companies with unclear operational status, 24 did not appear to have received a tax code and 44 did appear to have received one. We therefore strongly suspect that the 24 without tax codes never became operational, as they would have lacked the red invoice VAT book needed to formally transact any business, at least officially. They were therefore added to those firms confirmed as being closed or non-operational. For the 44 unclear firms that had been issued a tax code, it is conceivable that they are currently operational, although our investigations could find no trace of them, and it seems likely that a substantial proportion of these are so-called ghost firms. Of the companies in our sample that were confirmed as being closed, four appeared to still have valid tax codes. This may have been an administrative oversight, but might also be a case where effectively defunct firms were still purchasing VAT red invoice books. Of the 59 firms in our sample that had not been issued with a tax code, 14 were identified as being operational and were therefore seemingly operating without the use of red invoice VAT books.

Based on the above survey work, we can report our own headline numbers for our random sample of 300 companies located in and around Hanoi that were registered as new companies in the first three years since the Enterprise Law was enacted:

- Two hundred and eighteen companies (72.7% of the sample) were confirmed or assumed to be operational;
- Thirty-eight companies (12.7%) were confirmed or strongly suspected to be closed; and
- Forty-four (14.7%) remained of unclear operational status.
- Table 3 below provides the survey results from Phase One in more detail, both in terms of simple company numbers (within the sample of 300 firms) and also percentages. The results are also broken down into the three legal corporate forms and the three years of registration.

**Table 3: Survey results from phase one**

By Number	Confirmed Operational	Confirmed or Assumed	Closed Still Unclear	Total Sample
<i>By Legal Status</i>				
Private	31	5	0	36
Limited Liability	160	29	39	228
Shareholding	27	4	5	36
<b>Total</b>	<b>218</b>	<b>38</b>	<b>44</b>	<b>300</b>
<i>By Year of Registration</i>				
2000	75	17	8	100
2001	68	12	20	100
2002	75	9	16	100
<b>Total</b>	<b>218</b>	<b>38</b>	<b>44</b>	<b>300</b>
<b>By Percentage</b>				
<i>By Legal Status</i>				
Private	10%	1%	1%	12%
Limited Liability	53%	10%	13%	76%
Shareholding	9%	2%	1%	12%
<b>Total</b>	<b>73%</b>	<b>13%</b>	<b>15%</b>	<b>100%</b>
<i>By Year of Registration</i>				
2000	25%	5%	3%	33%
2001	23%	4%	7%	34%
2002	25%	3%	5%	33%
<b>Total</b>	<b>73%</b>	<b>13%</b>	<b>15%</b>	<b>100%</b>

\* All figures are rounded.

**Table 4: New company registrations in four years between January 1<sup>st</sup> 2000 and December 31<sup>st</sup> 2003**

	Private Enterprise	Limited Liability Company	Joint Stock Co.	Partnership	One Member Limited Liability Company	State-Owned Company	Total
<b>Vietnam (Total)</b>	<b>27,865</b>	<b>46,752</b>	<b>8,635</b>	<b>6</b>	<b>157</b>	<b>75</b>	<b>83,490</b>
<i>Sample</i>							
Hanoi	1,085	11,190	3,522	0	65	0	15,862
Ha Tay	219	717	135	0	7	0	1,078
Bac Ninh	264	468	53	0	0	0	785
Hung Yen	137	305	34	0	0	0	476
Vinh Phuc	118	362	31	0	1	0	512

Source: NBIC database.

### 3.4 INFERENCES AND CONCLUSIONS FROM PHASE ONE

A number of basic inferences and conclusions can be drawn from Phase One of the survey, notwithstanding the limitations of extrapolating too much from our relatively small and regionally contained sample.

#### 3.4.1 Headline numbers are inflated

Our survey results seem to suggest that the aggregate official statistics (headline numbers) for companies that have registered are greater than the number of formal companies actually operating. In this regard, the headline numbers provided by the NBIC database provide an inflated picture of the real situation. If our results were extrapolated nationally, our small survey would suggest that around 73% of newly registered companies are actually operational<sup>14</sup>. This is to be expected, particularly in a country where the number of new registrations is rising so rapidly. It mirrors a similar situation with foreign investment projects in Vietnam, where the number of approved projects and of pledged/approved capital tends to be markedly greater than the actual number of operational projects and disbursed capital. However, it should be kept in mind that a very

14 This percentage figure (of operational firms versus registered firms) is higher than the GSO figures and may reflect the greater effort made in our survey to track down companies of unclear operational status. Given that our survey only spanned 300 firms, and the GSO must count tens of thousands for firms each year, this is not surprising.

substantial number of household and informal businesses, which are potentially eligible for official company registration, are not included in the official statistics and headline numbers.

### **3.4.2 Closures are difficult to count**

One might expect a substantial proportion of the companies registered to have formally closed down their operations, having found their business activity to be not viable (it is inevitable that not all start-up companies will be successful). However, our survey results unearthed relatively few companies (14 firms, or 5% of the total sample) that had officially ceased operations. Indeed, of these 14 firms, just 3 (1% of the sample) had completed the formal cessation procedures. This suggests that the process of formal cessation of a business is either difficult and/or the incentives for doing so are not adequate. As a result, companies prefer to just informally fade away or go into a state of suspended animation, possibly with an eye to becoming active at some point in the future when conditions change for the better.

### **3.4.3 Tax codes are a useful way of ascertaining company status**

There were a significant number of companies in our sample whose operational status remained unclear, even after a series of checks and site visits were made. It is interesting to note that just a third of these unclear firms appear to have had no tax code. One might have expected a more substantial proportion to have had no tax code as a result of someone formally registering a company but then, for whatever reason, not advancing to the next stage of tax code issuance and start-up. In the case of companies with uncertain operational status and no tax code, it is almost certain that they did not become operational as they would lack the red invoice VAT book necessary for invoicing customers. If we add these companies (8% of the sample) to those confirmed as closed (5% of the sample), we can assert with some authority that at least 13% of the firms in our sample were non-operational. Indeed, one might suggest that the number of tax codes issued is a more accurate indicator of new businesses actually commencing operations than the company registrations logged by the NBIC database.

### **3.4.4 Weaknesses exist in the NBIC database**

Our survey work suggests that a number of weaknesses currently exist in the NBIC database, notably with regard to the quality of data on each company. When downloading information on the 300 individual companies selected for our sample, we often found information missing from various fields in the NBIC database. This suggests that the initial inputting of data is not sufficiently accurate. When we then checked the data provided in the NBIC database with each of the companies listed, we found quite a high proportion of the information to be incorrect. Most notably, we found that 118 of the companies (39% of the sample) were at addresses other than those cited in the NBIC



database, often having relocated since registration. This suggests that the information in the database is not sufficiently well maintained or updated. The problem appears to stem from a combination of inadequate reporting by the companies themselves and inadequate updating by DPI offices. Through interviews with DPI officials in one province, it became clear that numerous companies ignore current regulations on the need to annually report their activities (including changes of address), and that such regulations - which include the penalty of revoking the business license - are not enforced. Officials at the DPI offices also appear to be under-resourced and the relatively small number of staff are unable to regularly check up on companies already registered. The de facto result is that the DPI's processing work sometimes ends upon issuance of the business registration document, with no effective means of subsequent monitoring. There are also problems with the database itself, which at present only collates data electronically from DPI offices in 11 major cities and provinces across the country<sup>15</sup>. For all other provinces, the data is sent by the DPI offices in paper form and must then be entered manually, which adds considerably to the risk of inputting errors being made.

### **3.4.5 Re-registration skews the figures**

Forty-nine companies (or 16% of the sample) registered prior to the enactment of the Enterprise Law in January 2000 and subsequently re-registered. This kind of revolving registration would suggest that the headline numbers for company registration might be slightly inflated, as some companies have a tendency to re-register themselves, presumably in order to benefit from fiscal or other incentives offered to ostensibly new firms, or for other reasons that are to their benefit.

### **3.4.6 The VAT system encourages some companies to register**

It is worth noting that manufacturing companies only accounted for 12% of our random sample. Notwithstanding the caveats noted in an earlier section (regarding both the delineation of manufacturing and service companies and the potential for bias in our small sample) this illustrates the extent to which a large proportion of new companies being established under the Enterprise Law are small trading or service companies. In this context, it is interesting to speculate how many of the new company registrations by trading companies may have stemmed from the need to issue VAT red invoice books to customers. If so, a major driving force in the migration of informal household firms into formal companies, as seen in the substantial rise in registrations, may have been the introduction of the VAT system in Vietnam, which broadly coincided with the promulgation of the Enterprise Law in early 2000.

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15 Some of the cities that have computerized their DPI registration systems have developed their own software, independent of the national NBIC, resulting in incompatibility difficulties.

### Box 1: The experience of province Z<sup>16</sup>

According to the DPI and tax offices in Province Z, the two main reasons why newly registered firms do not go on to purchase a red invoice book after getting their business registration certificate and tax code are: i) an inability to find land or premises (so the business does not proceed further); or ii) an inability to realize commercial contracts with business partners, which had been a major motivating factor behind the establishment of the new company (and so the business does not proceed further). At least in terms of start-up ventures, this seems to suggest that quite a number of applicants register for a company license prior to commencing the business itself. It is only when the initial conditions on which the business was envisaged do not materialize that they halt operations. This tends to happen after both the business registration license and the tax code have been issued but before the new company purchases its first red invoice book. This being the case, counting the number of companies that have bought a red invoice book, rather than the number of business certificates or tax codes issued, might be a better way of measuring the number of companies actually operational in Vietnam.

The time required for registration in Province Z is just two to three days. This short time period is due to the small number of business registrations received. In 2003, a few hundred new companies were registered, just three companies submitted an application to formally close down, and no firms filed for bankruptcy. The head of the DPI registry mentioned a common practice among firms of registering their chartered capital at a lower level than reality in order to reduce their annual certificate maintenance fee.

Under current regulations, a company should have its business registration license revoked if it does not submit annual reports. In reality, however, only about 30% of companies in Province Z submit reports yet the DPI has never yet revoked a license. The local DPI office reminds businesses of their obligations in this regard three times each year (before the deadline for submitting, on the deadline, and after it), but the response rate is always low. DPI officials attributed this to the fact that there are no penalties imposed on firms that fail to submit their reports. As for the threat of license revocation, this is deemed to be ineffective as the local DPI regards it as too severe a penalty to be practical.

The tax department in Province Z has 380 staff, compared with just three staff in the DPI registration office. Consequently, tax officers tend to know much more about the condition and performance of firms in the province than their DPI counterparts, at least after registration. The DPI officers, on the other hand, tend to focus on the initial company registration. Indeed, the DPI office sometimes does not record changes - such as change of address or line of business - if firms do not submit their annual reports. As noted above, around 70% of firms in Province Z fail to submit these reports.

16 All case studies profiled in boxes are real. The names of the provinces, companies, etc. have been changed.

### 3.5 A NUMBER OF POSSIBLE REASONS FOR DISTORTION OF THE HEADLINE NUMBERS

Headline numbers for company formations are distorted because:

- Some informal companies, such as household enterprises, may prefer not to register in a more formal legal sense even though they are eligible to do so and more than meet the requirements to do so;
- Some registered companies may not formally register their closure, opting instead to remain in a state of temporary suspension or indefinite hibernation;
- Some company registrations may be an inadvertent by-product of regulatory or fiscal distortions, as entrepreneurs seek to take advantage of tax incentives or other benefits that may accrue from enacting multiple registrations/companies<sup>17</sup>;
- Some company registrations may be the by-product of more illicit intentions by individuals or companies (e.g. to acquire and then resell red invoice VAT books);
- Some local companies may register under the separate Foreign Investment Law in order to take advantage of the different fiscal incentive regime that pertains to foreign-invested companies; and
- There is accidental evidence of double counting by the GSO and NBIC. This problem stems from various factors such as: change of legal status resulting in a new business registration and/or tax code; opening a branch office in a different location: etc.

The precise extent to which these inflationary and deflationary factors balance each other out is unclear.

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<sup>17</sup> For example, to take advantage of the corporate income tax holiday provided to newly registered companies, or other fiscal incentives offered to companies that establish operations in specific locations. Such incentives can prompt existing firms to establish multiple additional companies rather than simply reinvesting in the initial business; horizontal growth instead of vertical growth.

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## CHAPTER IV

### RESEARCH FINDINGS: A WALK THROUGH THE BUSINESS REGISTRATION PROCESS

Following the enactment of the Enterprise Law in 2000, the business registration process for new private companies has simplified significantly, as widely perceived and evidenced by this survey. This improvement has been widely commended by the business community in Vietnam. The four principal steps of the business registration process and start-up process are as follows:

- (i) Register for a business certificate from the local DPI;
- (ii) Get a corporate seal made and register it at the local police station;
- (iii) Receive a company tax code from the local tax office; and
- (iv) Purchase a red invoice book from the tax office.

Firms must follow this process, one step after another, according to this strict sequence. It is not possible to pursue multiple steps in tandem. Our survey found that, on average, it took a firm about 50 days to complete the whole registration and start-up process.

#### 4.1 BUSINESS REGISTRATION CERTIFICATE

The majority of entrepreneurs interviewed in Phase Two of our survey found this first element of the business registration process to be relatively quick and simple. Firms can either hire a service provider (such as a law firm) to register on their behalf, or conduct the work themselves. The official fee for business certificate registration is VND200,000 (around US\$13).

In our sub-sample of 47 companies interviewed, roughly 42% of firms said they had hired a service provider to assist them in the registration process. Most of these firms hired a service provider to carry out the whole registration process (i.e. comprising registration certificate, tax code, company seal and red invoice book) and paid a lump sum for this service. On average, these firms paid VND2.2 million (around US\$140) to the service provider for the whole registration package and on average the process took 23 days to complete. All the firms interviewed were satisfied with the service provided.

About 55% of firms in our survey said they conducted the registration process themselves. On average, it took these firms 42 to 56 days to get the whole package done (more than twice as long as those firms using service providers). For just the business certificate, it usually took a firm 14 to 20 days to register. In general, most of the firms were satisfied with the process. About half said they paid some unofficial fees to speed

up the registration process. The other half said they did not pay any such fees and had not faced any major difficulties as a result.

There was evidence from our survey that the registration process could take longer if firms do not pay some sort of unofficial fee, albeit a relatively small one. One director who did not pay such a fee said that it took his firm more than two months to register. The firm did not pay any unofficial fees, despite suggestions by officers at the registration office that he should pay some extra money to speed up the process. With an unofficial fee, firms may also get more extensive instructions from registration officers and thereby save time in preparing the required registration documents. One of the factors that appears to be behind this unofficial fee issue is that the registration office is often overloaded and officers do not have enough time to provide instructions in detail to everyone. A director of a consulting firm described the firm's registration experience as follows:

*"The quality of service in the registration office is very poor. There are facilities and human resource shortages so workers in the registration office are overloaded. We had to wait a long time and return (to the office) about five times. The registration officers did not give proper instructions even though they knew there were mistakes in our documents. They did not tell us of our mistakes at one time (but on a series of different occasions), so we had to refill forms many times over."*

There were also complaints about the incompleteness of the list of business activities that applicant firms can cite when registering. Two firms interviewed said that their type of business activity was not on the list, and so they had to register in a general category. But there were concerns that this may cause problems later on, particularly when the firms must deal with tax officials in assessing their tax payment obligations.

One member of our research team visited a DPI registration office for a firsthand look at the process.

## Box 2: A visit to a Registration Office of Planning and Investment

Full and detailed instructions on the process of registering a business were provided on wall posters at the DPI office. Photocopies of these instructions were also on sale for people to take away and peruse more closely. The photocopies were sold for VND20,000 each (around US\$1.25). By following the instructions outlined in them, applicants can prepare all their business registration application documents without professional assistance.

Once the documents are ready, they are submitted to the registration officers in the Department of Planning & Investment office. The registration officers ask the applicant to return after a few days, at which time they would inform him/her whether his/her documents were completed properly and could be accepted for processing. If there were no mistakes the applicant should receive a registration certificate within 15 days.

The fee for registration (with an official receipt) is VND200,000 (around US\$12.50). This is paid when the applicant receives his/her registration certificate. However, if there are mistakes in the application documents, the applicant will be asked to prepare a new set and apply again.

Of the people who were in the registration office when MPDF visited, one man from a local law firm said he frequently came to assist people as they filled in their company registration applications. He advised that if they offered some under-the-table money the application would proceed faster and more smoothly. However, if no such money was provided the officer would point out mistakes in the application and tell the applicant to re-apply. The difficulty here is that the officer would not point out all the mistakes at one time and when an applicant fixed one mistake, the officer would then point out another during the second application process. As a result, some people were forced to re-apply for their business registration several times. The mistakes highlighted by registration office personnel are sometimes very minor and it is therefore virtually impossible to be sure that no such errors exist and that documents are adequately prepared for application. This is even true for service providers such as law firms that frequently apply on behalf of their clients. However, if under-the-table money is paid, the registration officers will usually be more lenient and will point out all possible mistakes in the application documents up front. The lawyer we interviewed did not reveal how much under-the-table money was required to smooth the application process.

Another person MPDF spoke to was applying for an adjustment in her company's registration details. She said she was able to do this quickly and easily and had done so several times in the past, although she did not know why her company adjusted its registration certificate so frequently (two or three times each year). She said she always put VND50,000 (around US\$3.15) in with the application documents and the process always seemed to go smoothly.

## 4.2 COMPANY SEAL REGISTRATION

After obtaining the business registration certificate, a company can start to register its official company seal with the local Department of Police. The seal-making process itself is simple and usually takes a week to 10 days. A number of firms interviewed said they paid an unofficial fee to the Department of Police, while others paid the official fee only. No firms interviewed reported any trouble in making their company seal. However, some firms considered ten days for the seal-making to be too long, particularly since a company cannot proceed to the next step of the registration process (registering for a tax code) without a company seal.

## 4.3 TAX CODE REGISTRATION

After obtaining the company seal, a company can register for a tax code at the local Department of Taxation. It usually takes 15 days to receive the code, which is used for both VAT and corporate income tax. As with the company seal registration, the majority of firms interviewed did not report any problems in the tax code registration process. However, around 6% of surveyed firms were dissatisfied with the process, as they had to go to the tax office several times and pay an unofficial fee. None remembered specific details. One director interviewed described the process as being "complicated and taking a long time." She paid a small unofficial fee to the officers in charge but thought that was normal:

*"At first, they asked us to come back over and over again. But then we gave them something under the table, not much, and it was done. You know, it is an unwritten law. In dealing with these procedures you have to be quick-minded and flexible. We are more interested in doing business (than in administration) so see these procedures as simply something that must be done, we do not think of them as a problem. We want to have a good relationship with them (tax officials) because they will manage our taxes in the future. Also, I think that (under the table payments are) kind of fair: if they just live off their salaries they would be poor. It is like giving them a gift to say thank you."*

## 4.4 PURCHASING THE RED INVOICE BOOK

The procedures involved in purchasing the first red invoice book were at times complicated and frustrating. Even company directors were required to present themselves to tax officers during the first purchase of a red invoice book. Although the procedures had reportedly improved prior to our study, they were still quite complicated at the time of research. The principal reason for this appeared to be that, in a bid to avoid selling red invoices to ghost firms, it often took time for tax officers to make sure that they were not issuing red invoice books to illicit applicants. About half of the firms interviewed reported that they paid some unofficial fee to tax officers to get things running smoothly. They all thought this was a fact of life and did not consider the amount given to be significant.

### Box 3: Law firm A

Local Law Firm A was established in 2001 in Hanoi and specializes in corporate legal advisory services. To date, the firm has served around 1,800 clients, mostly in areas such as: business registration; registering changes in business activities since commencing operations; copyright and trademark issues; etc. In addition to helping numerous new companies to register, the firm has also helped formally close about 30 firms and has helped a further five to temporarily suspend operations. It has about 15 staff working in Hanoi and surrounding provinces.

In providing these legal services, Law Firm A perceives a number of difficulties that companies encounter with the business registration process. For example, when registering the company name, Decree Three allows for duplication of names in different provinces, while Decree 54 prohibits this. Furthermore, the definition of what words and abbreviations can or cannot be included in a company name is vague, giving room for registration officers at the local DPI to delay the application process. This view is supported by the owner of a new firm who told us that she was not permitted to use a foreign or invented word in the formal title of her company, although initial indications suggested this would not be a problem.

Administrative and regulatory issues for some specific kinds of business are also unclear, according to Law Firm A. For example, legal advisory activities are partly managed by the DPI, under the Enterprise Law, and partly managed by the Ministry of Justice. According to the law firm, registration officials in some DPI offices request additional documents to be submitted at the time of registration (which are not required under the Enterprise Law). For example, a registration office in one district of Hanoi wanted a copy of the applicant's office leasing contract. There also appeared to be some confusion among registration officials about the distinction between limited liability and joint stock companies, leading to requests for unnecessary documentation.

In the view of Law Firm A, the most troublesome part of the pre-operation approval process is obtaining the tax code. Even though by law the tax department does not need to request any additional documents and should provide a tax code to any firm that has been newly registered by the DPI - a process which should be quite simple with the proper software - the tax department usually prolongs this process, taking on average 15 days to issue a tax code (yet in cases where a 'gift' was made to the processing staff, the tax office issued a tax code within one working day). Further, the tax department also asked for the applicant's office leasing contract, and required the lessee to show documentation of a certificate of land-use right (CLUR), with all relevant taxes paid. At present, about 75% to 80% of houses in Hanoi and surrounding areas are unable to meet this condition.

As a cumulative result of the above, the whole registration process typically takes 45 to 60 days when it should not take more than 10 days in total, from applying for the registration certificate to getting the tax code.

In terms of formally closing down a company, Law Firm A believes that the requirement that a company must first complete the finalization process with the tax office is the most troublesome issue. Current regulations do not stipulate a limited time period for tax officials to complete this procedure and so some officers delay this final visit, seeing little personal incentive to hurry.



#### Box 4: The complex world of companies X and Y

Company X is a limited liability company based in Hanoi, which was formally established in July 2002. It claims to have a diverse range of business interests, from motorbike retailing and chemicals trading, to operating a restaurant. Company X was established by a family that has traded motorbikes for many years and was initially registered as a firm in 1995.

Mr. X, the managing director, said he received his company registration certificate and tax code in 2002 without major incident. However, he has been unable to purchase the red invoice book. According to Mr. X, this is ostensibly because there are too many companies already registered at the same address and the local tax authority has concerns about potential invoice fraud. But Mr. X suspects that the problem may really stem from the fact that he did not offer money to local tax officials.

The address of Company X also serves as a shop and office for Company Y, which also sells motorbikes. Indeed, Mr. X claims it sells as many as 2,000 motorbikes each year. When we visited, there were 30 new Hondas parked in the premises and business looked brisk. According to Mr. X (an equity holder of both Company X and Company Y), besides Company Y, his family has also registered five other companies at the same address (although we could only find Company X and Company Y on the NBIC database), each owned by a different family member. The reason for doing this was to separate responsibilities and benefits among siblings and prevent family disputes.

In practical terms, Company X is non-operational. Not even the company name is shown on the premises. However, the company exists in legal terms and its owners still pay the annual certificate maintenance tax. The reason the owners have not closed down Company X is that they regard the certificate maintenance tax to be sufficiently small and hope they will be able to purchase the red invoice book for Company X one day, at which time they will start operating the company.

In summary, the registration process has been simplified and the majority of firms appear to be broadly satisfied with the process. There were, however, a number of areas that could be improved. The time it takes to register a new company is still excessive by international standards. The current procedures could be simplified to allow firms to simultaneously register for the company seal, tax code and purchase invoices and thereby shorten the whole registration period. Well-codified and simple procedures could help reduce the prevalence of unofficial fees.

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## CHAPTER V

### RESEARCH FINDINGS: BEYOND REGISTRATION

This chapter reports findings from Phase Two of our study on the kinds of constraints that companies tend to encounter after registration. These stem from the interviews conducted with 47 operational firms within our sample and are divided into six thematic categories: issues relating to land and premises; issues relating to access to capital; inspections by government agencies; tax issues in general and the purchase of VAT red invoice books in particular; sub-licenses; and customs procedures.

Discussion of these obstacles is preceded by a brief profile of the 47 firms interviewed and the chapter concludes with some commentary.

#### 5.1 PROFILE OF THE 47 COMPANIES INTERVIEWED

Thirty-three firms interviewed (roughly 70% of the sample) were limited liability companies. Three firms (roughly 6%) were registered as private companies, and 24% were joint stock companies. This broad composition mirrors the pattern of registered private business enterprises throughout Vietnam, where limited liability companies tend to dominate in terms of numbers. Since registering, 90% of the firms had not made any changes to their ownership structure.

Roughly three quarters of the firms interviewed were operating in the broad area of trade and services. Only 25% were engaged in production activity of some kind. Again, this composition of firms in the sample mirrors quite well the general pattern of private firms in Vietnam, where trade and services tend to dominate. Most of the enterprises were small in terms of their registered capital (an average of VND1.33 billion)<sup>18</sup> and had an average of 28 employees in 2003. In general, there was a slight increase in firm size over the previous three years, both in terms of registered capital and number of employees. However, only one fifth of companies interviewed reported that they had officially increased their registered capital since initially registering; the majority kept their official registered capital unchanged. Table 6 below shows the origins of the 47 firms interviewed.

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18 Equivalent to about US\$85,000. For more details, see Tables 9, 10 and 11 in the appendix.

**Table 5: Company Origins<sup>19</sup>**

Origin	No. of Firms	%
Previously an informal entity	21	44.7
A wholly new company established by an entre preneur	15	31.9
Previously a different legal entity	5	10.7
A direct subsidiary, affiliate or spin-off of another company	5	10.7
Other	1	2.1
<b>Total</b>	<b>47</b>	<b>100</b>

It is interesting to note that roughly 45% of the firms interviewed had previously been informal entities (household businesses). There were a number of reasons cited by the owners of these former household businesses explaining why they had decided to register as a formal business entity. The most common was related to tax issues and the VAT red invoice book. Informal businesses are not normally entitled to buy red invoice books and without them they cannot sell their goods to certain types of clients (such as State-owned enterprises and government organizations), which require these invoices for their own accounting purposes.

Another reason mentioned by a number of firms was that a formal business entity has the benefit of greater transparency in the calculation of its tax payment obligations. The calculation of VAT for formal businesses appears to be more straightforward, based directly on the invoices issued<sup>20</sup>. But in the case of informal businesses, tax payments are negotiated between the owner(s) and tax officials, in which the former is in a more vulnerable position. Other perceived benefits associated with being a formal business are the ability to export directly and to lease land from the government. In contrast, informal businesses are not allowed to export directly and must serve any overseas customers through a third party. An informal firm may not lease land from the government. Although the reasons cited for formalizing operations varied, a common and overarching reason was that an informal business probably cannot expand and grow effectively beyond a certain level.

Roughly a third (32%) of the companies interviewed appeared to be genuinely new start-up ventures established by entrepreneurs since the Enterprise Law of 2000. About 11% of companies actually predated the Enterprise Law, but had re-registered as a new form of business, either to take advantage of some benefits, or simply to become consistent with the new law.

<sup>19</sup> The sub-sample from which these figures are derived consisted of just 47 firms, so percentages are purely indicative.

<sup>20</sup> Obtaining VAT invoice books is another story - see discussion in section 5.2.4.

The majority of firms reported that they were profitable. However, it is worth noting that owners of small private firms often do not take into account the opportunity cost of their own labor (i.e. they do not include their own salary in the calculation of company expenses) and their own property (on which the company is located). Although most of the firms claimed to be doing "fine," many of the interviewees had found operating their businesses to be more difficult than they had initially expected. When asked how easy or difficult they had found operating the business to be, only around 13% of respondents felt the operation was easier than expected, compared with 49% who found the operation of their business to be more difficult than expected. A similar pattern was found with regard to profitability. Roughly 45% of firms in the sample had found their business to be less profitable than expected, and only about 9% felt the company profits were more than expected<sup>21</sup>.

Despite these sober responses, the large majority of firms (roughly 90%) had continued to conduct the same kind of business since their initial start-up and only 10% had made significant changes in their business line. Also, most entrepreneurs interviewed appeared optimistic about the future of their business. Roughly 45% said they would expand their existing operations, 15% would diversify into new lines of business or new markets, and 34% would maintain operations at broadly the same level. Only one firm reported that it would reduce the scale of its operations, and one other firm intended to either temporarily suspend or completely close down its operations<sup>22</sup>.

## 5.2 OBSTACLES

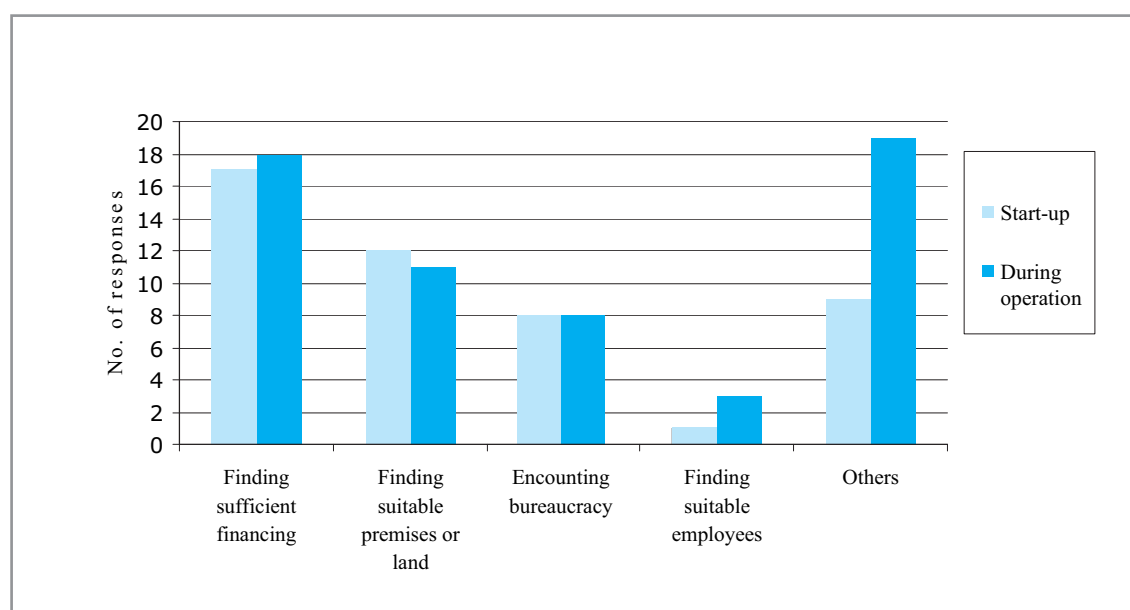
### 5.2.1 Land and premises

Access to land has clearly become a major issue facing private businesses in Vietnam. Land-related problems often arise during the start-up phase, and in many cases continue throughout the full life span of the company. Limited access to land has partly accounted for the relatively small size of most private firms in Vietnam, as well as the precise kind of business they have chosen to pursue. The relatively high proportion of private firms operating in services and trade (90% in our sample of 300 firms) is at least partly a consequence of land-related issues, as most service and trading companies generally do not require as much space to operate as manufacturing firms.

In our sample of interviewed firms, one quarter cited the issue of finding suitable premises or land as the most difficult aspect of their start-up process. Indeed, finding suitable premises or land was ranked second highest (only behind finding sufficient financing) in the list of challenges faced when starting-up and operating a business. Figure 2 on page 32 shows the frequency of responses to each perceived obstacle, for both the business start-up phase, and during the subsequent operational phase.

21 There may be a degree of false modesty in these responses, with companies not seeking to attract attention to the full extent of their profitability.

22 Although these responses look promising, we should remain wary of the potential bias in the sample.

**Figure 2: Broad categories of obstacles encountered**

Tellingly, less than 10% of the firms interviewed in this survey were currently situated on their own land (i.e. the company's land), and only one company was located in an industrial park. All the rest were located on either private property owned by the company's owners (roughly a quarter of the sample) or in rented premises (roughly half of the sample).

Being located on rented land, often on short-term rental contracts, tends to create uncertainties and difficulties. There are two major sources from which private firms can lease premises: State-owned enterprises or private landowners. Firms that need a relatively large space to operate (such as some manufacturers, and trading firms that require relatively large warehouses) often try to lease such land from State-owned enterprises. Around 11% of our interview sample had rented land from State-owned enterprises. The rental terms are often short- to medium-term (with 10 years as the maximum among firms in our survey) and it is therefore understandable that these firms were somewhat reluctant to invest in a large amount of fixed capital. For this reason, they tended not to expand or develop their operations to any great extent.

In some cases, State-owned enterprises were not officially allowed to lease land to private companies but rented it out unofficially. As a result, the rent the private company paid to the State-owned enterprise was not taken into consideration by tax officials as a legitimate tax-deductible expense. In addition, as the rent was unofficial, the lessee's legal position was vulnerable should any dispute arise, and the court may not enforce the contract.

### Box 5: Land in short supply

Company A needs about 2,000 square meters for its factory but because of its relatively small size it is unable to acquire land in an industrial park. So the company has to rent land from an equitized former State-owned enterprise in Hai Duong province. As the land is rented, the company feels it cannot justify substantial investment in its infrastructure. The workers also do not want to work in a temporary factory.

Other problems pertain to the rental and electricity costs, which are both significant. The SOE that rents the space cannot officially do so, meaning that the agreement with Company A is unofficial. The same is true for the use of electricity in the factory, so the host State enterprise cannot issue red invoices for the electricity Company A uses and the company cannot show these invoices - for either rent or electricity - when claiming legitimate expenses for tax deduction purposes.

Although unofficially renting land from a State-owned enterprise is certainly not ideal (causing the lessee many uncertainties and problems), the situation is often worse for firms that rent land from private owners. Small firms, usually involved in trade activity, often rent their office space or outlets from private owners. The rental term is normally six months to one year. Most of the private lessors in Vietnam do not wish to lease their property for a long period, as they may decide to use the land for other purposes after renting it for a certain period of time. Some modify the rental terms to their advantage at the end of a contractual period, causing the lessee additional problems. The lessee may have to look for a new place at short notice, and may lose customers as a result.

### Box 6: Hard to secure a long-term lease

Company B rented a piece of land from an individual and built an office on it, with the hope that the lease term could be extended. However, the owner took back the land with the house on it after two years, made some renovations, and then rented to Company B again but at a higher price.

Company C uses a place rented from a tourism company under the City's Youth Union (a non-profit organization) for its office and shop. But the rental contract is very short and might be terminated anytime if the tourism company finds another use for the property or chooses to lease it out to another company on more favorable terms. The space, just 120 square meters, is too small for Company C to expand operations.

Firms that are situated on the owner's own property (25% of our interview sample) are also not without problems. The premises are normally small, which limits expansion, and yet again there are tax-related problems. For example, it can often be difficult to negotiate with tax officials on legitimate overhead expenses incurred by the company, such as

electricity and water, as it becomes difficult to delineate which expenses are personal and which stem from the company itself. One company owner complained: "It is difficult to find a long-term office so for now I have to use my own home. That means that many company expenses (rent, electricity, water□) are incurred in my home and do not qualify for tax deduction".

Another business owner explained that not having a land-use right certificate ('red book') has added to her difficulties:

*"I have had problems related to this land and house. We are supposed to be issued a red book for this land but have not gotten one yet. When we do, things will be easier. The land used to belong to my husband's parents, who divided it among their children. My husband and I bought the shares from his siblings so all of the land now belongs to us, although it is still in my father-in-law's name. That being the case, he had to sign a document saying he gave permission for us to use this land for our business. We have since invested a great deal of money in the property but because it is technically my father-in-law's, we cannot count our investment as a legitimate business cost or use the land as collateral for a bank loan. My father-in-law says that when he gets the red book he will legally transfer the land to us, but we have already lost many business opportunities due to the confusion".*

The majority of owners we spoke to were not content with their existing company premises. We asked them how they were dissatisfied and classified their responses into four broad categories: location, size, cost, and lease length. Table 6 shows our findings:

**Table 6: Degree of discontentment with premises**

Not content with:	% of sample*
Location	34
Size	34
Lease Length	26
Cost	15

\* Some respondents cited more than one area of dissatisfaction.

Although the majority of firms were not content with their existing premises, only a small number tried to buy or lease land designated for business purposes. Only 15% of firms in our sample tried to buy land from the government. There are a number of reasons for this; one of the most fundamental being insufficient supply. There is currently very little land designated for business purposes and available for lease in Vietnam, despite government efforts to change this. Also, many private businesses are small and either cannot afford, or are not eligible, to lease government land that has been set aside for business use. For those that are eligible to lease, problems encountered include complicated bureaucratic

procedures and land clearance difficulties. Bureaucratic complexities have deterred some firms from applying for land leases - several entrepreneurs interviewed believe they would never get government land so did not bother to apply for it - and the high cost of government land (once unofficial charges have been taken into account) put off other potential tenants. Land clearance is also problematic, as the case study below clearly illustrates.

### Box 7: Compensation for land clearance

Company D rented 1.4 hectares of land in a province near Hanoi city. It started its application process in May 2001 and 17 months later received provincial approval. In April 2003, the provincial People's Committee approved a plan to take the land from its current occupants and lease it to Company D for 50 years. However, Company D was left with the problem of compensating the existing land users and clearing the site. The firm managed to clear only 82% of the land: "We have not managed to get the rest from current users because they will not take our money" and have refused to move on, explained the company's director. "They keep asking for more (compensation) and we cannot afford it. They have been encouraged by the National Assembly's discussion of the land law (during which) some Assembly members have spoken out in support of land users. So now people are asking for more money.

"I am very tired of this. When I applied and did the paperwork, I dealt with the province, but then the province passed the task to the district and I had to deal directly with the district, then the commune, then the village, and now with each individual household. The people using the land say many things: they say that other companies pay more so we should pay more; they say their fields are delineated differently from in official documents; they say they were allocated the land and their boundaries are fixed (but have nonetheless managed to encroach on adjacent land and increase their plot size)... These people are tough; when communal and provincial cadres came to solve the dispute, they told them to go home. They say the officials are corrupt. Only the company can come, but then the people refuse to see my staff and say, 'tell your director to come'. So now I have to go and sweet talk every single household. They say the director has a lot of money so [I] should go and buy land somewhere else. They tell me not to buy land here. They see it as buying land. We just want to rent this land from the province.

"A major part of the problem is that within this piece of land there are plots that are classified as agricultural land but that people hope will one day be reclassified as much more expensive residential land. They have a point: even if it cannot be used as residential land now, at some point in the future it probably will be reclassified. So they do not want to let go of it and they ask for a lot of money in compensation. People ask why the province has included agricultural land in an industrial area. All of the land we are still trying to clear belongs to households that hold agricultural land".

Although Company D has not completely finished clearing the land, it has started to level it. "We're hoping those people who are holding out will see us doing this and feel that they must agree. Also, we hope they will see that the other families who have accepted our



compensation are earning interest - worth more than their farming incomes - on that money.

"Some people are very unreasonable. They have given us the land but then come back and take away the soil. They use it to fill their ponds so that they can sell those for more money. I have had to assign guards to the place and yesterday there was a big fight. Fortunately, nobody was injured.

"In April 2002, the province picked another lot for us, which has road access and no agricultural land. Then in August that year they decided not to give it to us but instead gave us this lot".

### **Land access**

"On the map given by the province, there is a 24-meter-wide road that comes to our land from the highway but the province does not want to spend money on the road and said we should build it ourselves and they will pay us back later. But we cannot afford to do that so have had to ask another company - that has a plot adjacent to ours with access from another road - to let us access our land through theirs. Of course, we have to pay them money for this. They allowed us to make a five-meter-wide dirt road along the side of their land but say they have handed that land over to the construction company that is building their factory so we have to pay that company some money too.

"Early in our negotiations with the province, they said a lot of good things. For example, they said they would bring water and electricity to the site. Yet now it seems we will have to pay for the installation of a high-voltage power line from an existing provincial line that runs along the highway and does not reach our land. We cannot buy the new line because we do not have the money. We feel like we have been trapped. They were very positive at the start to get us in. Now we are in and have invested money so we have to continue despite all these problems.

"Even if the People's Committee wants to interfere, it is likely that the relevant departments will not listen. The People's Committee chairman is new and not very senior - he used to be at the same level as, or lower than, the department directors - so the People's Committee cannot make the departments do things they don't want to. Anyway, the People's Committee does not seem to care very much about helping. It used to hold meetings with local enterprises but the enterprises were so vocal in their criticism of the province that the People's Committee became overwhelmed. Now they summon individual enterprises to meet over lunch".

## **5.2.2 Capital**

Limited access to capital is a formidable barrier faced by small businesses in many developing (and even developed) countries. The ongoing difficulty faced by Vietnamese private enterprises in accessing capital has been identified and discussed in a number of publications in recent years. Our study confirms that this issue remains a constraint, even

as the general situation gradually improves. As shown in Figure 2 (page 32), finding sufficient capital is top of the list of difficulties cited by private enterprises, both in the start-up phase and during subsequent operations. The majority of companies interviewed were unable to borrow from banks and limited access to credit has hindered their expansion and growth. Firms therefore tend to pursue business in areas that require minimum capital investment. One entrepreneur expressed the issue thus: "I think capital is a common problem for private companies, including our own. If we could borrow from banks we could conduct other lines of business outlined in our license. We have been most active in head hunting services because this work does not require much initial capital investment".

An executive from another firm that appeared to have overcome the land constraint issue but then faced the problem of getting capital to fund expansion (or at least to make better use of the space available) said: "After leasing larger premises in an industrial zone, we wanted to invest in a production line for between 200 and 300 workers. This would cost approximately VND2 billion (around US\$127,000), but we did not have any mortgage collateral and could not borrow from banks. If we do not invest now, we will miss many business opportunities because we cannot process big orders from overseas".

Collateral requirements appear to be the major barrier to financing. The majority of enterprises interviewed were unable to borrow from banks because they lacked adequate security to provide for the loan. Many entrepreneurs were willing to offer their homes and other property as collateral but said banks have a tendency to under-value property given as collateral. Complicated procedures involved in the loan application process were also perceived as a deterrent. As a result, a number of firms in our sample said it was simply not worth applying for bank loans. One entrepreneur said a bank estimated her house and a small hotel - offered as collateral property - at VND1 billion, but after completing all the paperwork the bank told her that with this collateral she could only borrow up to VND100 million. She estimated the property was worth more than VND5 billion at current market rates. She later changed her mind and decided not to proceed with the loan as she said "it was not worth it".

The procedures involved in the loan application processes can also be cumbersome, especially in cases where the property offered as collateral does not have the appropriate title deeds (Red Book). In such cases, firms that wish to proceed with the loan application must go through additional steps to prove their ownership of the property. Similarly, firms can face difficulty in proving their ownership of other forms of assets provided as collateral - such as machinery, equipment and other goods - if they do not have proper red invoices for these goods. Unfortunately, because many firms buy products from other private companies, they do not get a red invoice.

There were also complaints about credit officers. One entrepreneur said in order to borrow VND500 million, it took her two months to go through all the paperwork and she

had to pay the credit official a kickback of 1% of the total loan. Of course, there are some cases where firms deliberately report lower profit figures or even losses in order to avoid paying taxes and in these situations it is understandable that banks are reluctant to provide loans.

Since many firms are unable to get credit through formal channels, they must often rely on capital from family, friends and other informal sources. In these cases, interest rates can be quite high. One interviewee said she had to pay an interest rate as high as 2.5% a month for the loans borrowed from friends. A number of firms have borrowed money from banks through a third party, such as a State-owned enterprise. For example, Company E established a relationship with a State-owned trading company in which the State firm lent Company E the capital it needed to import goods and conducted all of the importing procedures in return for a commission and interest payments on the loan.

### 5.2.3 Inspections

There was frustration among the private businesses surveyed regarding frequent inspections and visits by officials from various government agencies. From the interviews, 57% of firms had experienced frequent or somewhat frequent visits from government agencies, while the remaining 43% had experienced only occasional visits.

The visits were of various kinds, often depending on the specific nature of the business. There could be visits from police officers, fire police officers, 'market controllers', officials from information and culture departments, health staff from the labor department, and environment inspectors. The visits most often cited were from the police and market control officers. There were also visits from different social groups asking for charity donations or requesting support for local activities and events. These could be frustrating at times, as the following case illustrates: Since building a new factory in an industrial zone, Company F encountered frequent visits by all kinds of local authorities and organizations asking for contributions to causes ranging from buying treasury bonds and building a local temple to supporting poor people and investing in a local security fund. IT was even asked to support a local soccer team. Each contribution cost the company from VND200,000 to VND500,000. To maintain a good relationship with the local authorities, Company F felt it could not refuse.

Although private firms still endure numerous unnecessary inspections, the situation seems to have improved in recent years. Among the interviewees there were few cases of officials arbitrarily inspecting firms. In most cases, interviewees said that officials were simply doing their jobs and most of the visits were not considered intrusive. Based on the responses provided by interviewees, we grouped the inspections into three broad categories: demanding, neutral, and undemanding. Only a fifth of firms surveyed had experienced 'demanding' inspection visits.

Several companies reported that they gave officials some 'tea money' (normally around VND50,000 to VND100,000) each time they visited. However, they believed that officials

would not cause them trouble, even if they did not pay them, unless the company was genuinely violating government laws and regulations. As one interviewee said, "The market police come five to seven times a year, whenever there is a campaign against counterfeit products. They just come and look at the products here and we do not have any fake products, so we do not have any problems". She said she did not pay anything to the police. An executive from another company echoed her view: "The market police come about twice a year, without advance notice. They come to check on our products but we do not have any problems. We may give them some cigarettes and drink money, but they do not do anything bad to us even if we do not, because we have not done anything wrong".

#### **5.2.4 Tax issues and purchasing VAT red invoice books**

There are continuing problems relating to tax and the VAT red invoice book in Vietnam, most notably in the way the tax regime is administered and enforced. For numerous private firms the impression one gets of the tax process is that of a rather unbalanced bargaining process between the company and tax officials. The complicated procedures pertaining to the purchase of red invoice books also appear to be a major source of frustration.

The procedures for the purchase of VAT red invoice books are at times very cumbersome and frustrating, judging from our interviews. Not only do managing directors themselves sometimes have to go and purchase these books, but some firms are even required to show their business contracts to the relevant tax officers before they can purchase a red invoice book. In response to pressure from the business community, there have been some improvements in the process. However, the firms interviewed still found the procedures to be cumbersome and time consuming. A number of firms interviewed said that for each purchase, they often had to come to the tax office at least twice, and it could take the company accountant a full day or even more to purchase a book of red invoices. At the time of the study, in order to purchase the invoices, firms were required to submit a number of documents, including a report on the used invoices (purchased previously) and a purchase request containing signed approval from a tax official in charge. A number of firms had sometimes had difficulty finding out this official's whereabouts.

Numerous firms also complained that they were allowed to purchase only one book of invoices (consisting of 50 or 100 invoices) each time, and they could only buy a new book after the previous one have been fully used up. As a consequence, companies found themselves repeatedly running out of red invoices. They therefore had to ask their customers to either wait for invoices or delay delivery. According to one company interviewed: "Purchasing red invoices is a very time consuming process. Because the company is not allowed to purchase more than one book at a time, we need to go every month. Last month was the first time we could purchase the invoices in one day; previously, it has taken three to four days. The tax office will only sell new invoices when they see all the previous ones have been used so there is a gap of several days when the

company does not have any invoices to issue to customers, who by law need them to transport goods. This problem is repeated every month and causes serious interruption to our business”.

There were also complaints about the working attitudes of the tax officials in charge. Some officers were criticized for a lack of professionalism. According to a few interviewees, tax officials failed to advise them properly and then punished them for trivial mistakes. A small number of firms interviewed said that they often paid an unofficial fee to the officers in charge each time they purchased the invoices, so as to smooth the process. One interviewee said: "The officers find many reasons to trouble our firm, but things can be resolved with money”.

From the interviews in our survey, the imposition of a seemingly random income tax rate by tax officials is common. Tax officials do not trust private companies' accounting practices and do not base their tax calculation strictly on a company's accounting books. Instead, they often impose a tax they think is reasonable, regardless of the actual performance of the enterprise. One firm interviewed said that tax officials tended to impose an income tax amount of around 5% of total sales. There is also an unstated rule that income tax must increase year on year, according to our interview responses. Firms must pay a higher rate than, or at least equal to, the amount they paid the previous year, regardless of whether they actually recorded a higher profit. One company director said: "If you have large profits, you pay a lot of tax. But then they think tax has to increase every year. If you have paid a lot once, they will not let you pay less next time even if you file for less tax. At the very least you will have to pay the same amount”. According to another company director, tax officers "do not allow enterprises to make a loss," even though the law clearly states differently.

Another problem cited was that companies are required to pay tax in advance, at the beginning of the year, with any difference supposedly paid by, or repaid to, the company at the end of the year. The actual amount is decided by the tax officials and is not wholly based on the firm's projected profit figures. According to one director, a company must accept the amount decided by the tax officer. If it "refuse(s) to follow that amount, it will get in a lot of trouble from the tax department”. A number of firms complained that they had continued to pay income tax in advance, year after year for four years, but the tax authority had still not looked at the actual profit figures in the company's accounts.

There also appeared to be problems involving the calculation of tax-deductible expenses. Many firms complained that tax officials did not regard some of the firm's actual expenses as legitimate tax deductible expenses and, as a consequence, the firms had to pay higher taxes. The following two quotes illustrate this issue:

*"They [the tax officials] do not accept that more than VND one million can be dedicated for tax purposes as interest on our bank loans. We mortgaged our homes to borrow money from the banks to finance the operations of this company but they*

*[the tax officials] say that the loan is not directly related to the company's assets so it is inappropriate to deduct these amounts".*

*"Based on the company's statements, tax officials will argue to eliminate or reduce some expenses and so increase the tax payment. For example they sanction a monthly worker salary of only VND500,000 even though the company is paying VND800,000. The reasoning is that a company of this size and in this business can hire workers at VND500,000/month and therefore we can file for salaries no higher than at that level. Other things, such as the free lunches the company provides to its workers, are not recognized as expenses either".*

A number of firms interviewed also complained about the attitude of tax officials. One company cited a problem it faced with regard to VAT. According to the company, a tax official said that for the previous year it was incorrectly charged a VAT rate of 5% when the rate should have been 10%. Now the company was being asked to pay VAT of 10% retroactively and if it failed to do so the tax officer would not sell any more red invoices to the company. The interviewee responded that his company reports and pays VAT on a monthly basis and asked why, if the tax officials found the 5% rate to be wrong, they had not advised him right away? He had already charged his customers a VAT rate of 5% and so had no way of financing the additional 5%. "We have a lot of difficulties in dealing with tax officers. They come to us almost once a month, looking at our books. If they discover something wrong they never tell us immediately but wait until the end of the year to point out our mistakes. I think they should keep us informed of newly updated rules and provide advice, but they never give us anything, they only take".

It would be unfair to point the finger at tax officials alone, as they are faced with their own duties and obligations and have their own collection targets to meet. As one respondent noted:

*"Buying a red invoice is complicated. It is not because tax people want to make it difficult, they are just strict and thorough in their work. We have to show them the invoices we have issued and they need to make sure we are operating. They are very thorough about this. One time a tax officer even visited us here to see if we were really operational. I think they are quite responsible when checking their area of responsibility".*

Anecdotal evidence would suggest that numerous firms try to avoid tax, or in some cases deliberately register false corporate entities whose business is the purchase of red invoice books, which they then sell to others. It is therefore to be expected that tax officials check whether a firm is genuinely operating.

### **5.2.5 Sub-licenses**

There are numerous additional business certifications or sub-licenses required, both in the registration phase and the operational phase for firms in certain areas of business. Sub-licenses are often issued by ministries and are used to standardize and regulate



business in specific fields. Despite the government's considerable efforts to reduce the total number of sub-licenses since enactment of the Enterprise Law, the number is still considerable. According to the Vietnam Chamber of Commerce and Industry, there were still more than 244 sub-licenses in effect as of November 2003.

In our interview sample, 23% of firms said they were required to have sub-licenses to operate in their line of business. Not all of these sub-licenses were considered by the firms to be rational or welcome. For example, private companies are generally not permitted to print any kind of book, magazine, newspaper, calendar, ticket, or receipt (i.e. any kind of printed material other than advertisements and packaging materials). Even for these, the business is required to have a written contract and a copy of the customer's business registration certification in place before printing. To print a company brochure, the company must get prior approval from the Department of Culture and Information on the content of the brochure. If officials should find the company is printing without approval, the business can be fined from VND5 million to VND50 million. The owner of one company said: "In practice, to meet our customers' demands, we almost never seek approval or require our customers to provide copies of their business registration certificate. If we did, we fear they would take their business elsewhere".

There are other sub-licenses that businesses are unhappy with. For example, one entrepreneur owned a company that trains people to do domestic work in Taiwan. The company reportedly provides high-quality language and housekeeping training but is not allowed to issue the certificates trainees need before working in Taiwan. Therefore, the firm is obliged to issue certificates through a third party, a State-owned organization that is allowed to issue them. According to the director, this practice is unfair as certification should be based upon the quality of service provided.

### **5.2.6 Customs procedures**

Nearly 30% of the firms interviewed deal with the customs office. More than a third of these hire a service provider and the remainder conduct the work themselves. In general, firms see no big problems in dealing with customs officers. However, it appears that they do have to pay unofficial fees to smooth the process. While some of the firms interviewed openly said they paid unofficial fees, others were reluctant to provide details. But all agreed that paying some unofficial fee was unavoidable. One of the reasons that many firms use a service provider to help them with the paperwork is, as a director put it, "(we) do not have to deal directly with customs officials".

## **5.3 ADDITIONAL COMMENTARY ON PHASE TWO**

Although the small sub-sample of 47 interviews means that the results of Phase Two of this project should be used with care, they do allow us to draw a number of important conclusions.

### **5.3.1 The registration process needs to be refined**

Our interview results and observations suggest that the initial business registration process has indeed improved over the last few years, as widely believed. In general, the current business registration process is not seen as a major obstacle deterring entrepreneurs from formally registering their business. Nevertheless, the registration process could be further improved so as to shorten the time it takes and lessen the cost of registering (including the payment of unofficial fees). The varying capacities of the DPI offices and the attitude of some officials are among the issues that could be addressed. Our small survey also indicates that although the business registration process itself has become markedly smoother, the secondary step of tax registration appears to be much less easy, and - in some extreme cases - may prevent newly registered firms from becoming operational.

### **5.3.2 Companies do see benefits of registering**

It appears that entrepreneurs have increasingly begun to recognize the benefits of formalizing their business and see the merits to be derived from upgrading from an informal or household enterprise into a registered company. Those benefits include greater transparency in dealing with various government officials and potentially greater business opportunities arising from a formal business. This is a positive sign for the business environment as a whole in Vietnam. However, given the small sample size of firms interviewed, it is beyond the scope of this report to identify specific trends driving business formalization in Vietnam. It should be noted that there is evidence to suggest that some firms register their business in order to take advantage of current loopholes in the regulatory and incentive regime rather than to pursue genuine business opportunities. More research is probably needed to shed light on the issue of what motivates or deters informal firms from migrating towards formal incorporation.

### **5.3.3 Sub-licenses undermine simplified registration procedures**

The simplified registration process is being undermined to some extent by the continued presence of various sub-licenses of debatable merit or utility. The prevalence of unnecessary sub-licenses slows down the course of business, raises transaction costs, and creates an environment that is vulnerable to rent-seeking activities. Furthermore, a number of sub-licenses explicitly or implicitly favor State-owned enterprises or government organizations and thus serve to tilt the playing field against private companies in Vietnam. Policymakers are aware of the situation and the government has made considerable progress in reducing the aggregate number of unwanted sub-licenses, but more can be done.

### **5.3.4 Land and capital in short supply**

Our study suggests that the two most pressing issues facing private businesses in Vietnam - insufficient access to land and capital - remain a problem for many firms despite recent



efforts to improve the situation and some tangible progress in both areas. The majority of private firms still rely heavily on renting land or premises, usually on a short-term basis. This results in uncertainty and can serve to deter businesses from expanding or investing in fixed assets. With regard to access to capital, complicated lending procedures and onerous collateral requirements continue to restrict private enterprises' access to bank loans.

#### **5.3.5 The tax system is a problem**

Finally, but importantly, the tax system appears to pose a number of problems for newly established companies, both during the initial registration process and during subsequent operations. These problems include difficulties purchasing VAT red invoice books and the opaque manner in which corporate income tax is calculated and enforced. As a result of improvements made in recent years to the company registration process itself, the taxation element (gaining a tax code and acquiring VAT red invoice books) has now arguably become the most difficult element of the whole business formation/start-up process.

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## CHAPTER VI

### CONCLUSIONS

Looking ahead, the long-term development of the private sector in Vietnam will depend in large part on the careful design and effective provision of an enabling environment that allows commercially successful private companies to develop and allows the assets and resources of unsuccessful companies to be better recycled and redistributed to optimum effect. This is part of the corporate sector life cycle from which the more dynamic firms can evolve and grow. The design and generation of such a benign business environment in turn necessitates having a relatively accurate profile of the private sector in Vietnam and a relatively clear vision of the business landscape in which it currently operates.

#### 6.1 ACCURATE STATISTICS NEEDED

Although it is not necessary for policymakers to have accurate real time information on the number of companies operating in Vietnam right down to the last small enterprise, it is desirable to have a robust sense of the underlying trends in business formations and to be fully aware of the weaknesses that exist in current statistical data. In this context, our survey has found that Vietnam's current company formation statistics should be used with some degree of caution and that a number of improvements could be usefully made in their collection. In particular, there is a need to improve the extent to which company closures (many of which are informal, with firms simply becoming dormant) are recorded more diligently by the NBIC and DPI offices. Using the analogy of a population census, nearly all company births (and some re-births) are being counted in Vietnam, but most company deaths are not. Other factors cumulatively serving to inflate the business registration statistics include the tendency for:

- Some existing firms to repeatedly re-register;
- Some to register each of their subsidiaries and branches in different locations as if they are separate firms; and
- Well-established informal household firms to register as formal companies for the first time.

Just 5% of firms in our sample had officially ceased operations and just 1% had actually completed formal business cessation procedures, but the preliminary evidence stemming from this survey - as well as from international experience - would strongly suggest that a far larger proportion of firms in Vietnam are non-operational. The closure of unsuccessful businesses is an inevitable and desirable part of the corporate life cycle and should not be inadvertently or deliberately hidden from view, as this gives a distorted picture.

For a more accurate picture of how many companies are actually operating in Vietnam, as opposed to simply registering at the DPI offices, the GSO statistics appear to be somewhat more reliable, notwithstanding a number of weaknesses in these figures too. One of the main weaknesses is the delay that occurs between the figures being collected and published, by which time they are more a matter of historical record, particularly in a business environment that is constantly evolving and a corporate community that is rapidly burgeoning. The fact that there is roughly a 40% margin of difference between the NBIC and GSO statistics (and this margin is increasing every year) is quite telling, and underlines the extent to which: i) official statistics should be used with some degree of care; and ii) the important differences in what they are actually measuring is fully understood by those who use and cite them.

It also needs to be continually borne in mind that *neither the NBIC nor the GSO statistics include informal household enterprises in Vietnam, which far outnumber formalized companies*. As many household firms more than meet the minimum eligibility criteria to become formal companies - and either choose to do so, or choose to remain informal, depending on the perceived relative merits of each option - the line of distinction between formal and informal enterprises is becoming increasingly blurred. As a consequence, the importance and utility of the headline numbers on formal companies registering and operating also becomes much less obvious. An attempt to measure the number of household firms in Vietnam is only conducted during the national census (every five years) and is done using sample and extrapolation techniques rather than a complete counting exercise.

*It could be argued that counting the number of firms given tax codes would be a slightly more accurate way of recording real company formations*, as a significant proportion of new firms fail to get tax codes after registering. It could also be argued that counting the number of firms that subsequently purchase red invoice VAT book would be an even more accurate way of recording new company formations. This is principally because, as our small survey showed, the issuance of the red invoice VAT books has probably become the most testing element of the whole registration process, and as such serves as a critical hurdle, or acid test, for new firms. But even this method does not overcome some of the other weaknesses in the data collection, notably the double counting and rotation of some firms. Indeed, the introduction of VAT red invoice books themselves may be inadvertently inflating the company registration statistics as well-established informal household enterprises decide to become formal entities in order to more easily purchase VAT red invoice books. If this is indeed the case, one might argue that the acceleration in company registrations since 2000 can be attributed as much to the introduction of the VAT system in Vietnam as to the Enterprise Law.

## 6.2 REGISTRATION PROCESS NEEDS TO BE FURTHER STREAMLINED

Notwithstanding recent commendable advances, the time it takes to register a new company and receive all the documents necessary to actually commence operations in

Vietnam is still somewhat excessive by international standards. Recent reports that have focused on the speed with which business registration certificates have been issued by DPI offices in some locations are somewhat misleading as they do not take into account the other formalities (such as the issuance of a tax code and first VAT red invoice book) necessary for a firm to actually begin operating. Put another way, the business formation process does not begin and end with the business registration certificate.

From the information and insights provided by the companies interviewed in Phase Two of this survey, it appears that improvements could be made in various elements of the business registration and monitoring process. In particular, steps could be taken to increase the capacity and capabilities of the DPI offices and their officers so as to: more uniformly consider applications; efficiently issue business registration certificates; and update information contained in the NBIC database on firms after registration (including recording those that cease operations). This could be done in conjunction with introducing measures that oblige all companies to inform the DPI offices of any major changes in their status within an acceptable timeframe. More appropriate penalties for firms that fail to comply with such obligations should also be considered. Current procedures could be simplified so as to allow firms to simultaneously apply for the company seal, tax code and purchase invoices (rather than sequentially as at present) and thereby shorten the whole registration period. Well-codified and simplified procedures could also help reduce the prevalence of unofficial fees being paid to help accelerate the process.

Within the context of current preparations to revise the Enterprise Law, the findings contained in this survey would suggest that *there would be diminishing returns from further policy improvements to the actual business registration process* as this is now relatively quick and efficient. However, *there remains room for improvement in how the business formation process is actually implemented* by the DPI offices and staff, and in other elements of the business start-up procedure, including tax and VAT. Exploring ways in which the various elements of the company formation process could be pursued simultaneously, rather than sequentially, would be particularly beneficial.

Despite the government's considerable effort to improve the business environment in general, and promote private businesses in particular, *the development of the private sector in Vietnam continues to be hampered by various constraints, most notably by limitations on access to suitable land and capital*. Although these constraints are common to small businesses everywhere they appear to be particularly pronounced in Vietnam. Without significant improvements in these areas many private businesses are likely to remain small, with small fixed capital and short-term horizons in terms of business strategy and planning. Furthermore, *private businesses still seem to face over regulation and excessive controls from various government agencies*. These issues need to be further addressed. In particular, the institutional capacities of various government agencies and the working attitudes of some staff are worthy of further attention. Ultimately, the administrative procedures governing business practices needs to be continually reviewed, simplified wherever possible and appropriate, and made more transparent for the benefit of both government agencies and private enterprises alike.

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## APPENDIX : ADDITIONAL INFORMATION ON SAMPLED COMPANIES

**Table 7: Total business registrations in survey area**

Province	2000					2001					2002				
	Private	Limited Liability	Share-holding	Total	Private	Limited Liability	Share-holding	Total	Private	Limited Liability	Share-holding	Total	Private	Limited Liability	Share-holding
Hanoi	260	1,251	140	1,651	236	2,124	329	2,689	325	4,926	1,270	6,521			
Ha Tay	53	63	9	125	44	177	19	240	89	227	41	357			
Hung Yen	15	15	0	30	24	30	1	55	18	50	4	72			
Bac Ninh	27	36	2	65	41	72	6	119	85	143	9	237			
Vinh Phuc	3	3	0	6	28	75	4	107	36	118	9	163			
<b>Total</b>	<b>358</b>	<b>1,368</b>	<b>151</b>	<b>1,877</b>	<b>373</b>	<b>2,478</b>	<b>359</b>	<b>3,210</b>	<b>553</b>	<b>5,464</b>	<b>1,333</b>	<b>7,350</b>			

*Note: This excludes partnership and one-member joint stock companies.*

**Table 8: Sample distribution**

Province	2000					2001					2002				
	Private	Limited Liability	Share-holding	Total	Private	Limited Liability	Share-holding	Total	Private	Limited Liability	Share-holding	Total	Private	Limited Liability	Share-holding
Hanoi	14	67	7	88	7	66	10	83	4	68	17	89			
Ha Tay	3	3	1	7	1	6	1	8	1	3	1	5			
Hung Yen	1	1	0	2	1	2	0	3	0	1	0	1			
Bac Ninh	1	2	0	3	1	2	0	3	1	2	0	3			
Vinh Phuc	0	0	0	0	1	2	0	3	0	2	0	2			
<b>Total</b>	<b>19</b>	<b>73</b>	<b>8</b>	<b>100</b>	<b>11</b>	<b>78</b>	<b>11</b>	<b>100</b>	<b>6</b>	<b>76</b>	<b>18</b>	<b>100</b>			

**Table 9: Sampled firms' average registered charter capital**

	<b>Number Of Co.s</b>	<b>Minimum (VND mln)</b>	<b>Maximum (VND mln)</b>	<b>Mean (VND mln)</b>
Charter capital	270	17	50,000	1,335.2

**Table 10: Number of sampled firms with registered charter capital of**

<b>Registered Charter Capital (VND mln)</b>	<b>Number of Companies</b>	<b>Percentage of Total</b>	<b>Cumulative Percentage</b>
0-500	118	43.7	43.7
501-1,000	77	28.5	72.2
1,001-5,000	69	25.6	97.8
5,001-10,000	5	1.9	99.7
>10,000	1	0.4	100.1
<b>Total</b>	<b>270</b>	<b>100.0</b>	

**Table 11: Average registered charter capital for different types of enterprise**

<b>Enterprise Type</b>	<b>Mean (VND mln)</b>	<b>Number of Enterprises</b>
Limited Liability	1,103.3	207
Private	520.7	32
Shareholding	3,724.6	31
<b>Total</b>	<b>1,335.2</b>	<b>270</b>

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