THE IMPACT OF INSTITUTIONS ON ENTREPRENEURSHIP: A CASE OF VIETNAM

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Abstract

This study attempts to examine the impact of institutional factors on entrepreneurship in Vietnam from 2005 to 2015. The study utilizes quantitative research methods with panel data collected from secondary sources of the General Statistics Office, Statistical Yearbook of Provinces, and the Provincial Competitiveness Index (PCI). The results based on fixed effects estimation show that the “entry cost” and “land access and stability in land use” are two indicators that have the strongest negative effect on entrepreneurship in Vietnam. Therefore, it is necessary to have specific policies to reduce the cost of market entry as well as more effective land use options to support entrepreneurship development in Vietnam.

Keywords: Entrepreneurship; Institutions; Vietnam.

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1. INTRODUCTION

Entrepreneurship is one of the "main vehicles" of economic development (Hisrich, Anokhin, & Grichnik, 2008). Dejardin (2000) asserted that the more entrepreneurs there are in an economy, the faster it will grow. Evidence and experiences in many countries have shown that raising awareness of the importance of entrepreneurial spirits and encouraging start-ups are powerful drivers of sustainable growth. Therefore, promoting entrepreneurship is a strategic priority of many governments, especially in developing countries. In Vietnam, the Company and Private Enterprise Law in 1990 has been seen as the first step in creating an environment for entrepreneurship development and innovation. The Enterprise Law in 2000 has brought more favourable conditions for the participation of private businesses. Since 2000, the number of new businesses has increased over time, as revealed in Figure 1. In particular, 2016 is considered as the "boom" year with more than 110,000 new registered enterprises and nearly 26,700 enterprises being back in operation.

Figure 1. Number of registered private enterprises 2000-2016

Source: Author's analysis from Ministry of Planning and Investment (2016).

Many factors of the business environment have been significantly improved in order to facilitate the development of the private sector such as reducing market entry costs, increasing business support activities or raising labor quality. However, compared to countries of the same level of economic development, the business environment in Vietnam still has many signs of weakness, with 9 out of 12 indicators of business

conditions ranking below average (VCCI, 2016a) in which the government support program indicator is reported to have the lowest ranking (50/62).

According to the Dona, Slavica, and Mike (2015), an ongoing paradox is that along with sharply increased awareness about the existence of business opportunities from 36.8% (2013) and 39.4% (2014) to 56.8%, the rate of adults having entrepreneurial intention has declined gradually and is still lower than average rate in the factor-driven economies. While the rate of adults having entrepreneurial intention reached 22.3%, the rate of business startups in Vietnam only reached 0.6%. So, it can be inferred that there is a limitation from transforming the entrepreneurial intention into a decision to start a business in Vietnam. In addition, the rate of business discontinuance is still at a high level, of 27%, implying that for every 100 entrepreneurs in the Total Early-stage Entrepreneurial Activity (TEA), 27 of them have given up their business. Figure 2 provides the comprehensive view of Vietnam entrepreneurial activities in 2015.

Figure 2. Vietnam entrepreneurial activities in 2015

Source: VCCI (2016a).

The objective of this study is to determine what institutional factors affect entrepreneurship development in Vietnam. This is necessary for providing

recommendations to promote entrepreneurship and innovation to develop the economy. The paper is organized as follows. Section 1 describes the objective of the study. Section 2 provides a literature review on institutions and entrepreneurship and formulates a set of hypotheses. Data and variables used in the analysis are described in Section 3. Section 4 presents the regression results while Section 5 offers concluding remarks and policy implications.

2. INSTITUTIONS AND ENTREPRENEURSHIP

The rate of entrepreneurial activity depends not only on the capability of individuals, but also on the institutional factors which create favorable conditions or cause barriers to entrepreneurship (Fogel, Hawk, Morck, & Yeung, 2009). Institutional barriers were first emphasized by Baumol (1990) and developed by other economists including Sobel (2008). These barriers include the lack of law enforcement, administrative barriers to entering the market, property rights, informal payments, and lack of governmental support. A good institutional environment creates favorable conditions for individuals to enter the market and expand their business. Zhou (2011), for instance, reported that regional deregulation in China has increased the net private sector's growth rate. In contrast, a weak institutional environment that does not protect property rights lacks supporting programs or increases harassment by local governments generating high transaction costs and low potential profits. Consequently, more and more entrepreneurs decide to exit the market. With this institutional framework in mind, this paper formulates the following hypotheses:

- H1: The better the quality of the institution is, the higher the number of non-state enterprises in the economy is.
- H2: The better the quality of the institution is, the higher the number of non-farm individual establishments in the economy is.

Institutions in transition economies not only increase the number of private enterprises and the individual establishments but also the size of the private sector that is shown by the number of workers in private companies (Zhou, 2011). Good institutional

environments help entrepreneurs feel secure to expand their business by hiring more workers. In Vietnam, the private sector¹ has also demonstrated its dynamics by creating new jobs (Tenev et al., 2003). Thus, the next two hypotheses are formulated as follows:

- H3: The better the quality of the institution is, the more employment in the non-state enterprise of the economy is.
- H4: The better the quality of the institution is, the more employment in individual establishments of the economy is.

3. DATA AND METHODOLOGY

3.1. Dependent variables

Entrepreneurial data is collected from the General Statistics Office in the period 2005-2015. In transition economies, good institutions not only increase the new entry rate of firms but also significantly reduce the failure rate of existing ones. Thus, stock indicators are considered the appropriate measures of entrepreneurial activities in Vietnam because they include both newly established firms and dissolved enterprises annually in each province and city. Another measure is the total number of jobs created by the private sector. The higher the share of labor force working in the private sector is, the higher entrepreneurial spirit the region reflects (Enrico & Tran, 2011).

Good institutions promote business development through expanding and innovating the production process and creating more jobs in the economy. Hence, in this paper, entrepreneurial activities are proxied by four indicators: (1) The number of non-state enterprises per 1,000 inhabitants; (2) The number of non-farm individual business establishments per 1,000 inhabitants; (3) Total employment in non-state owned enterprises per 1,000 inhabitants; and (4) Total employment in non-farm individual business establishments per 1,000 inhabitants (inhabitants here mean labor force). These

¹Private sector in Vietnam includes non-state enterprises and non-farm individual business establishments. Non-state enterprises have five types of enterprises: Collective, Private, Limited Co., Joint stock Co. with capital of state, and Joint Stock Co. without capital of state. An individual business establishment is a privately-owned economic organization which is not registered and operational under the Enterprise Law, where a regular business operation takes place with a definite address and at least one full-time employee.

metrics indicate the number of non-state enterprises and the number of employees working in this sector per 1,000 people in the working-age population in Vietnam. As these measures are not normally distributed, the logarithmic form is used to limit skewness.

3.2. Independent variables

Institutional indicators are measured by the Vietnam Chamber of Commerce and Industry (VCCI) and the Vietnam Competitiveness Initiative called the Provincial Competitiveness Index (PCI) from 2005 to 2015. PCI is designed to assess the business environment, quality of economic governance, and administrative reform efforts in Vietnam's sixty-four provinces by surveying domestic private firms.

PCI includes many of the best indicators and is often used to measure the quality of Vietnam's economic institutions (Phạm & Nguyễn, 2015; Phạm & Châu, 2015; Malesky & Taussig, 2009). PCI consists of ten governance sub-indexes that reflect the private sector's development. However, the indicator "competition environment and state-owned enterprise bias" was replaced by "equal competition" in 2013 and onwards, thus, it is excluded from measuring institutional quality in this paper. Therefore, there are nine sub-indexes of governance² as follows:

- *Entry costs*: The time it takes a firm to register, the time to receive all the necessary licenses needed to start a business, the number of licenses required to operate a business, and the perceived degree of difficulty to obtain all licenses/permit.
- *Land access and security of tenure*: Including two dimensions of the land problem confronting entrepreneurs and the level of ease to access land and security of tenure once the land is confiscated.

²The exactly definition of nine sub-indexes is directly cited in paper "Out of the gray: The impact of provincial institutions on business formalization in Vietnam" (Malesky & Taussig, 2009).

- *Transparency and access to information:* Indicating whether firms have access to the proper planning and legal documents necessary to run their business, whether those documents are equitably available, whether new policies and law are communicated to firms and predictably implemented, and the business utility of the provincial web page.
- *Time cost of regulatory compliance:* The time firms waste on bureaucratic compliance after registration, as well as the frequency of firms' operation prorogation for inspections by local regulatory agencies.
- *Informal charges:* How much firms pay in informal charge, how much of an obstacle those extra fees pose for their business operations, whether the payment of those extra fees results in expected results or "services", and whether provincial officials use compliance with local regulations to extract rents.
- *Proactivity of provincial leadership:* Indicator of the dynamism and creativity of provincial government in implementing central policies, designing their own initiatives for private sector development, and working within sometimes unclear national regulatory frameworks to assist and interpret in favor of local private firms.
- *Business development services:* Provincial services for private sector trade promotion, provision of regulatory information to firms, business partner matchmaking, provision of industrial zones or industrial clusters, and technological services for firms.
- *Labor and training:* The efforts by provincial authorities to promote vocational training and skill development for local industries and to assist in the placement of local labor with provincial businesses.
- *Confidence in legal institutions:* The private sector's confidence in provincial legal institutions; whether firms regard provincial institutions as an effective

vehicle for dispute resolution or as an avenue for lodging appeals against the corrupt official behavior.

All sub-indexes are scaled from 1 to 10 with a higher score indicating better institutional performance.

Malesky and Taussig (2009) show that PCI sub-indexes are all positively correlated and thus they effectively express the same thing. Therefore, the Principal Component Analysis method is used to reduce data sets by transforming the original set of variables to a new set of uncorrelated variables called principal components. The objective is to explain the variance of the observed data through several linear combinations of the original data (Nardo et al., 2008).

The Kaiser Meyer Olkin (KMO) index of 0.675 implies that using factor analysis is appropriate for the PCI indicators. Furthermore, the PCI sub-indexes correlation is confirmed by the Bartlett's test with a significance level of $\alpha < 0.05$ and thus the decision to use Principal Component Analysis (PCI) is reinforced in this study. Accordingly, the nine PCI sub-indexes were grouped into three factors responsible for about 68.6 % of the variance between sub-indexes. The first factor (PCIF1) contains five PCI sub-indexes: Transparency; Time costs; Business support services; Labor training; and Legal institutions that concerned with local policy initiatives or decisions to select and implement those policies (Malesky & Taussig, 2009). Therefore, the first factor is called the Policy Factor.

The second factor (PCIF2) has two sub-indexes of entry cost and land access. They represent the necessary resources and procedures that entrepreneurs must have to enter the market. Access and stability in land use affect not only the new establishments but also the termination of existing businesses in the private sector. These two sub-indexes are less relevant to policy enforcement but more relevant to formal barriers in the private sector (Malesky & Taussig, 2009). The second factor is called the Entry Barriers. And the third factor (PCIF3) contains two sub-indexes with lower correlation: Informal charge; and Pro-activity of provincial leadership.

The Cronbach's alpha coefficient of the PCIF1, PCIF2, and PCIF3 factors were 0.69; 0.80 and 0.56, respectively. The Cronbach's alpha coefficient is the most common estimation for consistency measurement (Nardo et al., 2008) and reliability of the sub-indexes in each factor. According to Nardo et al. (2008), the alpha coefficient of 0.7 is deemed acceptable. Meanwhile, many researchers proposed higher critical values, in the range of 0.75 to 0.8, and others also accepted the lower value of 0.6. Thus, it can be seen that PCIF1 and PCIF2 are more reliable than PCIF3.

3.3. Control variables

GDP per capita: A measure of the size of the economy. A rise in GDP per capita indicates a change in market demand, which encourages entrepreneurs to expand their business (Enrico & Tran, 2011). The logarithmic form of GDP per capita is used in order to reduce problems with non-normality.

GDP growth rate: A measure of the health of regional economic environment. It is often positively related to entrepreneurship across countries and over time (Bowen & de Clercq, 2008)

Municipal city dummy variable: Being coded 1 if it is a municipal city and 0 otherwise. There are five municipal cities in Vietnam: Hanoi, Haiphong, Danang, Hochiminh City, and Cantho.

Industrial park dummy variable: Being coded 1 if the provinces have many industrial parks, including in the Northern provinces (Thainguyen, Bacninh, and Bacgiang), Central provinces (Quangngai and Quangnam), and Southern provinces (Dongnai and Binhduong) and 0 otherwise. Two dummy variables are constant over time, so they are not added to the fixed effects (FE) model but will be captured by α_0 in equation (1).

3.4. Model specification

The model specification utilized to analyze the impact of institutions on entrepreneurship in Vietnam is given by the following equation:

$$\ln Y_{it} = \alpha_0 + \alpha_1 X_{1it} + \alpha_2 X_{2it} + \alpha_3 X_{3it} + \lambda \ln GDP_{it} + \sigma GDPGR_{it} + u_{it} \quad (1)$$

for $i = 1, 2, \dots, 63$ provinces; $t = 2005, 2006, \dots, 2015$, where Y_{it} is the entrepreneurship activities of province i in year t ; $X_{1it} \dots X_{3it}$ are PCI factors (PCIF1, PCIF2, PCIF3) of province i at year t .

There are missing observations in the measures for entrepreneurial activities in several years. Thus, the final data set is an unbalanced panel. Fixed effects (FE) model is applied to test the hypotheses. It is appropriate because the entrepreneurial activities change within the province as the institutional quality changes over time. It also yields less biased estimate than ordinary least square regression (OLS) and random effects (RE) model because it controls for all factors that are unobserved, having time-constant or very little over time (such as institutional factors).

4. EMPIRICAL FINDINGS

Table 1 presents the pairwise correlations. Most institutional variables have a positive correlation with four measures of entrepreneurial activities at a significance level of 5%. However, these correlations are relatively weak (the correlation coefficient is less than 0.4).

Table 1. Descriptive statistics and correlations matrix

Variables	Mean	SD	1	2	3	4	5	6	7	8	9
1	3.30	3.57	1								
2	79.55	26.69	0.34*	1							
3	78.13	68.28	0.89*	0.37*	1						
4	135.06	51.67	0.34*	0.94*	0.38*	1					
5	0	1	0.34*	0.27*	0.40*	0.27*	1				
6	0	1	0.05	0.24*	0.07*	0.21*	0.00	1			
7	0	1	-0.21*	0.40	-0.13*	0.11*	0.00	0.00	1		
8	26.60	39.17	0.45*	0.20*	0.40	0.23*	0.24*	-0.09*	-0.10*	1	
9	10.27	3.81	-0.08*	-0.02	-0.04	-0.01	-0.01	-0.12*	0.12*	-0.26*	1

Note: 1: Number of non-state enterprises; 2: Number of individual business establishments; 3: Total employment in non-state enterprises; 4: Total employment in individual business establishments; 5: PCIF1; 6: PCIF2; 7: PCIF3; 8: GDP (1,000 VND); and 9: GDPGR.

Table 1 also shows that most private enterprises in Vietnam are individual establishments. There are 82.85 private enterprises per 1,000 people in the working-age population (combining all types of enterprises). In the period of 2005-2015, there is a significant difference between the provinces in terms of the number of non-state enterprises and individual establishments as well as the labor force in each province as revealed in Table 2. In terms of average employment size, the non-state sector in Vietnam consists largely of small- and medium-sized enterprises with an average of 10 employees, and fewer than 2 employees in each individual business establishment.

Table 2. Entrepreneurial activities proxied by number of enterprises and total employment

Variable	2005	2010	2014
Number of non-state enterprises per 1,000 habitants	1.75	3.57	4.87
Number of individual business establishments per 1,000 habitats	66.99	79.57	85.49
Total employment in non-state enterprises per 1,000 habitants	49.89	44.35	43.04
Total employment in individual business establishments per 1,000 habitats	118.86	113.67	148.31

4.1. PCIF2 and entrepreneurial activities

The regression results are presented in Table 3. PCIF2 factor has a positive impact on all four entrepreneurial variables and it is statistically significant at a level of 1%. This implies that “entry cost” and “land access and stability in land use” are two sub-indexes that contribute an important role in promoting the development of private entrepreneurship in Vietnam. The results are consistent with (Zhou, 2011) who reports the positive impact of property right protection on entrepreneurship in China. This institutional factor has played an increasingly important role in the development of Chinese private sector for the period from 1998 to 2003. Estrin and Prevezer (2010) reach the same conclusion in comparing the institutional factors that affect new entrepreneurial activity rates in Brazil, China, India and Russia. Accordingly, property rights (including land title) do not hinder the entry rate in Brazil because its ownership is clearly defined. In contrast, having unclear land ownership title would negatively impact new entry rates in other countries.

Table 3. Regression results of the fixed effects model

Variables	Number of non-state enterprises	Number of individual business establishments	Total employment in non-state enterprises	Total employment in individual business establishments
PCI F1	0.010 (0.66)	0.015 (0.90)	0.041** (2.17)	0.018 (1.45)
PCI F2	0.036*** (2.98)	0.043*** (4.21)	0.066*** (5.02)	0.042*** (3.99)
PCI F3	0.003 (0.24)	0.004 (0.35)	0.030** (2.28)	0.006 (0.58)
GDP per capita (log)	0.556*** (11.49)	0.072** (2.32)	0.400*** (8.69)	0.088*** (2.76)
GDP growth rate	0.002 (0.53)	-0.006* (-1.94)	-0.004 (-0.75)	-0.002 (-1.00)
Constant	-4.504*** (-9.11)	3.680*** (11.70)	0.200 (0.43)	3.998*** (12.49)
R ² (adjusted)	0.656	0.117	0.566	0.151
Prob > F	0.000	0.000	0.000	0.000

Notes: t-statistics are in parentheses. *p < 0.10; **p < 0.05; ***p < 0.01

According to Zedillo (2004), the absence of ownership obstructed entrepreneurial spirit in many developing countries. In fact, both private enterprises and individual business establishments must have land and property right protection in order for the business to grow. Therefore, if land access is improved, it would encourage new entry. Also, high stability in land use such as clear ownership, low risk of reclamation and adequate compensation help to develop the private sector. In Vietnam, only 29.7% of interviewed non-state enterprises responded that they did not have obstacles in accessing land or expanding business premises (VCCI, 2016b). Only 61.9% of enterprises reported to have land use right certificates, up from 55.28% in 2006, but not a significant improvement. Not having land use right certificates would make it more difficult for entrepreneurs in collateralizing their assets in order to expand their business; furthermore, the land application procedure for business purposes is very complex and expensive. The stability in land use is also threatened by the high risk of land confiscation and only 25.45% of firms reported that they were compensated satisfactorily if being confiscated.

In the last three years (2014-2016), land access indicator has sharply fallen. It suggests that land use has been precarious and has become a concern for the development and promotion of the private sector. The regression results together with the current situation in Vietnam indicate that improving land access and stabilizing land use have led to an increase in the rate of new entry firms and reduction of the failure rate of existing ones, thus increasing the net growth of private enterprises. The same effect applies to the growth of private sector employment.

Meanwhile, entry costs only affect the new entry rate. The more complicated business registration procedures would create more obstacles to entrepreneurship development (Dreher & Gassebner, 2013). Individuals would be encouraged to set up new businesses if the business registration time and procedures are streamlined. Business registration is the first administrative procedure that entrepreneurs must face to confirm their rights and obligations to establish a business, which has been reformed positively to ensure the maximum benefit for businesses. In the period 2006-2016, there was a significant improvement in the implementation of basic market entry procedures. Currently, it takes seven days for registration, compared to twenty days in 2006, that is the lowest waiting time during the period of 12 PCI investigation years. The number of enterprises that need more than a month to officially get business running have also halved at 13% but has not improved much since 2010. Generally, market entry costs have been the most significant and sustainably improved indicator and contributed an important role in encouraging the establishment of new businesses (VCCI, 2016b).

According to the Doing Business in 2016 Report, the procedures in starting a business have been reduced from ten steps with waiting time of 41 days (2006) to nine steps with waiting time of 24 days. Although the entry time has declined significantly, it is still relatively low compared to other countries in the region such as Singapore, Myanmar, and Malaysia. The number of procedures still shows that compliance costs are higher than those in other countries such as Singapore, Thailand, Laos, Cambodia, and Malaysia.

4.2. PCIF1, PCIF3, and entrepreneurial activities

PCIF1 and PCIF3 have a positive impact on the labor force of non-state enterprises and it is statistically significant at 5% as reported in Table 3. Adequate employee training and government support policies, high legal enforcement and low time cost all have an influence on firm operations and expansion. Thus, the effect of PCIF1 on non-state enterprises has not been expressed through the number of private enterprises but on their size of employment. Nguyễn (2016) shows that institutional factors affecting the size of labor in Vietnamese enterprises are: Time cost; Quality of labor training; Legal system; and Informal charge.

PCIF1 and PCIF3 factors do not influence the non-farm individual business establishments. This can be explained that individual households have to face fewer stringent regulations than firms and that sector is more affected by local governments than by provincial authorities. Malesky (2009) provides the same reason to explain why individual business households do not want to be legalized into enterprises.

In addition, individual business establishments in Vietnam are small scale with only 1.7 employees, family members are the source of labor and they are low-skilled workers. Therefore, this is the basis for asserting that the PCIF1 policy factors do not affect the individual business sector.

GDP per capita has a statistically significant impact on all four entrepreneurship variables. GDP per capita is considered to be an important control variable and has a positive impact on entrepreneurial activities (Dreher & Gassebner, 2013). Dreher and Gassebner (2013) share the same view that GDP per capita increases entrepreneurial activities. In contrast, Ovaska and Sobel (2005) argue that per capita GDP does not have a significant impact on the number of new enterprises. Others suggest that GDP per capita even reduces entrepreneurial activities (Stel & Storey, 2003, as cited in Dreher & Gassebner, 2013). Previous studies have shown that per capita GDP has a non-linear impact on entrepreneurship (Martínez, 2005). Enrico and Tran (2011) conclude that in Vietnam higher GDP per capita indicates higher new entry firm rate. Individual wealth

plays an important role in establishing a new firm because the initial investments come mostly from the income and savings of the owner.

The GDP growth rate (GDPGR) only positively affects the number of individual business establishments but not the non-state enterprises. This result is reinforced by Zhou (2011), showing that GDP growth rate only positively affects individual firms but not private enterprises in China. This can be explained by the fact that individual small household businesses are more sensitive to economic fluctuations in the short run. Moreover, the growth of GDP in the province may create benefits in terms of demand for all firms in the country, not just for those within the province.

5. CONCLUSION

The private sector in Vietnam began to flourish in 2,000 after the Enterprise Law had been promulgated, especially in 2016 with more than 110,100 new enterprises and creation of 1.2 million jobs. The number of dissolved enterprises remains high (73,145 enterprises), but it has also decreased compared to 2015 (80,828 enterprises) (VCCI, 2016b). Many surveys also recorded positive changes in the business environment, creating more psychological optimism for entrepreneurs. Although national institutional quality such as the PCI scores has not improved significantly over 12 years (2005-2016), the quality of local economic governance has indeed influenced the development of private sector in the provinces.

This study shows that among the three groups of institutional variables, only PCIF2 has a positive impact on four measures of entrepreneurship at the 1% significance level. Meanwhile, PCIF1 and PCIF3 did not influence the development of the private sector. Hence, the two most important institutional issues that need to be improved to develop entrepreneurship in Vietnam with the objective of having more than one million private-owned enterprises are:

Firstly, the cost of market entry should be minimized. It is necessary to reduce the cost of starting a business including reducing waiting times and improving the application of information technology by online registration. Currently, the percentage of enterprises

doing business registration through the national portal only accounts for 14% (The Business Registration Management Agency, 2016). A proposal to encourage businesses to increase their online registration options is to build a 24/7 registration system such as Singapore or establish a “Business Registration Mobile Counter” - a very successful model in Malaysia.

Secondly, land access and sustainability in land use should be improved. Access to land is a problem for entrepreneurs who have to face the relocation policy to limit pollution in urban areas. While enterprises have difficulty in finding new business premises, land funds in industrial zones are still very large. The main reason is that the land rent in industrial zones/clusters is too high. Therefore, it is necessary to have the policy to encourage and support enterprises to access land in industrial zones. Currently, the draft of Support for Small and Medium Enterprises Law has a specific provision for supporting land rent up to 5 years for enterprises from the date of signing contract. In addition, the compensation policy must also be considered satisfactory in the case of land acquisition by shortening the difference in the provincial land price and market price. It is also necessary to clarify the acquisition plan to help enterprises in finding new business premises.

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