

Role of FDI by Japanese SMEs in Economic Development in Vietnam

Nguyen Nam Hai*

Abstract

Today FDI is one of the most important sources of capital and FDI by small and medium enterprises (SMEs) become an important part of it. As coming from SMEs, FDI by SMEs is expected to have some more desirable roles compared to FDI by LEs, especially in promoting development of local SMEs. Japanese SMEs are among the most active SMEs in term of undertaking FDI. This paper is to find the role of FDI by Japanese SMEs in Vietnam. The observations by previous researches on the role of FDI by SMEs are tested in the case of FDI by Japanese SMEs in Vietnam.

FDI by Japanese SMEs was found more labor- intensive, more export- oriented and transfers more suitable technology than FDI by Japanese LEs. FDI by Japanese SMEs also contributes to supporting industries that Vietnam is lacking now. However, the advantages of FDI by SMEs in promoting Vietnamese SMEs is rather limited when there are not many joint ventures with local SMEs and the weak capacity of local SMEs. The problems of FDI by Japanese SMEs due to their constraints themselves as well as weakness of Vietnam's investment environment. The policies to attract FDI by SMEs are necessary but they must go together with policies to promote establishment of new enterprises and strengthen local SMEs' capacity.

I. Introduction

Since its first days came into being, FDI has increased significantly and expanded to most the countries and regions in the world. By the time, FDI is not only a playground for the large and powerful multinational enterprises but also attracts many small and medium sized enterprises. In fact, the global FDI by SMEs has been rapidly rising since mid 1980s¹. In many developing countries, FDI, in different extends has contributed to the economic development. As undertaken by SMEs, FDI by SMEs could effects on the host developing countries in some different ways from FDI by LEs. FDI by SMEs is expected to contribute to development of local SMEs, the actors that are believed as vital for local economy.

Vietnam has been calling for foreign capital since 1988. A remarkable amount of FDI has poured to Vietnam and FDI plays an important role in Vietnam's economy. However, it is often critiqued that FDI to Vietnam is limited by low FDI disbursement rate, small jobs created by FDI, substantial trade deficit. FDI to Vietnam has been disproportionally directed to capital- intensive industries rather than labor- intensive industries that Vietnam has comparative advantage². Vietnam is still a transitional economy where still exist many consequences of the centrally planned mechanism such as weak private sectors and inadequate entrepreneurship. The FDI by SMEs to Vietnam could play a double role to act

*Graduate School of Asia-Pacific Studies, Waseda University, Doctoral Degree Program 早稲田大学大学院 アジア太平洋研究科博士後期課程

¹ UNDTAD (1998), Small and Medium Sized Multinational Corporation, Role, Impacts and Policy Implications

² For discussion of FDI to Vietnam, see Tran Binh Nam and Pham Do Chi (eds) (2003), NEU and JICA (2003)

as complementary source for FDI by LEs and promote Vietnamese SMEs. Here we take the case of Japanese SMEs due to the relatively important of Japan's FDI to Vietnam and the activeness of Japanese SMEs in undertaking FDI.

1. Literature Review:

Although the FDI is extensively studied, there are not many literatures on FDI by SMEs. The most comprehensive researches on FDI by SMEs in global scale were done by the United Nation's Conference on Trade and Development (UNCTAD) in the 1990s. The 1993 questionnaire- survey based study analyzes the nature and role of transnational SMEs from a developed country investing in developing countries as well as different trends among firms from different countries such as the US, Japan and EU. It finds that SMEs MNCs can contribute positively to development (UNCTAD, 1993). Buckley et al (1997) in evaluate the international technology transfer made by SMEs on country- basis... SMEs are considered as "alternative- and more desirable than large MNCs- technology suppliers for the developing countries, since small ones supposedly possess intermediate technology and create more employment opportunities because of their more labor- intensive operation". This is especially true for the case of Japanese SMEs (Terutomo, 1998). Later, in 1998, UNCTAD concentrates on the experiences of some countries in Asia as the region that has "a larger potential to mobilize FDI by SMEs than any other developing region". FDI by SMEs plays an important role in promoting local SMEs and developing local entrepreneurship.

The effect of FDI by SMEs could be easier to see from a specific country. Kojma (1973) observes that high proportion of Japanese FDI in manufacturing is undertaken by SMEs. He argues Japanese SMEs invest abroad to seek for low cost labor rather than to exploit their intangible asset. Japanese FDI is more beneficial to the host developing countries because it causes trade- created effect, while the US's FDI causes trade- diverted effect. Adachi (1998) study the positive role of FDI by Japanese SMEs in Thailand and their role in technology transfer through the case- study of two projects of companies from Aichi Prefecture. Chen Tian- Jy (1998) explores the effects of Taiwanese FDI to other Southeast Asian countries. He analyses different impacts from LEs and SMEs. The SMEs, which account the majority of Taiwanese firms, cause some more preferable effects.

Our research tries to find the role of FDI by Japanese SMEs in economic development in Vietnam. This paper introduces the argument for and against the FDI by SMEs, taking Japanese SMEs in Vietnam as the base for analysis. It firstly discusses the theoretical arguments for the FDI by SMEs, then briefly goes through the main trends and characteristics of FDI by Japanese SMEs in Vietnam, and finally focuses on its role (positive and negative) for Vietnamese economy.

2. The Observation from Previous Studies:

1) FDI projects of SMEs are more labor intensive than one of LEs:

FDI by SMEs generally is labor- intensive than LEs, therefore relatively creates more jobs, generating more income for local economy. That can improve the income distribution of the host developing countries. To evaluate which firms are more labor- intensive we use the capital- labor ratio. The rate of the total capital invested over the total labors employed. The

ratio indicates how much capital is used to create one job. We calculated average C-L for whole FDI projects of SMEs and LEs and that ratio in each industry.

2) *FDI projects of SMEs are more export- oriented than one of LEs:*

FDI by SMEs has higher rate of exports over total turnover than the FDI by LEs. Here share of projects that export more than 70% of their turnover is calculated for affiliates of SMEs and LEs.

3) *FDI by SMEs transfer subtly different technology that may be more suitable to local economy than LEs:*

The technology from the SMEs is small- sized and less sophisticated than of the LEs and that makes it easier to diffuse to local economy. The transferred technology will be analyzed in term of technology type and characteristics, labor's and labors' and managers' training using the case studies.

4) *SMEs contribute to form supporting industries that facilitate LE assemblers:* The technology transfer is most obvious in the case of joint- ventures, therefore the share of joint ventures in all projects is calculated. SMEs are many in the supporting industries that are essential to develop many important industries such as automobiles, electronics....

5) *FDI by SMEs helps to develop local SMEs and entrepreneurship:*

The projects of SMEs can be the model for local SMEs to follow or imitate. The model of the SMEs is more appropriate to follow because of the small size and most firms at the beginning are established as SME. Another effect is the former employees that spin out of the foreign company to set up their own firms. This effect was very robust for the Taiwanese SMEs.

6) *FDI by SMEs might have more specific problems:*

As having many constraints and lacking experience doing business in foreign countries. The failure is easier to happen in the SMEs' projects. The rate of dissolved projects of SMEs is higher than one of large LEs.

FDI by SMEs more often has problems in labor usage, and violation of laws and other environment regulations...

3. Definitions of SMEs and Data Sources:

Definition of SMEs is not homogenous but various from countries and organizations. For the case of Japan, the official definition is as follows:

Type of Business	Number of Employees	Capital
Manufacturing and other	Up to 300	¥ 300 million
Whole sailing	Up to 100	¥ 100 million
Retailing	Up to 50	¥ 50 million
Service Business	Up to 50	¥ 50 million

Source: SMA of Japan, 2003

For Vietnam, "SME is the independent production and business incorporated enterprise, whose registered capital does not exceed 10 billion Vietnam Dong or average annual employment level is fewer than 300 people" (SME Net, 2004)³.

³ <http://www.smenet.com.vn/TiengViet/Others/GioiThieu/SMEVietnam.asp>.

The research intensively uses the FDI data of Vietnam. A database of all Japanese FDI projects in Vietnam is built through many sources. The main source for Vietnam is Ministry of Planning and Investment (MPI), database of Licensed Projects published by Vietnam's Chamber of Commerce and Industry (VCCI) 1998, Toyo Kezai List of Japanese company affiliates 2003, JETRO's list of Japanese affiliates in Asia 1998. In our database, Japanese firms are separated into big MNCs and SMEs. Company is defined as SMEs using Japanese definition. The data of the capital and employment of the company is drawn from Nikkei Telecom 21 and the official website of the company. Company of which name could not be found in the Nikkei Telecom or in the Internet is considered as SME.

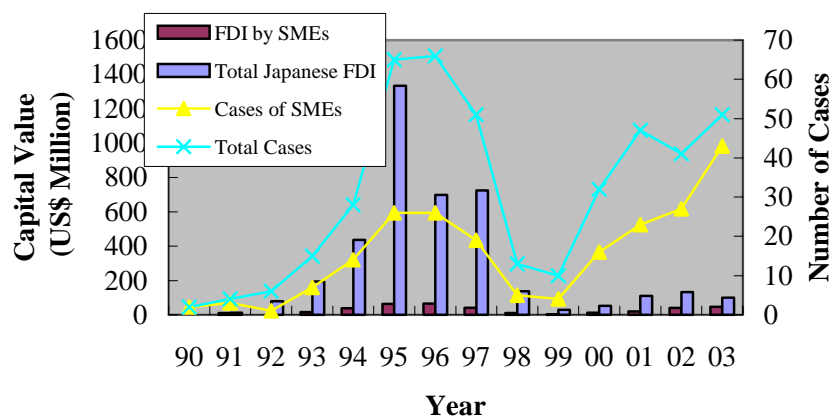
Beside the database, interviews and case studies are conducted to supplement the unavailable information and explore the issue in depth. Interviewees are divided into 4 groups: Japanese Agencies, Vietnamese Agencies, Japanese SMEs' affiliates and Japanese LEs' affiliates. The case- study firms are accidentally selected in various industrial sectors and locations to avoid selection bias. The two main locations are areas around Hanoi and Hochiminh City.

II. Trends of Japanese SMEs in Vietnam:

1. Value of Capital and Number of Cases:

The trend of FDI by Japanese SMEs is a long with the general trend of Japanese FDI. The number of projects and invested capital has rapidly increased until 1997, the year of the outbreak of the Asian financial crisis that affected almost all economic activities. After 2000, FDI by Japanese SMEs gradually recovered to the level of the peak of 1994- 1997, despite of total FDI from Japan is still far from the highest level in the past.

Figure 1: Number of Cases and Capital Value of FDI by Japanese SMEs in Vietnam



Source: Author's Compilation from combined database

The number of cases of FDI by Japanese SMEs accounts for about 60% of all the cases of Japanese FDI (the rate is nearly 90% in 2003). This shows a strong wave of Japanese SMEs coming to Vietnam after 2000.

In term of invested capital, FDI by Japanese SMEs accounts for very small part of the total Japanese FDI. Prior to 2000, SMEs' share is only less than 10 percent of total Japanese FDI. The recent years witness the remarkable increase of SMEs' FDI in both the number of cases and share in total value of Japanese FDI. That share has increased to more than 30 % since

2000 and nearly 50% in 2003. The FDI by Japanese SMEs almost recovered to the peak level of 1994- 1997. Thus we can say that the first boom in Japanese FDI before the Asian financial crisis is made of big firms and the second “boom” would be of the SMEs.

2. Sectoral Distribution:

Japanese SMEs concentrate most in textile and garment are SMEs, mainly are located in Tanthuan EPZ and Hochiminh area. They produce export to Japan as well as the third country. Following light industries are supporting and machinery industries, the strong point of Japanese SMEs compared to other Asian investors.

Table 1: Industrial structure of Japanese FDI

Industrial Sector	SMEs			LEs		
	No. of Cases	Share of Cases	Share of Capital	No. of Cases	Share of Cases	Share of Capital
Supporting Industries	40	18.40 %	20.39 %	36	16.82 %	6.73 %
Light Industries	54	24.88 %	15.12 %	11	5.14 %	2.05 %
Machinery	48	22.12 %	21.45 %	76	35.51 %	62.43 %
Agriculture, Forestry, Fisheries	13	6.00 %	4.49 %	5	2.33 %	0.61 %
Food Processing Industries	9	4.15 %	4.64 %	7	3.27 %	1.91 %
Information Technology	15	6.91 %	1.77 %	3	1.40 %	0.08 %
Services	33	15.21 %	8.23 %	51	23.83 %	12.92 %
Real Estate	6	2.76 %	23.9 %	12	5.61 %	9.10 %
Chemical				9	4.21 %	2.47 %
Oil & gas products				3	1.40 %	1.70 %
Total	217	100 %	100 %	214	100 %	100 %

Source: Author’s database

Agriculture, forestry and fisheries also are industries that Vietnam has competitiveness, so they are expected to attract many SMEs in. The fact is not so. Only 6% of cases of Japanese SMEs in these industries, two –folded of the LEs but still the number is modest. In term of the capital, the difference could be clearer when the share of SMEs in this sector is about 4.5% when that of the LEs is 0.6%.

The number of IT firms that has come to Vietnam since 1989 is not so many but it is new trend in Japanese FDI to Vietnam. Vietnam is said a promising land for this industry because IT industry needs only small capital but a lot of high skilled labors. In 2003, about 7 companies have joined Vietnamese market. Beside the big names such as NTT and NEC, we can see many Japanese SMEs IT firms in Vietnam. This time could be the “testing” and training stage for “real” investment in the future.

4. Regional distribution:

It could be expected that SMEs can invest in small- scale projects in many regions around the country and then create a more equal regional distribution of the FDI and help to develop agricultural and rural industries. Vietnam seems do not support that expectation. 60% of the SMEs chose Hochiminh city and its surroundings to invest, about one fourth of them chose other two big cities of Vietnam that are Hanoi and Haiphong. Hochiminh area is favorite

spot for foreign investors in Vietnam because of its better infrastructure and the rich experience in dealing with market mechanism in the past.

The trend in the value of capital of Japanese FDI is quite contrast. The capital concentrated much in Hanoi (Hanoi has attracted much more capital of the Japanese Les than Hochiminh city), Haiphong. The producers of vehicles such as such as Toyota, Yamaha, Honda seem prefer the North because they are more willing to follow the suggestion from the Government.

Japanese SMEs concentrate in the EPZ or IPs such as Tan Thuan EPZ, Nomura IP... The ratio of firms in EPZs and IPs of Japan is the highest among investor- countries in Vietnam but the ratio of the Japanese SMEs even higher. The EPZs and IPs have advantage of good infrastructure and the availability of relating agencies such as custom office.

III. Assessment of the role of FDI by Japanese SMEs in economic development in Vietnam:

1. FDI by Japanese in Vietnam is more labor- intensive in one by LEs:

The data on employment are available for about 70% of projects of Japanese FDI. Most affiliates of Japanese SMEs have employed less than 100 people. In average, each project of Japanese SMEs hires 90.38 people. The average size of affiliates of Japanese LEs is more than double, 206.7 people.

As Vietnam is a developing country, it is in short of capital and abundant in labor. The desired pattern of FDI to Vietnam is labor – intensive projects. In this aspect, the FDI by Japanese FDI is encouraged because its capital labor ratio of FDI by Japanese SMEs is very small, only less than one third of the ratio of Japanese LEs (Table 2).

Table 2: Labor size of projects by Japanese firms in Vietnam (Number of Cases)

Industries by sector	SMEs		LEs	
	Number of Cases	Average C/L Ratio	Number of Cases	Average C/L Ratio
Supporting Industries	19	45.14	28	91.71
Other Manufacturing Industries	27	37.79	62	109.01
Light industries	32	12.77	9	28.42
Agriculture, Forestry & Fisheries	7	55.48	5	244.28
Food Processing	8	55.96	5	54.84
IT	7	41.04	2	26.51
Services	26	163.22	39	554.13
Real estate	5	101.34	8	765.71
Chemical			7	100.40
Total	132	69.73	165	240.71

$$\text{*C/L Ratio} = \frac{\text{Total Value of Investment Capital}}{\text{Total employment}} \times 100\%$$

(Capital- Labor Ratio)

Source: Author's compilation from combined database

That trend is the some in most of the industries except the food processing industry where the ratios are almost the same because characteristic of LEs and SMEs this sectors is not so

different. It is much cheaper for Japanese SMEs than LEs to create one job. FDI by Japanese SMEs is more labor intensive and capital saving than FDI by Japanese LEs.

As seen in table 4.1, the scale of Japanese SMEs affiliates are often small or medium, as their employment level is often less than 300 people and even less than 100. However, we can find some companies have grown fast in Vietnam and become large firms in term of labors usage.

2. FDI by Japanese SMEs in Vietnam is more export- orientated than one by LEs:

Table 3 shows the export orientation of FDI by Japanese SMEs and LEs.

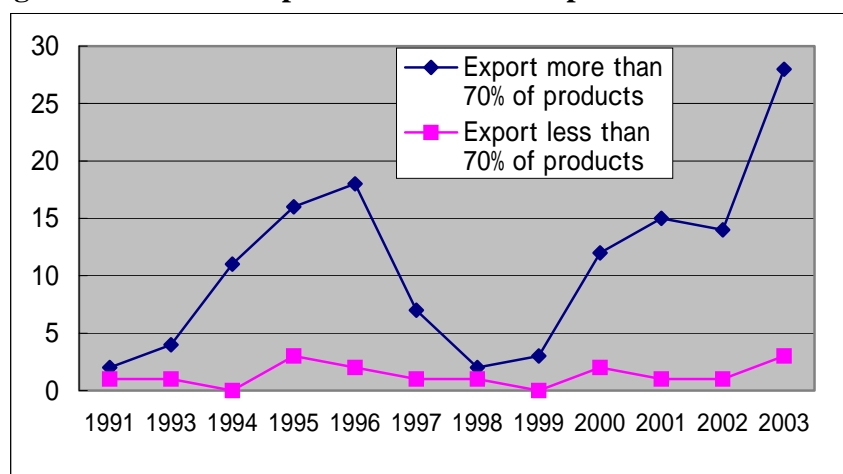
Table 3: Export Orientation of Japanese affiliates (Number of Cases)

Export Orientation	Company Type		Total
	SMEs	Les	
Export more than 70% of products	132 (89.2%)	67 (46.9%)	199 (68.4%)
Export less than 70% of products	16 (10.8%)	76 (53.1%)	92 (31.6%)
Total	148 (100%)	143 (100%)	291 (100%)

Source: Author's compilation from combined database

Nearly 90% of Japanese SMEs affiliates export more than 70% of their products while only about half of Japanese LEs affiliates do so. For manufacturing, most FDI projects of Japanese SMEs target foreign market; very few (mostly the firms in service sector) serve only domestic market. It is very difficult to find a project by Japanese SME that sells 100% of its products in domestic market. Even for companies that have high rate of domestic sale, their clients mainly are the Japanese LE- assemblers such as Honda, Toyota of Sony... The reason possibly is the relatively small size of Vietnamese market. Although the output of the SMEs projects is not so big, their products are for niche market that does not exist or suitable in Vietnam (price may be too high).

Figure 2: Trends in export orientation of Japanese SME 1991- 2003



Source: Author's calculation from combined database

The number of the export- oriented projects fluctuates from time to time, being affected by many factors while the number of domestic market- oriented projects is quite stable. Recent trend shows that there is sharp rise in the export- oriented projects. The rise in export-oriented projects is due to the improvements in the investment environment of Vietnam as well as the shift of Japanese investors that is not too concentrated on China. Another important reason is Vietnam has reached a bilateral trade agreement (BTA) with the US in 2000. Some Japanese SMEs producers in light industry produce clothing and shoes... to export to the US⁴.

3. Technology Transfer by Japanese SMEs would be more suitable to Vietnam than one by LEs:

b. Characteristics of technology transfer:

Production process includes many sub- processes, namely Production (Operation Quality control Maintenance), Engineering and Designing (Process Control, Plant & equipment development Production/ process development), R&D (Applied research, Basic research). For Vietnam, the technology transfer often takes place in processes in production stage. This includes the skills in assembling parts and components, simple processing such as turning, die- casting, and low- technology- level fabricating. The higher level is the quality control to ensure the quality of products.

In Vietnam, most of the affiliates produce according to the models sent from the headquarters in Japan; even the inputs are supplied from mother- firms. In industries of low technological level such as light industries, the affiliates in Vietnam can produce final products and directly ship to customers. Other upper technology stages are difficult to find in Vietnam, even for the LEs. Some LEs have been successful in adapting its products and reducing the price to meet local demand such as Honda Vietnam. But for the SMEs, because their products mainly are exports, there is little development of the products and process.

The transferred technology is small scale, ranging from thousands to hundreds of US dollars. Beside that, the technology is often using relatively more labor than technology of the big capital invested projects. That small- size and labor- intensive technology is suitable to a low- income country like Vietnam.

Among Japanese SMEs in Vietnam, some in the high tech industries and especially IT is new trend in FDI by Japanese SMEs in Vietnam. These industries are developing very fast and Vietnam has potential to develop that industries.

c. Training of Labors:

One important aspect of technology transfer is training labors in the foreign invested projects. The workers are taught how to function the machineries and doing some process. Further more, they can learn the idea of industrial production, the responsibility of the workers as the links on a production chain, the collectiveness of the works. In Japanese companies, Vietnamese workers are engraved on their mind about the Japanese way of doing that is production of high quality products.

Usually the new employees are trained shortly before starting their work in a company. The OJT (on- job- training) is a strong point of Japanese firms: the workers are trained while working and they can learn many skills. Most the firms rely mainly on the OJT. Beside that

⁴ Interview with Mr. Hoshino from JASMEC, 18th February 2004

Japanese technicians sometimes travel to Vietnam to instruct about the new machines or products as well as new methods.

For the small and medium projects, the percentage of Vietnamese staffs that are managers is higher compared to LEs and Vietnamese staffs are easier to be promoted in managerial positions. In most of Japanese SMEs in Vietnam, there is only one Japanese director (often is technician), bellows that is a Vietnamese deputy director. In many cases, the Japanese director is often absent in Vietnam. Therefore, the deputy director does all the routine works and acts as head of Vietnamese affiliate. As the small size, the managers often do many jobs from administration to exports- imports procedures and labor management. This helps them to develop multi-faced management skills and relations that are especially beneficial in the future when they can spin out to establish their own enterprises.

4. FDI by Japanese SMEs contributes to form supporting industries that support production of Japanese LE assemblers:

From table 1 in section 2.2 we can see that there are about 40 Japanese SMEs, a little bit higher the number of LEs in supporting industries. However, some of these firms do not sell any products in Vietnam. The number of Japanese firms in supporting industries in Vietnam is too small and, to the thousands of parts producers in Thailand or Malaysia. Anyway, together with some Vietnamese enterprises, these Japanese SMEs form the young supporting industry in Vietnam. They have supported the production of Japanese assemblers, helps them to fulfill obligations of localization. .

We can look at one example in the motorbike industry in Vietnam, the case of Honda Vietnam. Honda Vietnam is the firm that has get ratio of localization of about 80%, the highest among motorbikes producers. The firm has 43 parts suppliers in Vietnam (including Vietnamese, Japanese and other foreign firms). Among Japanese parts suppliers we can find Japanese SMEs namely Tsukuba, Takanichi, Machino that supply the important parts for Honda. These parts are often more sophisticated while Vietnamese firms supply the simple products such as simple plastic and some metal products.

Another example is the case of Canon Vietnam, which is established in 1999 in the Thang Long IP (Hanoi). The main products of company is printers, most are exports. Canon Vietnam has been trying to increase the localization rate. By August of 2004, it has 45 parts suppliers of which 20 Chinese suppliers provide 129 items, the largest numbers. In Vietnam there are 15 suppliers that provide 43 items.

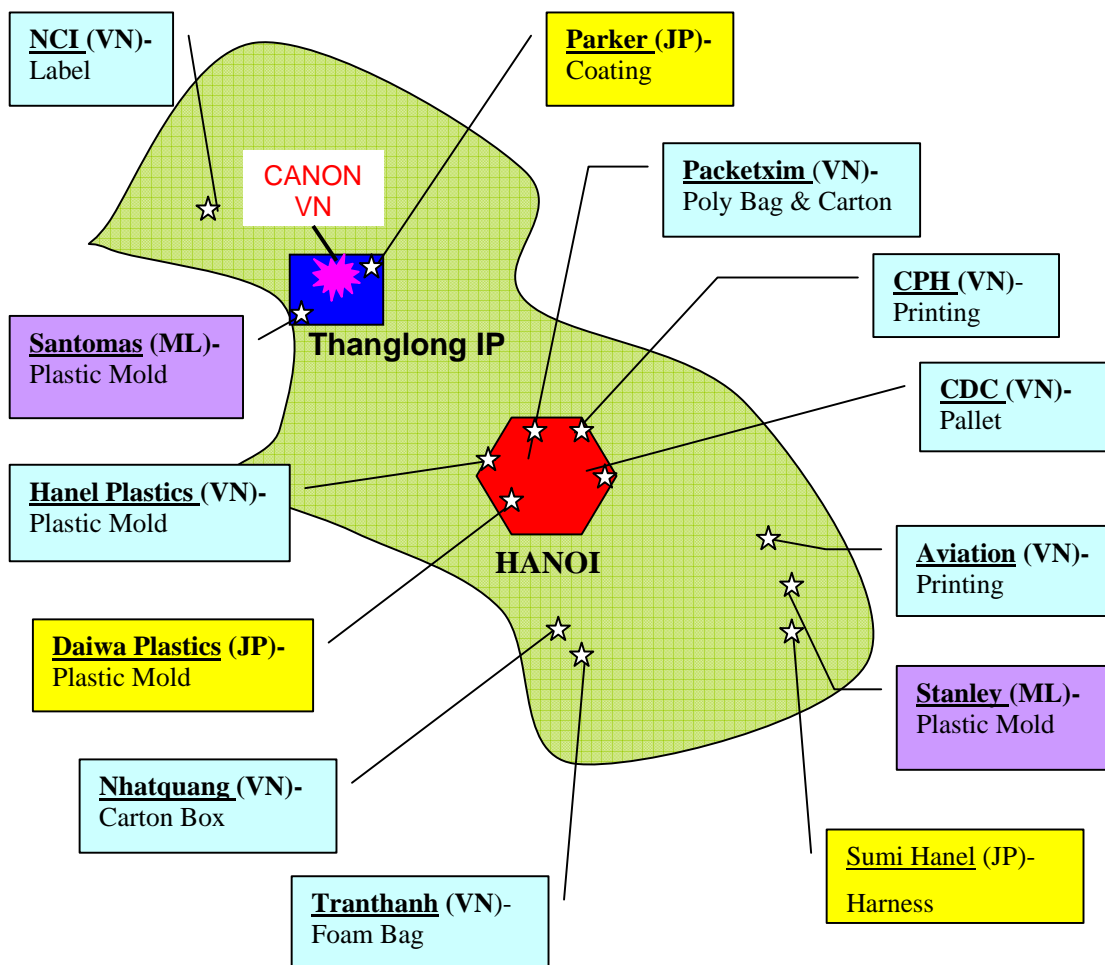
Table 4: Canon Vietnam’s World- wide Suppliers

Country	No. of Suppliers	No. of Items
Vietnam	15	43
Japan	4	83
China	20	129
Other	6	18
Total	45	234

Source: Canon Vietnam (August, 2004)

We can see the composition of the Canon's parts suppliers in Vietnam through the figure 2. Among 13 suppliers of Canon Vietnam around Hanoi, 3 are Japanese, 7 are Vietnamese, 2 are Malaysian. Although small in the number but the products of the 3 Japanese firms are coating and Harness, Plastic Mold, the products of the Malaysian are plastic mold but the products of Vietnamese firms almost all packaging materials, label or printing. The Japanese SMEs have contributed to the development of Canon Vietnam.

Figure 2: Hanoi Suppliers Map of Canon Vietnam



Source: Canon Vietnam (August 2004)

5. FDI by Japanese SMEs helps to promote the development of Vietnamese SMEs

a. The ownership characteristic of Japanese FDI:

The research by UNTAD shows that SMEs are more willing to make joint venture with local SMEs than 100% foreign own enterprise⁵. The situation of Japanese SMEs in Vietnam is opposite to that. 72% of all projects of Japanese SMEs in Vietnam are wholly Japanese

⁵ In UNCTAD, 1999, p. 183, 100% foreign capital projects account for 47% of all FDI projects of SMEs and for 53% of all FDI projects of LEs is.

owned, compared to lower rate of LEs is 55.4%. This share is high compared to other countries. That of Taiwanese SMEs in Vietnam is nearly 50% only⁶. That of Japanese SMEs in Thailand even lower, less than 7.4%⁷.

Table 5: Ownership type of FDI by Japanese SMEs (Number of Cases)

Investment Form	Japanese LEs	Japanese SMEs	Global SMEs
100% foreign capital	118 55.4 %	153 72.0 %	47%
70 – 100% foreign capital	39 18.4 %	37 12.3 %	---
Less than 70% foreign capital	56 25.4 %	23 10.7 %	---
Total	213 100 %	213 100 %	

Source: Author's calculation from combined database, data of global SMEs investors are extracted from UNCTAD (1993), p. 183

There are many reason make Japanese SMEs prefer the FDI form of wholly Japanese capital. In the early years of calling FDI, Vietnam was reluctant to projects of wholly foreign capital but after time to time, that discrimination has faded. Another reason is the weakness and problems of the existing joint- ventures. These problems include disagreement in the management board of Vietnamese Japanese side in choosing suppliers of inputs, the labors burden from Vietnamese partners...Another reason is Vietnamese mechanic industries are still very poorly developed and even are unavailable, so a joint venture with Vietnamese partner becomes difficult or impossible.

b. The Effects on development of Vietnamese SMEs:

The most direct effect of FDI on local SMEs is the effect on local partner of the joint ventures with local partners. However, the rate of Japanese SMEs that formed joint ventures with Vietnamese partners is quite low as discussed earlier. That suggests that this kind of effect in Vietnam is rather limited. We can look at Huunghi Kikuchi Company, a case of smooth cooperation of the joint venture. The local company, Huunghi Company has learnt much experience from the joint venture and it can expand its production capacity and increases its export a lot to the EU and US.

Beside that direct effect, the foreign firm affiliates can be the exemplary case for Vietnamese SMEs. The Vietnamese firms can learn the idea and the way of doing business of Japanese firm and create their own enterprises. That promotes the entrepreneurial spirit among Vietnamese people and promises to give birth to many new ventures. A positive aspect of this is imitation that violates the copyrights that worry foreign investors but on the other side,

⁶ Among Taiwanese SMEs in Vietnam, all firms have Taiwanese ownership of over 50%, half of them have 100% Taiwanese ownership. (Tain- Jy Chen, 1998, p.222). The sample projects were proved by local government in 1986- 1992

⁷ 7.4 % of the projects have 90- 100% Japanese ownership. Data are for the year before 1990. (Adachi, 1993, p. 197)

we can say the local firms are trying to make the products by themselves, making competition to foreign firms that may hold monopoly.

About the spinning- out effect, in Vietnam, there are some cases but still very few. The manager of Thien An company (Hochiminh city) was working for a Japanese company but he has quite the company to establish his own firm majoring in IT industry. It is pity that the similar cases are difficult to find. Staff in the Japanese firms seems satisfied with his job and do not want to leave and challenge themselves.

6. FDI by Japanese SMEs faces more problems than one by LEs:

a. The rate of dissolved projects:

As being discussed in the previous chapter, although SMEs overwhelms the majority of cases of Japanese FDI by their capital share is still small. The small scale of project sometimes prevents them from expand production capacity.

The rate of unsuccessful projects over all FDI projects of Japanese SMEs in Vietnam is higher than of the LEs. Among 67 dissolved projects of Japanese SMEs, 42 projects (62.7%) are of Japanese SMEs, 25 projects (37.3 %) are of Japanese LEs, while FDI by SMEs account for only about half of the total number of cases of all Japanese FDI.

Table 6: The Dissolved Projects of Japanese FDI (by the end of 2003)

	Number of Cases	Percent (%)
SMEs	42	62.7
LEs	25	37.3
Total	67	100.0

Source: Author's database

There are some reasons for the higher rate of dissolution of the FDI by Japanese SMEs. One may be the problem of the parent firms in Japan. As SMEs, the possibility of failure and bankruptcy of course is much higher than the old age LEs. The difficulties of the parent firms would make them withdraw their foreign activity and close foreign affiliates. Another reason is the fact that project in Vietnam is their first oversea affiliate, they do not have any experience in doing business in a foreign country, and therefore the possibility of failure would be higher than the experienced LEs.

One important reason is the capacity constraints, esp. human resource of the Japanese SMEs. In most of their affiliate in Vietnam, there is only a Japanese manager, that manager sometimes is technician or engineer and not so good at management, this may effect some on the performance of the firm. The example of a Japanese producer of furniture can illustrate the capacity limitation of the SMEs.

A company produces wooden furniture in a niche market. The company's products are American style products. After deciding to invest in Vietnam, the company has chosen location in an industrial park and has already paid the deposit for land rent. When deploying the plan to set up factory, it faces a serious obstacle. It could not find any of its staff that is willing to dispatch to work in Vietnam. Because the parent company in Japan is located in a quite remote area, its staff is not good in English

*and familiar with foreign situation. They are afraid of and refuse working in a foreign country; some of them even said that they would leave the company if they were forced to go to Vietnam. It is very pity and until August 2004, they could not find any solution*⁸.

The weakness of Vietnamese investment environment can cause the failure for the Japanese SMEs, as Vietnam's affiliate is the first foreign branch of some of them. Policy changing of Vietnamese government is one of the most serious difficulties for Japanese SMEs in Vietnam. For Japanese firms, they usually build a plan for the business year and closely follow that plan, even rigidly keep with that. The happened changes in the policy of the host government make Japanese very difficult because they lack flexibility⁹.

b. Other problems:

For Japanese firms, their way of using labor is to build the loyalty and pay labors enough for them to regenerate their energy. The policy of some Taiwanese and Korean SMEs is rather different, they try to explore the labors as much as they can. Labor conflicts rarely happen in Japanese SMEs affiliates. Generally, the relation between managers and employees in Japanese SMEs affiliates is cooperative and friendly. There is almost no strike or suit against the Japanese managers. There are some cases of troublesome labor issue but not of the Japanese SMEs but ironically the Japanese LEs.

V. Conclusion:

The research has explored the role of Japanese SMEs in Vietnam by testing the observations by previous researches. *First*, compare to FDI by Japanese LEs, FDI by Japanese SMEs is relatively more labor- intensive. *Second*, FDI by SMEs relatively generates more export. *Third*, it has transferred the small- size, labor- intensive technology that is more suitable to Vietnam. *Fourth*, Japanese SMEs have contributed to form supporting industries that facilitate the production of LEs assemblers but this effect is still small. *Fifth*, with the fact that Japanese SMEs investors established few joint- ventures and the weak capacity of Vietnamese SMEs, the spill- over effects such as demonstration and spinning- out on Vietnamese SMEs is still modest due to. *Sixth*, the FDI by Japanese SMEs has a higher rate of failed projects compare to LEs. It is due to capacity constraints of Japanese SMEs and some problems of Vietnam's investment environment. Compared to other Asian countries, FDI by Japanese SMEs in Vietnam is better in complying the laws, well treating the labor and having strong machinery manufacturing.

In short, we can say that FDI by Japanese SMEs can positively contribute to economic development of Vietnam in various ways. Thus it is necessary to build policies to attract this source of FDI. Furthermore, to maximize the benefits of FDI by Japanese SMEs, the FDI policies must come together with the policies to ease the barriers in establishing a new enterprise and strengthen capacity of Vietnamese SMEs.

⁸ According to the information given by Mr. Yamakawa, JASMEC adviser in Hochiminh city, in the interview on 9th August 2004

⁹ Machida Takeshi, former bureau chief of Nikkei Newspaper in Hanoi, 30 October 2004.

Reference:

Adachi, Fumihiko, 1993, "Small and medium- sized firms in Japan's Foreign direct investment", in Tran Van Tho (ed.), *Japan's Foreign Direct Investment in Thailand: Patterns and Issues*, Japan Center for Economic Research (CER)

Buckley, Peter J. et al, 1997 (eds.) *International Technology Transfer by Small and Medium-sized Enterprises*, Mc Milan

Chen, Tain- Jy (ed.), 1998, *Taiwanese Firms in Southeast Asia, Networking Across Borders*, Edward Elgar

Fujita, Mai, 2000, *Foreign Direct Investment, Trade and Vietnam's Interdependence in the APEC Region*, Institute of Developing Economies

Fukushima, Hiroshi, 1997, "Economic Effects and Problems of Foreign Direct Investment, Focusing on Japanese Small and Medium Enterprises" in *Saga Daigaku Keizai Ronshu 30 (3/4): 145- 166*

Japan External Trade Organization (JETRO), 1997, *Directory of Japanese- affiliated Companies in ASIA: 1998- 1999*

National Economics University (NEU) and Japan International Cooperation Agency (JICA), *Vietnam's Industrialization Strategy in the Age of Globalization*

Small and Medium -sized Enterprises Agency of Japan (SMA), *White Paper on Small and Medium- sized Enterprises*, various issues

Small and Medium Size Enterprises (SME) Net (of Vietnam), 2004, <http://www.smenet.com.vn>

Toyo Kezai, 2003, *Japanese Overseas Investment 2003* (Kaigai Shinshutsu Kigyo Soran)

Tran Binh Nam and Pham Do Chi (eds), 2003, *The Vietnamese economy: awakening the dormant dragon*, Routledge Curzon

Tran Van Tho, 2005, *Foreign Direct Investment and Economic Development: the case of Vietnam (forthcoming)*

UNCTAD, 1993, *Small and Medium Sized Transnational Corporations, Role, Impacts and Policy Implications*

UNCTAD, 1998, *Handbook on Foreign Direct Investment by Small and Medium- Sized Enterprises, Lessons from Asia*

Urata, Shujiro, 1996, *Japanese Foreign Direct Investment and Technology Transfer in Asia*,
Institute of Developing Economies