

# The Informal Sector and The Recognition of Its Role in Inclusive Growth in Vietnam

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**Abstract:** *Household businesses are unincorporated businesses owned by individuals or families who produce or distribute goods and services for the market. The non-farm household business sector is the second major employer in Vietnam, after the agriculture sector, and also an important component of the national economy. This sector is characterized by a large proportion of informal businesses, with no business registration, and a small share of formal household businesses. The informal sector in Vietnam, therefore, is the major part of the household businesses sector. The household business and the informal sector have expanded in the last three decades and its importance would likely remain in the near future. It is a major player in the promotion of inclusive economic growth by providing jobs for a large segment of the population, by its flexibility, by the dynamism of one of its segments, and by the large room for improvement of its productivity. Yet, it is largely left out of the Government's policies. By collecting new data, the NOPOOR project has contributed findings to this policy paper, raising the attention of the policy makers of this sector in order to achieve more productive employment and to tackle the vulnerability of its workers.*

**Keywords:** Informal sector, Household business, Human Development, Sustainable Development Goals, Vietnam

## 1. Introduction

There is a broad consensus that Vietnam has made impressive achievements in recent decades, both in human development and economic performance. Yet, as highlighted in the Human Development Report 2015 (UNDP and VASS, 2016), progress has slowed in the last decade, especially when compared to countries with similar levels of development. In particular, Vietnam has recently become less effective at translating economic gains into human development. The country therefore faces new social and economic policy challenges to achieve more inclusive growth. Inclusive growth refers to rapid economic growth and a fair distribution of its benefit to provide opportunities for all and leave no one behind. Inclusive growth is part of the Sustainable Development Goals (SDGs), to which Vietnam has been committed since 2015, particularly Goal 8, “to promote inclusive and sustainable economic growth, employment and decent work for all”.

Achieving higher productivity and tackling workers’ vulnerability are important objectives of Vietnam’s new growth model. Thus, household businesses and the informal sector have formed a cornerstone for achieving those objectives for the following reasons:

- *First*, the household business sector is the second major job provider, after the agriculture sector, with almost one-third of all employees and more than half of all non-farm workers. One of Vietnam’s key challenges is therefore to improve

productivity and working conditions in the sector. Productivity growth could be achieved via employment in the industries with higher productivity.

- *Second*, household businesses and the informal sector help increase the resilience of Vietnam’s economy. They act as a buffer and absorb workers who leave the agriculture sector or are laid off from the formal sector. The flexibility and relative independence of the household business sector allow its resilience against economic shocks.

- *Thirdly*, the workers in household businesses and in the informal sector in particular are highly vulnerable to sudden shocks and setbacks. They may be able to afford their daily living, but often at a basic level, without social insurance while not being eligible for social assistance. Therefore, boosting the productivity of the sector and reducing the vulnerability of its workers are critical for a broad-based growth, social stability, and human development.

Yet, there still lacks policies to support household businesses. By collecting and analyzing innovative data of this sector, the study enabled by the NOPOOR project<sup>1</sup>

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<sup>1</sup> The NOPOOR project based on a primary data set provides new evidence on household businesses and the informal sector. Taking the Household Business and Informal Sector Survey (HB&IS 2014/15), the methodology of the 1-2-3 surveys is adopted together with mixed business/household surveys conducted by DIAL researchers (Razafindrakoto and Roubaud, 2003) in numerous developing countries. The NOPOOR survey was conducted in late 2014 and early 2015 and is the first national survey ever of this sector in Vietnam with full coverage of its different components. It is representative of the

has contributed to raising the attention of policy makers on these business activities and to the reform of the Law on Small- and Medium-sized Enterprises as well as new policies towards this sector.

## 2. Household businesses and the informal sector are major players in the Vietnamese economy

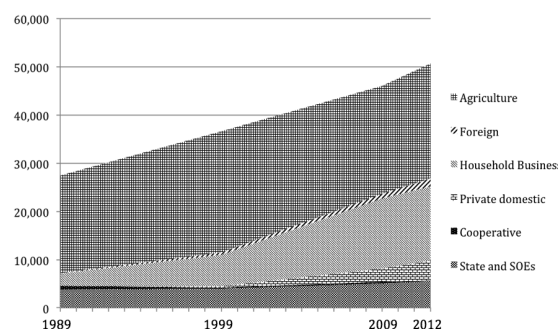
The household business sector comprises individuals or households running all kind of non-farm business activities in manufacturing, services and trade. They could be local convenient store owners, repairers, street petty traders, motorbike-taxi drivers, small restaurant runners, street food vendors, or tailors, etc. Calculations based on the Labor Force Survey in 2014 by GSO show that this sector was composed of nine million establishments with 16 million workers. Only some of those establishment, usually the large ones, had a business registration

while the majority did not. Thus, those who were not registered (at the district level) operated in the informal sector. The estimated figures in the sector were 6.5 million establishments and 9 million employed workers.

The household business sector is the second employer after agriculture sector providing nearly one third of total employment and 57% of non-farm employment in 2014. Since the Doi Moi was launched, the household business sector has been the main job provider in Vietnam. During the decade 1999-2009, more than half of the labour force increment was absorbed by household businesses. Since then, the number of jobs created in this sector has slightly decreased while foreign and domestic formal enterprises absorbed more new comers in the labour force, but household businesses remain a key sector for job creation.

entire country, including urban and rural areas, based on a sub-sample of 3,411 household business owners drawn from the Labour Force Survey (LFS) of the General Statistics Office (GSO). It contains different modules that provide specific information on the sector's characteristics and its workers, and on how it operates and integrates into the national economy. Relying on the previous IRD-DIAL/GSO-ISS informal sector project (2006-2011), which was carried out as the first survey of the informal sector in Vietnam but restricted in Hanoi and Ho Chi Minh City (Cling et al., 2010). The NOPOOR's HB&IS 2014/15 survey was conducted by the Centre for Analysis and Forecasting (CAF), Vietnam Academy of Social Sciences (VASS) in cooperation with the research unit of DIAL, French National Research Institute for Sustainable Development (IRD) and Paris-Dauphine University. Technical support was provided by the GSO and the Mekong Development Research Institute (MDRI). This paper presents our findings based on the HB&IS 2014/15.

**Figure 1: Labor force by economic sector, 1989-2012 (Person)**



Source: Authors' calculations based on Population and Housing Census and Labor Force Surveys from 1989 to 2012 by GSO.

Besides providing jobs and income to a large share of the working population, the household business sector is generally the

most suited to address labour matching constraints faced by household business owners. These people generally work in this sector not because they cannot find a job elsewhere but the household business sector is the best option compared to the other options open to them. Only one out of five had the jobs because they could not find work in another sector. They do not want to enter the agricultural sectors because farmers do not earn enough. The work in the private sector is not a magic bullet because it generally undermines the work-life balance. Employment in the public sector might be preferable to running a household business, but it might be out of reach. Half of household business owners thought they earned better or enjoyed more independence compared to farming or being employed in an enterprise. Although most of them might have a limited range of opportunities, they were satisfied with their jobs and did not wish to work as an employee in a private enterprise.

More than half of the households and informal businesses, who are expanding rapidly in number, are located in rural areas. Many farmers diversify their activities by engaging informally in trade or in other non-farm activities. The large presence of household businesses and their contribution to employment and income generation in rural areas in Vietnam upset the idea that the informal sector is an urban phenomenon. In Vietnam, 60% of informal businesses are located in rural areas. It is worth mentioning that they are numerous in villages around cities.

The household business sector is a major contributor to the gross domestic product (GDP) of Vietnam, generating almost one-third of the non-farm GDP and 23% of total GDP. In trade, the household business sector's contribution is very high: 63% of value-added generated by the trade sector comes from household businesses. Despite the recent expansion of commercial centres, trade in Vietnam is mostly in the hands of small family businesses and petty traders.

Thus, this sector creates wealth in the country and provides incomes to a large part of the population. Its contribution relies on investments and employment by the households, with nearly no input from financial institutions. Nevertheless, the low investment in this sector, below 10% of the value added and much less than 23% of the total investment in the economy, limits its capacity of growth. The operation of household businesses provides workers with immediate and generally low incomes, rather than for accumulation.

Although household businesses and the informal sector can be seen everywhere and are part of everyday life, they are not well embedded in the economy from the point of dealings and flows with the formal enterprise sector. Household businesses mainly trade with each other and with final customers, not with formal enterprises. Very few of them engage in subcontracting arrangements with formal enterprises. The relative isolation of household businesses and, in particular, informal ones, in the economy explains

why the household business sector is resilient in the event of economic shocks. Fluctuations in the formal enterprise sector have little impact on the informal sector. Yet, it is highly dependent on final demand, as it mostly produces and sells to final consumers. The steady growth in individual incomes is a powerful driver for the sector.

### 3. This sector has the potential to contribute to inclusive growth

**Table 1. Average aggregates per month  
(million VND)**

	Informal HBs		Formal HBs	
	Mean	Median	Mean	Median
Turnover	23.4	7.5	57.6	21.9
Value Added	6.3	2.6	14.3	5.5
Profit	4.9	2.3	12	4.3

*Source:* Authors' calculations based on the HB&IS 2014/15.

The scale of operations in the household business sector is particularly small, especially for informal ones. One in two informal businesses is made of just one person working alone. The median value added generated per month by an informal business household was 2.6 million VND in 2014. Consequently, around half of informal household business owners make a profit below the minimum wage. Productivity (amount of wealth or value added per worker) is also low in the informal sector. It is just above the level of productivity in the agricultural sector. Formal household businesses do better with a median value

added of 5.5 million VND per month and a level of productivity closer to domestic enterprises (table 1).

The low productivity could be explained by a surplus of labour, especially family labour. Four businesses out of ten employ spouse and/or children even if the turnover is insufficient. Fierce competition in trade and services also reduces margins and value-added. The low level of assets and capital of the businesses is another reason for the low productivity.

The average picture paints over the sector's wide range of income, profitability, scale and mode of operation. The heterogeneity of this sector is huge, with people making big profits while others don't even get a survival income. By way of an illustration, 10% richest businesses earned an average profit of 145 times higher than the 10% poorest. 23% of household businesses reported their profit at less than 3 million VND per month while 19% reported more than 50 million VND per month; 3% of household businesses invested more than half of the total investment of the sector. The upper segment of the household business sector was more efficient, suggesting that there is strong potential for improving productivity in this sector and increasing its contribution to economic growth. Some owners behaved as entrepreneurs, looking for new markets and taking risks.

We have identified the business owners who are more open to modernization. Based on a set of behavioural variables, a large segment of around one-third of household businesses can be described as

dynamic. These mostly formal household businesses are innovators and in step with the country's modernization. Many have wage workers. They invest in equipment, operate on a larger scale, are willing to develop their business, and innovate their product or their production process for potential new customers or change suppliers to reduce their costs.

#### **4. The need to address worker vulnerability in household businesses and the informal sector**

Household business owners and their employees are extremely vulnerable. Household business owners' low incomes rule out their capacity to deal with business shocks and illness by adopting coping strategies free of negative repercussions in the long run. Poor working conditions make employees particularly vulnerable and these conditions have not really improved in the last years. Social security is a key policy to tackle this vulnerability, especially in a context where social security for all is a stated policy target for 2025. Health insurance has posted impressive progress in terms of coverage in the household business sector, but obstacles to universal coverage still prevail.

From the household business owner side, shocks and illness are the main source of vulnerability. Almost one-third of household business owners have suffered at least one shock calling for significant expenditure in the previous 24-month period. Addition to these shocks, illness is also especially frequent and has long-term impacts on the activity of household

businesses. Around 40% of household business heads had experienced illness that affected their work in the previous 12 months. The direct cost of the sickness is particularly high: health expenditures by informal household business owners amounted to 41% of the profit generated by their business, and they often crowded out expenditure on the household business. Strategies to cope with shock and illness have often long-lasting repercussions, such as the strategy used by a one out of ten informal household businesses to sell productive assets.

Contrary to a popular belief, a large share of household business owners could not count on assistance from friends or family in the event of difficulties, making them even more vulnerable. 36% of household business owners were highly vulnerable as their social network did not secure them any risk-sharing or informal insurance mechanisms to cope with shocks: they could not borrow money for short periods of time while family and friends were unable to provide financial support for their business. Meanwhile, they did not belong to an informal rotating credit and savings association. This belies the commonly held view that traditional solidarity in Vietnam offsets the lack of formal insurance.

Employees in household businesses, when they are not a member of the owners' family, lack social protection. Non-standard forms of employment and low earnings place them in a precarious and vulnerable situation. Only 2% of household business employees had a

written contract and one quarter of them had a health insurance. Part-time work was frequent and a non-negligible part of employees worked with a temporary status. Wage workers' earnings in the household business sector have improved since 2007 but at a slower rate than wages in other sectors, so the earnings gap has widened between wage workers in the household business sector and the formal enterprise sector. Household business wage workers' earnings are still far behind the earnings of their counterparts in the formal enterprise sector. The rate of increase of wages in the household business sector is below the one in formal enterprises.

### **5. The future of the household business sector**

The importance of the household business sector should be maintained in the near future. The contribution of the household business sector to job creation has decreased recently for two reasons. First, the number of young people coming to the working age has started to decrease because cohorts reaching the working age are now less numerous. Second, employment creation by foreign and domestic formal enterprises has increased, leaving less jobs to household businesses. Nevertheless, the decline of labour in agriculture and the still dynamic demographic trend will maintain labour supply in non-farm activities at a high level. Household businesses should absorb a significant part of it.

Recently, the growing formalization of household businesses (through registration

of their business) has tenuously reduced the share of informal employment in the labour force. Between 2007 and 2012, according to the Labour Force Surveys by the GSO, employment in the informal sector had slightly declined. These years, however, saw an exceptional surge in employment in agriculture, probably because of the 2008 crisis.

Self-employed workers, especially in insecure trading activities, are tending to be replaced by household businesses with employees. A process of creation of formal businesses and demise of informal activities is at work. The formalization of informal activities is an objective of the policies that aim at promoting decent work. As for more important businesses in this sector, if it was confirmed, the formalization process would help raise the productivity and better integration of the household sector in the economy.

The shift from the agricultural sector to the informal sector and the strong complementarity between these two sectors swell the ranks of workers in the informal sector. Working in the informal sector is an agricultural business diversification strategy for a not-inconsiderable proportion of households. This strategy is becoming increasingly widespread. Therefore, the decrease in the informal sector should be slowed in the coming years by this diversification strategy of households involved in farm activities.

**Table 2. Previous job, by age (%)**

	<= 40	>40
No previous job	35.4	32.0
Previous job	64.6	68.0
• <i>State</i>	6.4	13.6
• <i>Formal Enterprise</i>	10.9	4.2
• <i>HBs</i>	47.3	50.2

Source: Authors' calculations based on the HB&IS 2014/15.

Young people who start working growingly prefer to work as employees, often in formal enterprises. The average age of household business owners (not of the employees) was higher than in other sectors of the economy. For many of them, the status of the owner of a business came after their previous jobs. Two thirds of household business owners had another job before starting their business. Among those who had a job before, one out of four used to work in the formal sector, mainly in the public sector or in state-owned enterprises for over-40 people<sup>1</sup> and in the private sector for younger owners (table 2).

So, the household business not only grows with the young people that do not find work elsewhere but also, in an important proportion, with people leaving the formal sector to create their own business.

In all, one can predict that employment in the household business sector as a whole will continue to grow in the coming decade. However, the distribution

between formal and informal household businesses is more difficult to predict. The growth might be higher in formal businesses and lower in the informal sector. Formalization of informal businesses is a complex and hardly predictable phenomenon. It depends on the policies set up nationally or locally, as well as on the general economic context (the behaviours of final consumers for instance).

## 6. Policy implications

Most of the household business owners complained of many problems in their business and their need for support is huge. Eight in ten household businesses had problems running their business. The most widespread problem was a lack of market outlets, reflecting the strong competition between household businesses and a lack of information available on market opportunities. This calls for a policy designed to improve the information available to household businesses on market opportunities in order to develop niches for the sector, especially in trade. The information gathered when setting up a business came mostly from family members and based on the experience of past generations. The fact that there is almost no other source of information, such as formal associations, highlights the urgent need to develop other information channels, particularly those able to convey innovative information. Excessive competition in petty trade reduces the margin of traders and maintains their income at a low level. Skills are also an important factor to be

<sup>1</sup> This high proportion is due to the restructuring of state-owned companies in the 1990s where dismissed workers often decided to start their own business.

developed in order to facilitate market research prior to business start-ups and the creation of innovative products. The demand of business owners is more for a better access to market information, including access to big orders, rather than for marketing or organizational skills, but one cannot be done without the other.

While the main problem identified by household businesses is market outlets, their demand for support is mainly for better access to bank loans. Almost half of household businesses complained about their financial constraints and asked for help to access secured loans. Credit constraint places a strong restriction on the development of household businesses' activities and their capacity to invest and innovate. Formal credit is not suited to household business demand, giving rise to crowding-out effects from informal credit and credit constraint. On the supply side, the lack of very short-term credit leads to considerable cash flow problems, which make them even more vulnerable. In particular, microfinance institutions should do more to target the most credit-constrained informal household businesses. Conversely, the absence of long-term credit for household businesses may be one of the causes of the very low rate of investment. More generally, the credit constraint is also due to the lack of recognition of household businesses by government institutions. This calls for the integration of household business in the government's enterprise policy. On the demand side, support is needed to improve the creditworthiness

information provided by household businesses in order to make formal credit institutions less reluctant to provide them with loans. Training in management and accounting techniques might be effective in this respect, as more than half of all formal household businesses did not keep books.

The vulnerability of household business workers to shocks, in particular to illness, and the inefficiency of informal risk-sharing mechanisms call for improvements to the coverage and quality of the social security in the household business sector. In 2014, 54% of household business owners had a health insurance card, half of them through the voluntary scheme. Progress is much more mixed as far as employees are concerned. Less than one-quarter were covered by health insurance and this figure dropped to just 14% when family workers were not considered. Incentives should be created for employers to provide their employees with health insurance. In addition, the cost of health insurance is beyond the means of the poorest household business owners, especially in the informal sector. Health insurance coverage could be improved for these household businesses by expanding - or improving the allocation of - social assistance. More than two-thirds of the poorest quartile of household businesses do not benefit from social assistance, while a not-inconsiderable share of the highest-earning household businesses do. Furthermore, the observed phenomenon of adverse selection places a question mark over the long-term sustainability

of the voluntary scheme. The voluntary scheme is subscribed mostly by less healthy household business owners. Raising the awareness of currently healthy household businesses as to the importance of being covered against health risks, hence encouraging them to contribute to the voluntary scheme, would increase the sustainability of the scheme and make funds available for better reimbursement of health expenditures and wider social assistance coverage.

## 7. Conclusion

The contribution of the household business sector to employment and the creation of wealth makes it as an important player in growth. This sector is critical to inclusive growth as it provides jobs and incomes to the poor and vulnerable people. It has a strong power to mobilise capital from the households for the economic activity. It delivers goods and services in activities not occupied by formal enterprises. It has a strong growth potential because it still, on average, has a low level of technology, equipment and skills which can be improved. It also includes a dynamic and innovative segment that allows investment in new markets. It is flexible and able to adapt rapidly to new activities.

The household business sector plays a key role in the Vietnamese economy and will continue in the medium run. Yet, as in other developing countries, it has to date been largely left out of public policies. Greater sector inclusion in public policy and the development

of supportive actions for the sector are necessary conditions to achieve a new growth model for Vietnam with benefits for more of the population □

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