

Supporting Industries in Vietnam

From the Perspective of Japanese Manufacturing Firms

Kenichi Ohno

(VDF & GRIPS)

April 2006



Hearings

- Opinions of Japanese firms on the draft Supporting Industry Master Plan
- Hearings were conducted from late February to early April 2006
 - Intensive hearings in North--March 6 to 11
 - Intensive hearings in South--March 13 to 17
 - Company names are confidential
- We heard from 32 Japanese firms
 - 15 electronics and electrical firm, 14 motorbike firms, and 9 automobile firms (6 overlaps)
 - 19 in North, 13 in South
 - Also, opinions of experts and Vietnamese firms



Today's Menu

- Current situation of local procurement
- Relationship among demand size, the growth of supporting industries, and competitiveness
- (Main) Key factors for developing supporting industries

We present opinions of Japanese FDI firms (with quotes) as selected and interpreted by VDF
Preliminary – VDF report under preparation



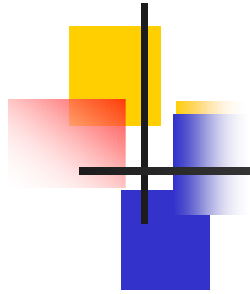
Overview of Current Localization

Motorbikes

- The most advanced in local procurement.
- Local procurement reaches 75%.

Electrical and Electronics

- Local supply is increasing in recent years. For example, one TV assembler has localized almost all plastic parts.
- However, local procurement, which is about 20% to 40%, is still far behind what firms desire.



Automobiles

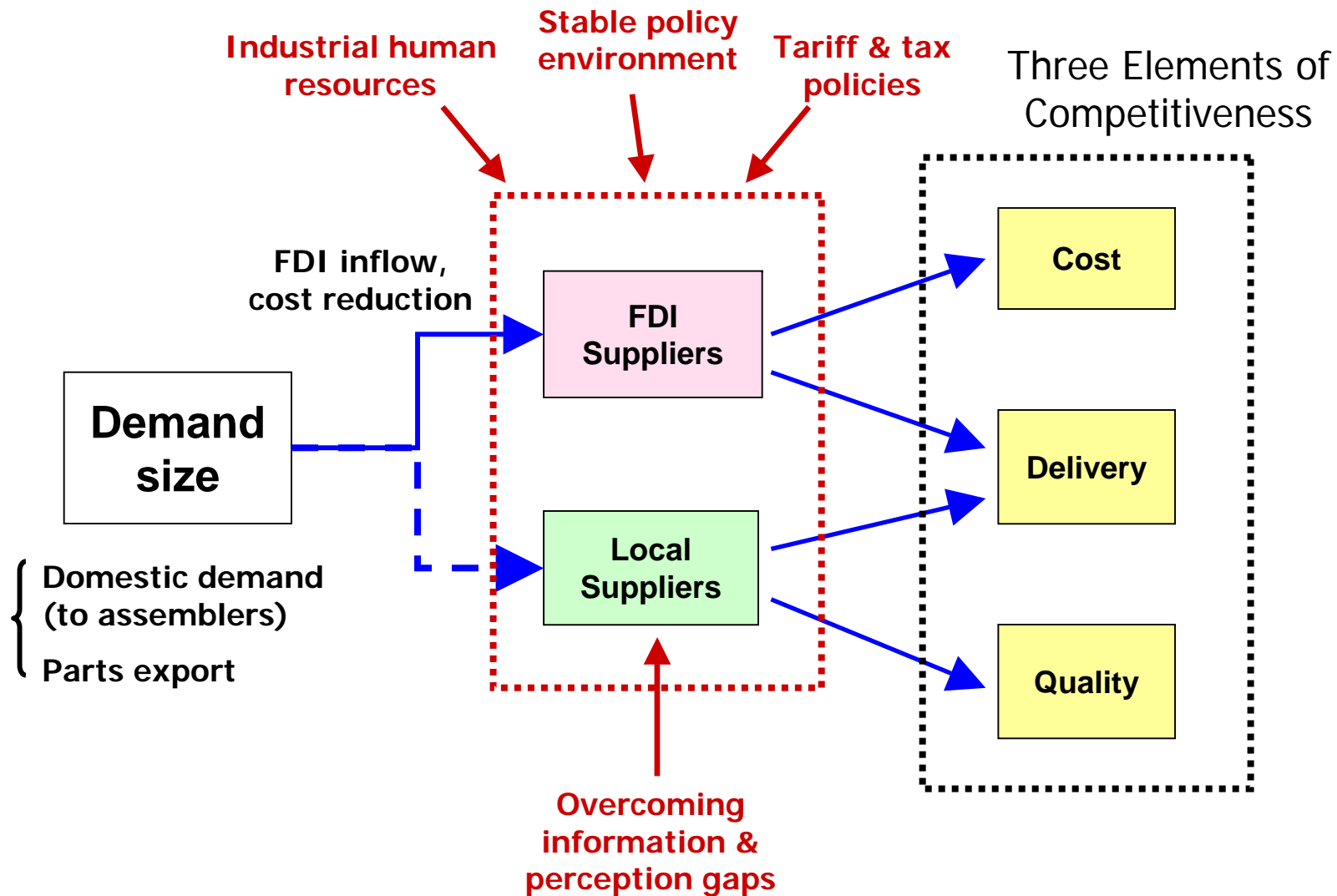
- The slowest progress. Local procurement is from 5 to 10%.
- Only some labor-intensive parts such as wire harness are localized.
- Serious short-term issues, such as second-hand car imports and special consumption tax, prevent long-term strategic planning.



Sources of Competitiveness

- Competitiveness depends on QCD (quality, cost, delivery).
- Parts cost looms large in production cost.
 - “Parts cost accounts for 80% of production cost, while labor cost is only 2%” – a consumer-electronics manufacturer.
- Most crucial factor for SI development is demand size.
- After demand size, the following are also needed.
 - High-quality industrial human resources
 - Proper tax and tariff policy
 - Overcoming information and perception gaps
 - Stable policy environment

How to Achieve Agglomeration and Competitiveness in Parts Industries



Key Factors for SI Promotion

- Demand size!!!
- High-level industrial human resources
- Tariff reduction for parts and materials
- Tax incentives for SI investment
- Overcoming information and perception gaps (for linking local suppliers with FDI)
- General policy stability
- Other measures

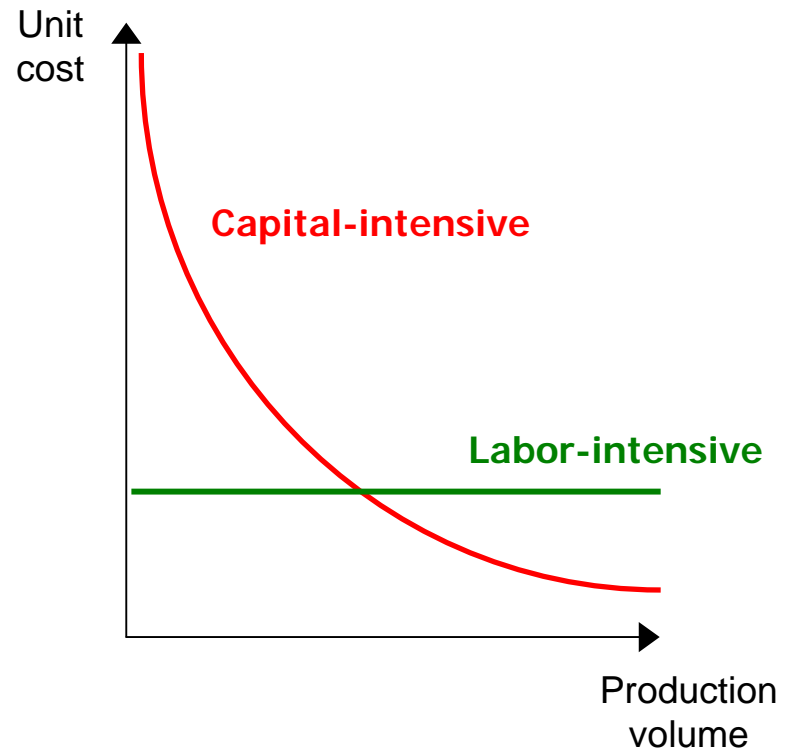
1. Why is Demand Size So Important?

Generally, supporting industries are more capital-intensive than final assembly

- Large investment in equipment (indivisibility)
- Unit cost declines inversely with production volume

“Supporting industries will develop naturally, even without promotion policy, if demand size is sufficiently large.”

– an auto parts supplier.



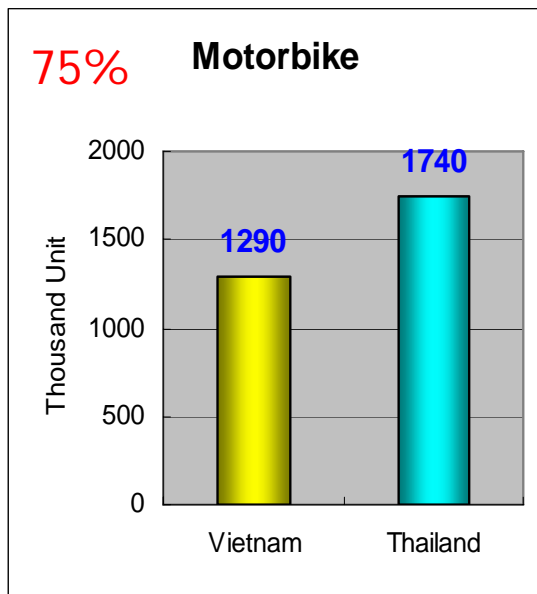
Limited Demand Size in Vietnam

The larger the demand size, the higher the local procurement ratio.

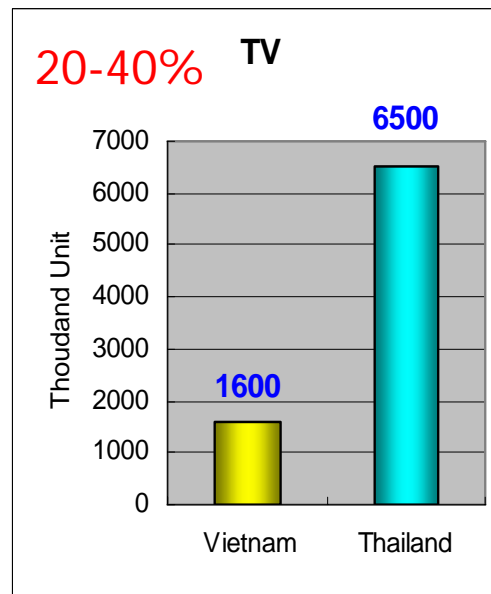
Motorbikes > E&E > Automobiles

Localization

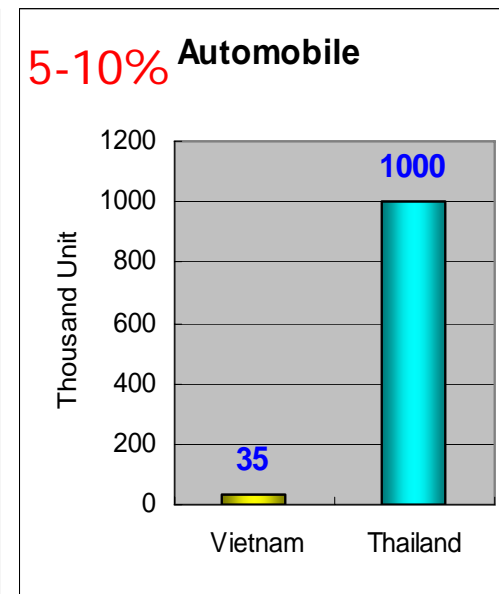
<Production-size comparison: Vietnam vs. Thailand>



Data for 2003 (Mishima)

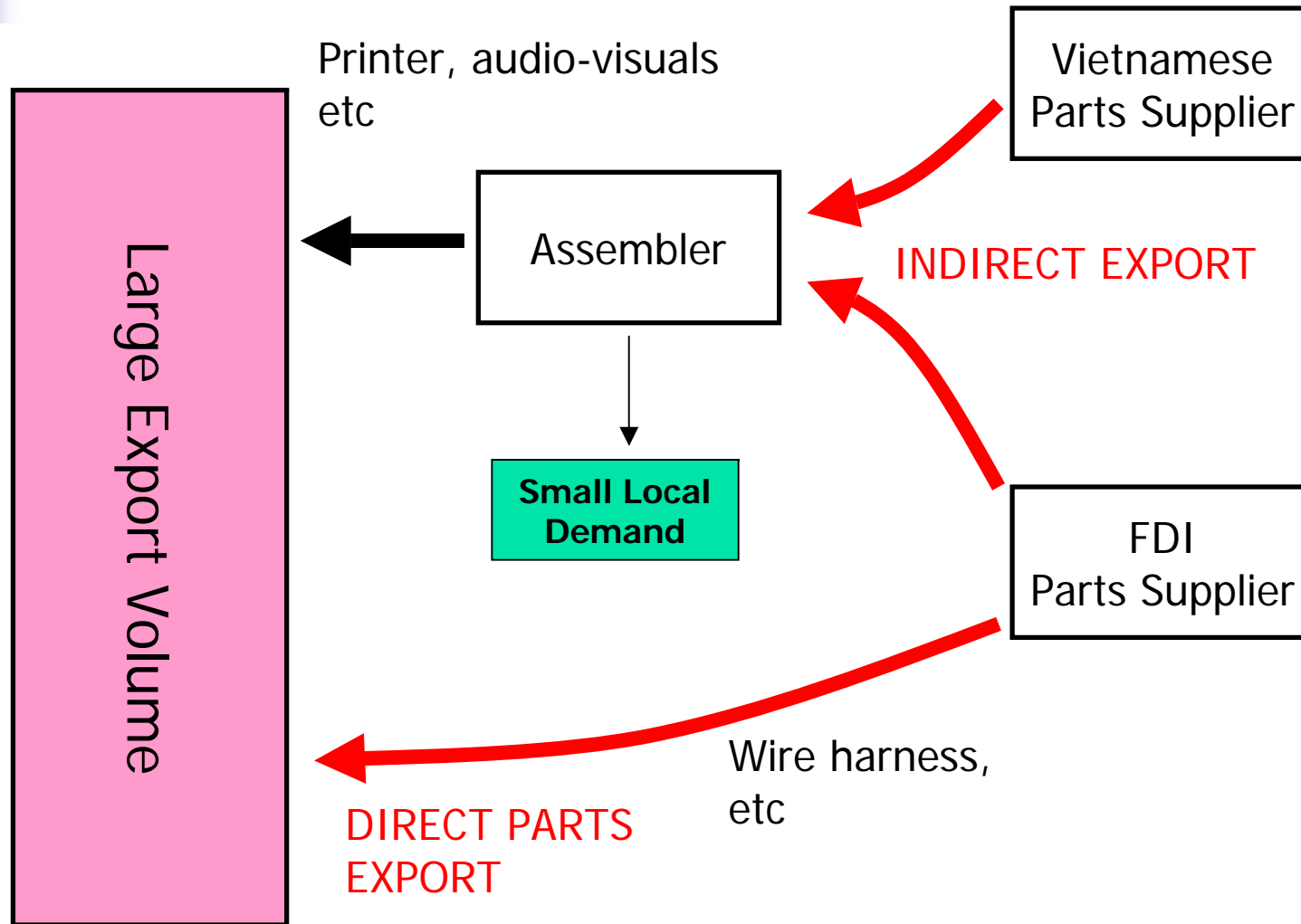


Data for 2002 (GSO, New Net Asia)



Data for 2005 (VDF-MOI hearing)

Possibility of Export?





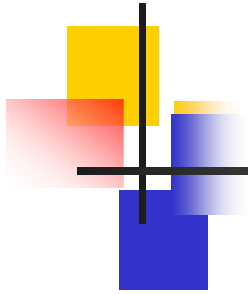
Conditions for Direct Parts Export

- International cost competitiveness is crucial
 - Labor-intensive (using VN's diligent but cheap labor)
 - Input/material cost must be low
 - Import tariffs on inputs must be low
 - Quick and efficient logistic service must be available
- Compact-size parts which do not require daily/hourly delivery
- Note: export decision depends on the global strategy of MNC headquarters, not the factory in Vietnam



2. Industrial Human Resources

- “Meisters” are needed for competitive supporting industries
 - Someone who can manage & improve the whole process, not just one skill
 - Very skilled machine operator who can repair, adjust, improve, teach
 - Super assembler in cell production (assembling a whole product by one person)
- Simple assembly or machine operation is not enough (anyone, any country can do it)



“Highly-skilled workers are required, rather than new machines. If we have high quality engineers, even second-hand machines are acceptable”
– a local plastic parts supplier.

“Product quality should be always guaranteed 100%. 99% is not enough. This one percent explains the difference between FDI suppliers and local suppliers”
– a Japanese expert.

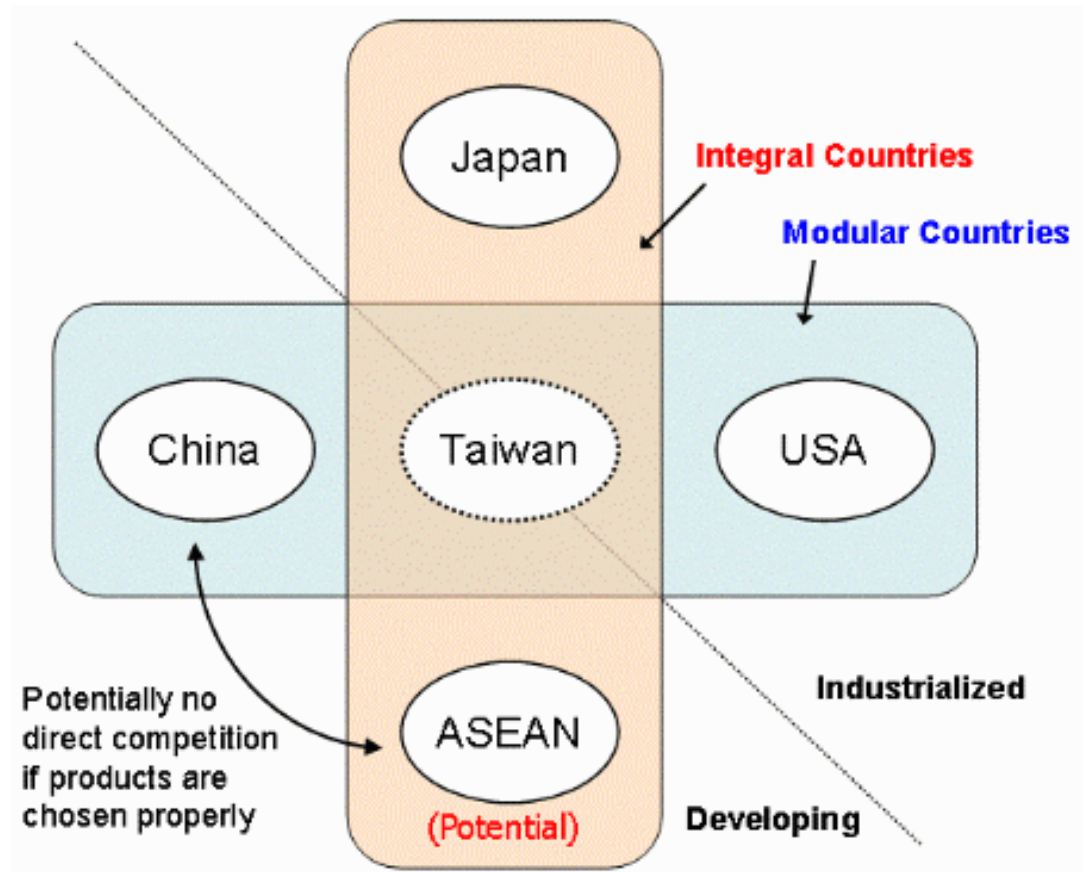
Why Skill Building is Crucial

Strategic alliance based on business architecture theory

In order to
--Cope with China challenge
--Break through the ASEAN
“glass ceiling”

Vietnam should become a strategic partner in **Integral Manufacturing**

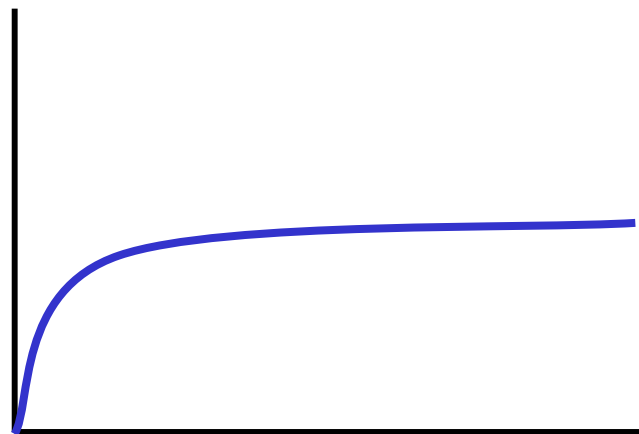
(Don't copy China's modular manufacturing)



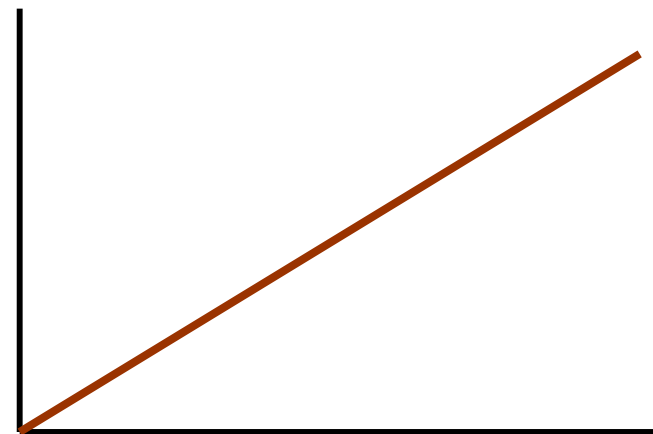
Source: Prof. Fujimoto (Tokyo Univ.)

	Modular manufacturing	Integral manufacturing
Parts interface	Parts are common and can be used for any model	Each product has unique parts, specifically designed
Merits	Quick results and flexibility	Endless pursuit of quality
Demerits	No differentiation, excess entry, low profit, lack of R&D	It takes much energy and time to achieve results
Institutional requirement	Openness, quick decision making, flexible outsourcing	Long-term relations, building internal skills & knowledge

Performance



Time



Time



Measures for Industrial Human Resources

Subsidizing firms' training cost

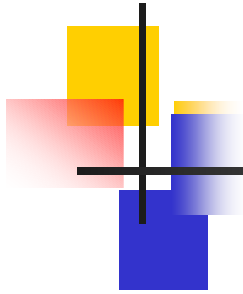
- The master plan suggests subsidizing 50% of the cost.
- “Does it include the cost for internal training too?”
– an auto parts supplier.

Establishing the Meister System

- To increase engineers who pursue “100%” (perfection)
- National, provincial, and firm-level systems

Promoting collaborative training programs

- Example: Malaysia's Penang Skills Development Center
- When labor demand is rising, this kind of program has a good chance of support and success



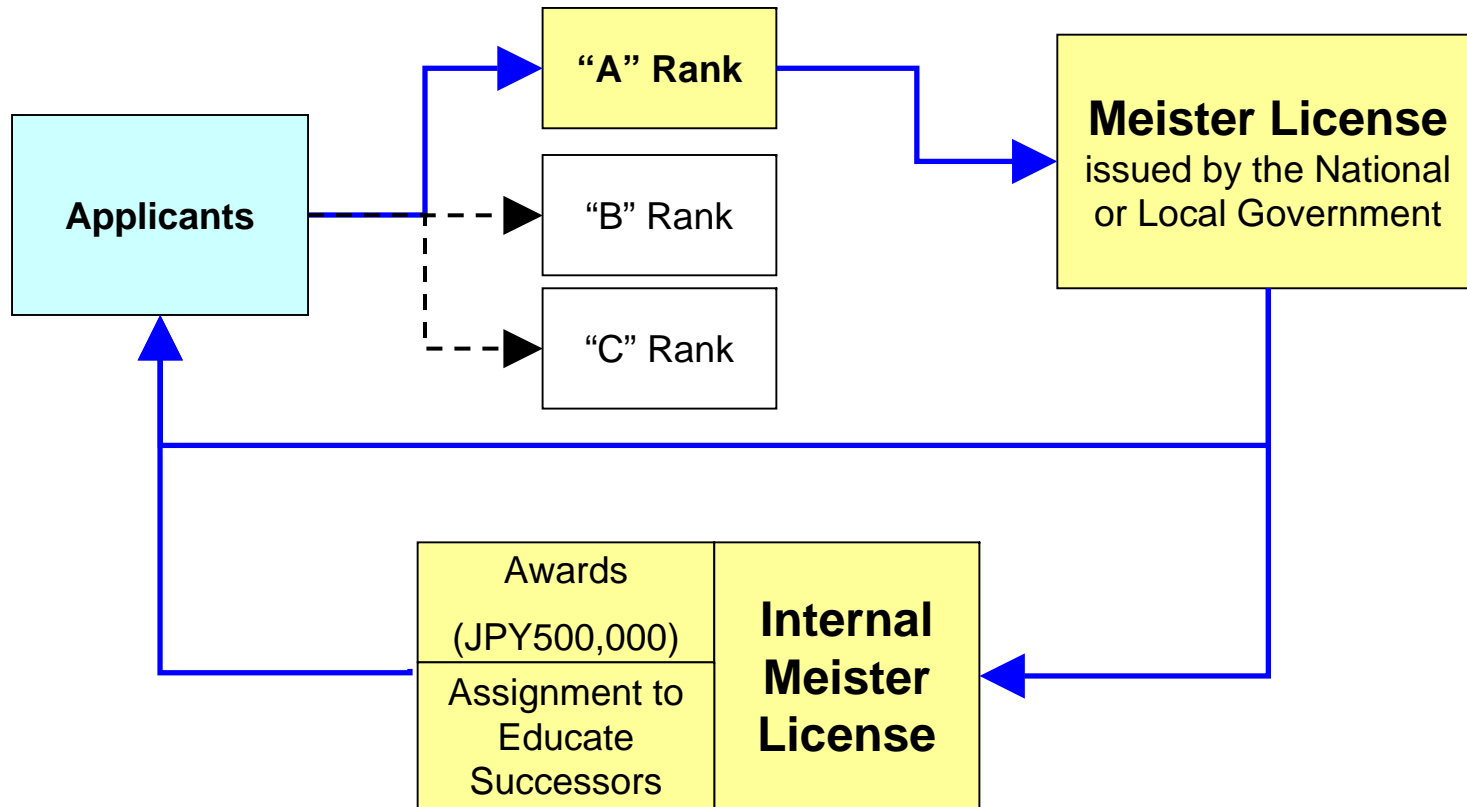
Strengthen practical engineering education at schools

“We sent our workers to Japan for training but the results were less than expected, because Vietnamese engineers did not have basic knowledge.”

– a motorbike parts supplier.

Taking advantage of existing training and incentive programs such as AOTS, JODC, Skill Olympics, etc.

The “Meister” System in Japan



There are

- Meister Systems at central or local government levels
- Meister Systems within individual companies



Curbing Job Hopping

- For integral manufacturing, good staff with long-term vision must stay in one company
- Some FDI firms report increasing job hopping, but others enjoy low labor turnover (reasons: wage level, location, employee policy, company philosophy?)

“At our company, job hopping by medium-level engineers has increased significantly in the last 2-3 years.”

-- an electronic parts exporter.

“Ideally, we don’t want to lose any workers we have trained. But those who go to other companies will indirectly contribute to Vietnam’s industrialization.”

-- a computer device assembler.

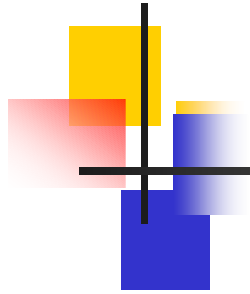


3. Import Duty Reduction for Parts and Raw Materials

- Zero parts tariff (or at least less than 5%, both CEPT & MFN) will enhance cost competitiveness
 - We need to study its total impacts on FDI, growth, jobs, fiscal revenue, etc.
 - Thailand already has zero parts tariffs.
- “Give-and-take” between government and FDI firms (VDF suggestion)

Government should work on improving policies, and FDI firms should work on achieving some targets in production, export or localization, *conditional on good policies*. If they cooperate productively, blaming each other will end.

(Note: some companies still fear numerical targets)



- **Tariff reduction on raw materials**

“Because the import tariff on steel products rose from 0% to 7%, we may need to increase the price of metal parts.”

– a motorbike parts supplier.

- **Capacity building of customs officers**

High-quality industrial materials (not available in VN) and common materials (produced in VN) should be distinguished



4. Tax Incentives for Supporting Industries

- Special treatment for supporting industries
 - To provide incentives for both FDI and local suppliers.
 - To develop supporting industries as a national priority goal as in Thailand and Malaysia.
- Common concerns of policy makers
 - Tax revenue
 - “Government revenue may decrease at first, but will increase in the long run as FDI and industries grow.”
 - a Japanese expert
 - Fairness (every producer wants special treatment)
 - “I understand the concern, but concentration of resources is necessary and inevitable. You must support those industries that are crucial” – a consumer electronics manufacturer.
 - FDI parts will dominate, local suppliers may be wiped out
 - “In the future, division of labor with local suppliers is preferable.” – a molding-tool supplier.



5. Information and Perception Gaps

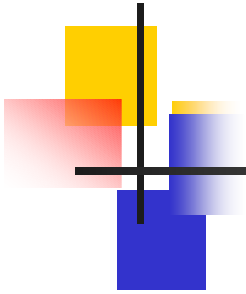
- Information gap

- FDI assemblers do not know where potentially good local suppliers are.
- It is time consuming for each company to check telephone directories or ask friends

“In order to find one capable supplier, we need to check 100 firms.” – an electronics manufacturer.

- Perception gap

- Local suppliers complain that no Japanese companies respond when they send a sample or catalog.
- In fact, to become a partner of Japan’s integral manufacturing, 2 or 3 years of intense learning and negotiations are necessary.



“Sincere attitude toward business, accurate self-assessment of capacity, and the commitment to quality are important.”

-- More than one Vietnamese suppliers doing business with Japanese companies.

“When we visit a Vietnamese supplier, we look at the attitude of the general director. That is the most important thing.”

-- A computer device assembler.



Establishment of Supporting Industries Database

- Yellow-page-style database is not sufficient.
- Japanese firms think the following information is crucial:
 - Management policy ⇒ Top priority
 - Product quality
 - Cost
 - Flexibility of delivery
 - Production capacity



6. Stable Policy Environment

- General problems are lack of communication with businesses, ambiguity of purpose, and sudden implementation
- Examples in early 2006:
 - Second-hand car import issue
 - Minimum wage increase and strikes in Dong Nai
- FDI firms expect: “Probably other issues will arise in the future...”
 - “We had a business plan when we came to Vietnam, but it became useless now, due to a series of inconsistent policies.”
 - an automobile assembler.

- 
- Many Japanese suppliers are “risk-averse”

“Many Japanese suppliers are SMEs with small capital. Unlike big companies, they are extremely afraid of any business failure. The government should declare and ensure full support, by drafting a good master plan.”

– a material supplier.

- “*Ondosa*” (temperature gap) between headquarters and general director in Vietnam

--GD in VN wants to expand his factory very much (very hot)

--Tokyo HQ doesn't care much about VN (cool or cold).

“I am doing everything to invite our group companies to VN, but I can't convince HQ if so many bad policies continue to be issued”

-- An electronics and electrical assembler



7. Raw Materials

- Some firms pointed out the lack of raw materials in Vietnam, in comparison with Thailand and Malaysia
- However, raw material industries are highly capital intensive
 - ⇒ Need great industrial agglomeration before building such facilities
 - “China developed material industries for PCB, because it has a few hundred PCB assemblers.” – an electronics manufacturer.
- Meanwhile, tariff reduction on highly-demanded raw materials is a more urgent issue.



8. Financing for Local Suppliers

- Banks should improve the loan mechanism for small and medium enterprises

“The big four commercial banks excessively focus on SOEs, with less attention on SMEs.”

– a Japanese expert.

“Both state-owned and private banks take too much time for new loan examination. Foreign banks can approve it much faster. I don’t apply loans to local banks any more.”

– a Vietnamese supplier to FDI companies.



9. Improvement of Industrial and Safety Standards

- Safety standard will reduce import of low-quality products and parts.
- Industrial standards are necessary to ensure high quality production
 - E.g. Japan Industrial Standard (JIS)
- The government should provide information on environmental laws in developed countries (Vietnam's markets)
 - E.g. The Restriction on Hazardous Substance (ROHS) in EU.