

**BUILDING
SUPPORTING
INDUSTRIES
IN VIETNAM**

Vol.1

**Edited by
Kenichi Ohno**

VIETNAM DEVELOPMENT FORUM

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Contact:

Vietnam Development Forum

Suite 401, Hanoi Central Office Building

44B Ly Thuong Kiet St., Hanoi, Vietnam

Phone: 84-4-936 2633 / Fax: 84-4-936 2634

Email: hellovdf@vdf.org.vn

Website: <http://www.vdf.org.vn>

Vietnam Development Forum Tokyo

National Graduate Institute for Policy Studies (GRIPS)

7-22-1 Roppongi, Minato-ku, Tokyo 106-8677, Japan

Phone: 81-3-6439 6000 / Fax: 81-3-6439 6010

Email: vngrripsnet@grips.ac.jp

Website: <http://www.grips.ac.jp/vietnam/VDFTokyo/index.html>

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Introduction and Summary

Vietnam is one of the best performing developing countries in the world. Economic growth has been recorded at about 8 percent during the past decade, during which the industrial sector has played an increasing role in both value and employment creation. Swift changes in economic structure have attracted an increasing flow of foreign investments, particularly in the manufacturing sector, which in turn has helped Vietnam to promote higher economic growth. Moreover, under globalization with fiercer competition, both foreign and local enterprises in Vietnam need to improve their international competitiveness through good business connections. Given this need, supporting industries are becoming extremely important to the business strategies of the foreign manufacturing enterprises, especially assemblers, in Vietnam. The demand of the foreign enterprises in Vietnam for good local suppliers has necessitated more comprehensive industrial policies in developing these industries.

However, supporting industries in Vietnam have not been fully developed; they are just at the early stages of development. This limits business opportunities for the foreign-invested enterprises, specifically assemblers, because it is costly and time-consuming for them to find good local suppliers. In this context, conducting studies and proposing policy actions for the development of the supporting industries in Vietnam is an urgent task. This book is published for these purposes. It contains four papers, each addressing a different topic on the current situation of Vietnam's supporting industries and international experiences in developing these industries. These papers were presented and commented on in a number of workshops and conferences held inside and outside Vietnam. It is the hope of the editor that the contents of this book will extend beyond those directly involved in the related field of research, and that the book will provide crucial information about the current situation and policy directions for the development of Vietnam's supporting industries. The following are summaries of the papers in this book.

The first paper, written by the Vietnam Development Forum (VDF) research team, provides an overview on the supporting industries in Vietnam from the perspective of Japanese manufacturing firms, and then proposes a set

of policy directions to develop these industries. The analyses are based mainly on a series of hearings between the Ministry of Industry, Vietnam (MOI) and Japanese manufacturing firms operating in Vietnam, which were held by VDF from late February to early April 2006. There are 38 firms in the sample, including 15 electrical and electronic firms, 14 motorbike firms, and 9 automobile firms. The existing situation of local procurement shows that the supporting industries in Vietnam are relatively underdeveloped in comparison with other countries in the region, such as Malaysia and Thailand. Although progress in the local procurement ratio has been recorded, it differs significantly across the studied sectors.

Before making detailed analyses on enhancing the growth of supporting industries in Vietnam, the paper argues that competitiveness and demand size are two determinants for the development of these industries. Regarding competitiveness, the paper indicates that under the standards of Japanese manufacturing, *quality*, *cost*, and *delivery* (QCD) are extremely important. The parts cost in the studied sectors usually occupies 70–90 percent compared with labor cost of less than 10 percent, so the Japanese manufacturing firms need to reduce the cost related to parts procurement, which in turn helps them to attain cost competitiveness. To achieve this, most parts must be made in Vietnam because importing parts from other countries will incur additional costs in transportation, storage, and handling. In addition, Japanese assemblers in Vietnam want parts suppliers to be located close by to enable high-frequency, on-time delivery of parts in order to minimize inventory and production lead time. To this end, Vietnamese parts suppliers first need to improve *quality* and *delivery* of parts. About the demand size, the paper argues that large demand size is crucial for supporting industries because they require relatively large minimum orders to enter the market, and they are generally more capital-intensive than the final assembly. More importantly, some supporting industries, such as molding and metal pressing, require expensive machines, which are indivisible, and therefore they can reduce the unit capital cost by increasing the volume of production. Such increase needs to be guaranteed by a large demand.

Once the two factors mentioned above are attained, four additional areas must be promoted to accelerate the growth of supporting industries in Vietnam: high-quality industrial human resources, attractive tax and tariff poli-

cies, stable policy environment, and overcoming the information and perception gaps between foreign direct investment (FDI) assemblers and Vietnamese suppliers. For instance, the majority view among Japanese firms is that high-quality industrial human resources are much more important than high-tech machines because second-hand machines operated by high-skilled workers may be superior to brand-new machines operated by low-skilled workers. To improve the human resources for industrial development, the paper proposes a number of policy directions to enhance the existing training programs and promote new programs with both public and private efforts.

Along with these issues, the paper discusses other two issues, which are also crucial for the development of supporting industries in Vietnam: industrial and safety standards, and unavailability of raw materials. Dealing with these issues is important for meeting international standards and ensuring efficient operation.

In order to make a concrete development strategy for the supporting industries in Vietnam, Nguyen Thi Xuan Thuy, in the second paper in the book, argues that the term “supporting industries” needs to be defined properly to suit the socio-economic conditions of the country and the targets of industrial strategy. Therefore, her paper mainly focuses on reviewing different concepts of “supporting industries” and their development, and then proposes a definition for Vietnam.

According to the author, although the term “supporting industries” is widely used in many countries, it is still ambiguous and without consensus in definition. This term is used differently in different countries, depending on the economic conditions and policy purposes. For instance, Thailand defines supporting industries as the enterprises that produce parts and components that are used in the final assembly processes of the automobile, machinery and electronic manufacturing industries, while the US Department of Energy defines supporting industries as those that supply materials and processes necessary to form and fabricate products before they are marketed to end-use industries. Moreover, the term has also been changed to adapt to changes in economic conditions and policy directions of the country. For example, in the *White Paper on Economic Cooperation 1985* by Japan’s Ministry of International Trade and Industry (MITI, now called the Ministry of Economy, Trade, and Industry—

METI), the term “supporting industries” was used to refer to small and medium enterprises (SMEs) that contribute to strengthening industrial structure in Asian countries for medium and long terms, or the SMEs that produce parts and components. However, in the New Asian Industrial Development Plan to promote industrial cooperation between Japan and four countries in the Association of Southeast Asian Nations (ASEAN 4: Indonesia, Malaysia, the Philippines, and Thailand), MITI defined “supporting industries” as industries that supply the necessary things such as raw materials, parts and capital goods for assembly-type industries.

In addition to these concepts, the paper also provides a number of related concepts in order to see the different development stages of supporting industries. Subcontracting, ancillary industries, parts and components industries, and vendors are some of these concepts.

Going further with the case of Vietnam, where the term “supporting industries” has been used only since 2003, the paper suggests that without a clear definition of supporting industries, it is more difficult for Vietnam to have concrete industrial policies and strategies, and to mobilize all necessary resources for the development of supporting industries. Based on the current development context, the author then proposes a definition of these industries in Vietnam. Furthermore, reviewing international experiences in developing supporting industries with such important policies as local content regulations, promotion of FDI into supporting industries, linkage promotion, and participation in the global production networks, the paper indicates some lessons that Vietnam can learn to foster these industries.

Using a broad definition of “supporting industries,” which refers to a group of industries that supply the diverse parts and materials used in the production of industrial products, the third paper of the book, by Toshiyuki Baba, aims at describing quantitatively the procurement structure of supporting industries for key manufacturing categories in Asia. The paper uses the Asian International Input-Output Tables to reveal the industrial structures that are composed of the industries in each country in the region. Three tables corresponding to 1975, 1990, and 1995 are used to analyze the industrial relations between ASEAN 4, the Republic of Korea, and Japan with particular focus on automotive/motorcycle and electrical/electronic industries.

Providing formulas for estimating domestic direct procurement rate (DDPR) and domestic indirect procurement rate (DIPR), the author shows that indirect linkage effects are greater than direct linkage effects in these studied sectors in Japan, while ASEAN 4 and the Republic of Korea have lower domestic linkage effects in comparison with Japan. According to the author, this finding can be elucidated by a possibility that lower domestic linkage effects are due to low levels of domestic procurement.

Regarding automotive/motorcycle industries, the paper shows that in ASEAN 4 both direct and indirect procurement rates from their own countries were stagnantly low during 1975–1990, while they developed during 1990–1995, and dependency on Japan was greater than that on domestic sources. This can be explained by the fact that these countries experienced major economic expansion in the latter period. The situation for the Republic of Korea was contrasted with that of ASEAN 4, in which both direct and indirect procurement rates from domestic sources increased over time, while those from a major external source (Japan) declined steadily. For Japan, there was almost no change during this 20-year period because both direct and indirect procurements were approximately 100 percent from domestic sources.

The same analysis is also used for the electrical and electronic industries. The findings imply that the foreign dependency was significant in ASEAN 4 in the studied period. Meanwhile, domestic direct and indirect procurements in the Republic of Korea expanded in the 1975–1990 period and declined during the 1990s. This situation went along with an increase in foreign procurements. For Japan, domestic sources were still significantly important, and foreign sources, particularly the US, increased steadily.

To provide a more thorough analysis on these changes of domestic-based and foreign-based procurements in the studied countries, the paper shows some possible causes, including differences in the characteristics of parts, in the quality required by the market, and in policies of each government. These differences are useful information for the policy makers in proposing their industrial development policies.

It is emphasized in the first three papers of this book that local procurement of parts and components benefits both FDI assemblers and local parts suppliers because FDI assemblers are able to reduce additional costs, such as

transportation and inventory, associated with imports, while local suppliers can increase business volume and absorb updated technology through business relations with FDI assemblers. Therefore, it is commonly agreed that promoting local procurement is a key to FDI-led industrial growth in developing countries. Yet, most FDI assemblers in Vietnam do not have sufficient information on where good Vietnamese parts suppliers are located in order to attain cost competitiveness through fruitful business connections with these local suppliers. To investigate this research question, Junichi Mori presents an analysis of designing and managing databases for supporting industries in the last paper of the book.

The author explains the importance of such databases in Vietnam. According to various sources of information such as Japan External Trade Organization (JETRO) (2004) and VDF (2006), FDI assemblers in Vietnam face serious difficulties in promoting parts localization because local parts procurement in all manufacturing sectors in Vietnam was much lower than in other ASEAN countries. More seriously, it is also costly and time-consuming for FDI assemblers in Vietnam to find appropriate and good parts suppliers in Vietnam. Creating databases of supporting industries is therefore urgently necessary.

To go further with designing databases for supporting industries in Vietnam, the paper describes desirable characteristics of such databases. It is shown that the current yellow-page-type business directories in Vietnam cannot provide sufficient information for FDI assemblers to find their appropriate local partners. It is also emphasized that the main difference between databases for supporting industries and business directories is the depth of firm-level data. To obtain the required information, the paper then illustrates the mutual relation between criteria of supplier selection and the required items in databases for supporting industries.

For creating appropriate databases that can meet the demand of FDI assemblers, the author provides useful information about databases of supporting industries in Japan. Among many others, Okaya City database and Monozukuri-net are excellent examples. To create such databases, various related issues need to be considered thoroughly. For instance, motivating SMEs to participate in the databases requires such important activities as good public-private partnerships, intensive company visits, and business matching services.

We hope that this book will help the readers understand more thoroughly the current status of the supporting industries in Vietnam. If VDF can contribute its mite to promote development of Vietnam's supporting industries, we will be more than happy.

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