



Enhancing Enterprise Competitiveness and SME Linkages in Vietnam

AmCham Supplier Day 2018

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Outline of Presentation

- Context – Opportunities & Challenges
- Scope and Framework of the SME Linkages Report
- Focus of Analysis
- Key Findings
 - Firm-Level Analysis What does the data say?
 - Key Market Failures in Linkages Programs
- Examples of success with linkages in Vietnam
- International experience on what works and what does not
- What is WBG Doing on Enhancing Enterprise Competitiveness and SME Linkages

FRAGMENTATION OF PRODUCTION INTO GLOBAL VALUE CHAINS HAS CREATED OPPORTUNITIES AND CHALLENGES FOR VIETNAM



Opportunities

Risk of low value added trap

- Large scale foreign investment and export-led manufacturing driven **employment** growth for predominantly assembly jobs

Weak backward linkages

- Short run opportunities for local **supplier development program**
- Medium run opportunities to **upgrade** in the value chain by drawing on the vast resources available in the global supply-base

Low management capabilities

Challenges

Weak backward linkages

- **Space for local firms has narrowed** in manufacturing sectors because major lead firms (Samsung, Ford, Toyota) in GVCs generally use the same set of “global suppliers” everywhere

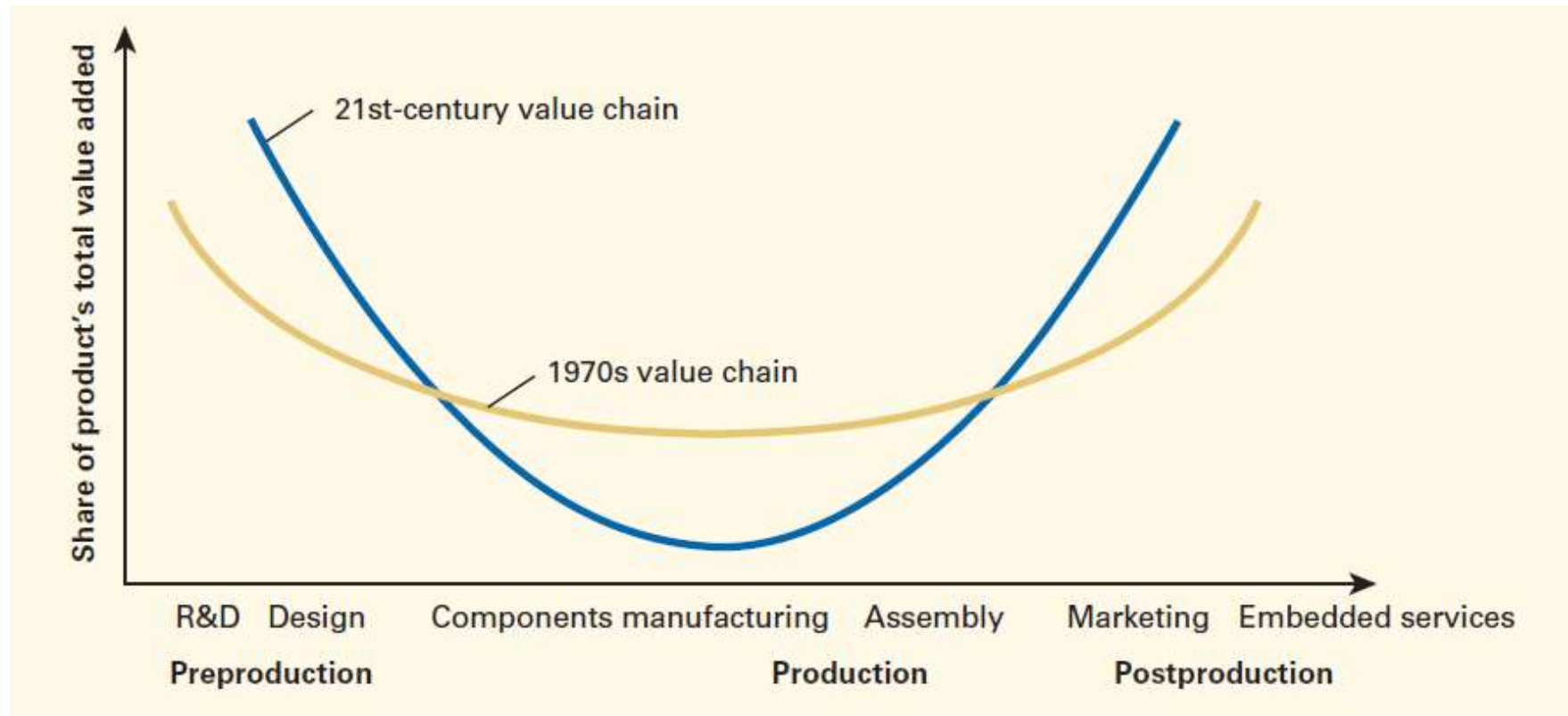
Risk of low value added trap

- High value functions (innovation, design, post-production services) stay **outside of Vietnam**
- Vietnam becomes stuck in a “**low value added trap**”, failing to develop high value functions or innovation capabilities
- Longer run risks as **lower cost competitors** draw foreign investment away from Vietnam

Emerging Opportunities : Services



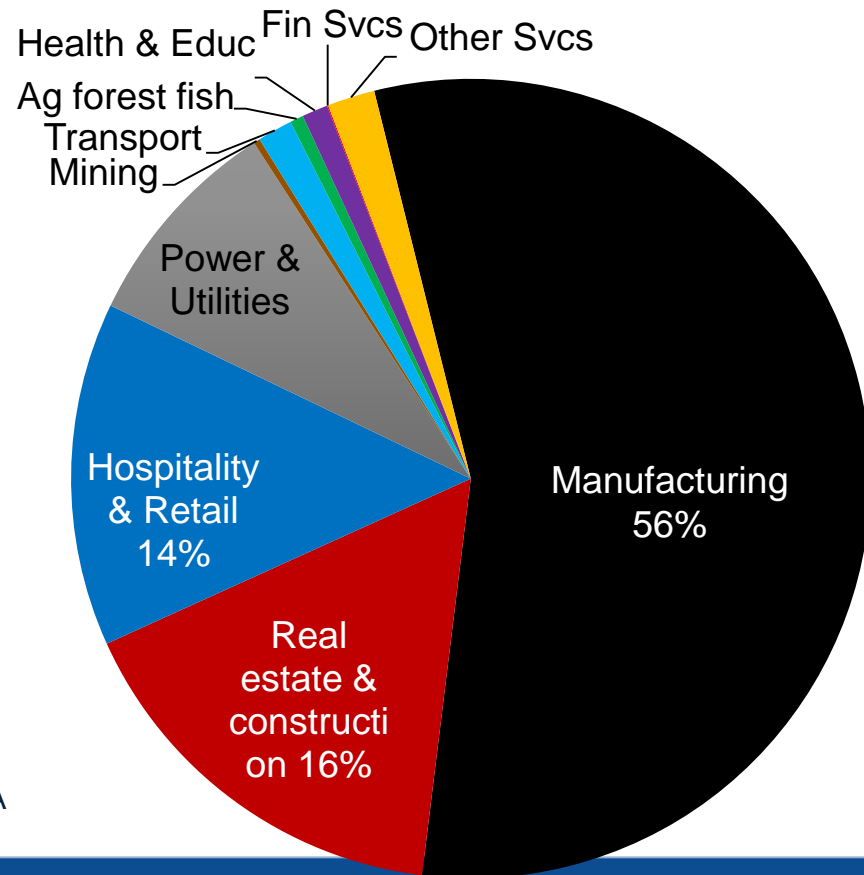
Services increasingly matter for manufacturing competitiveness and account for much of the **value added** in a product





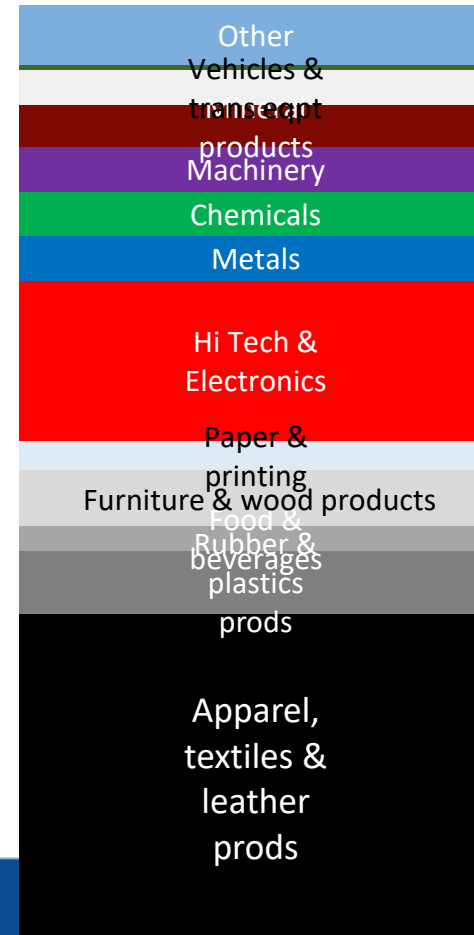
In which FDI Sectors are the Opportunities for Domestic Suppliers?

Vietnam FDI Inflows by sector
Total registered value, 2010-2016



Source: FIA

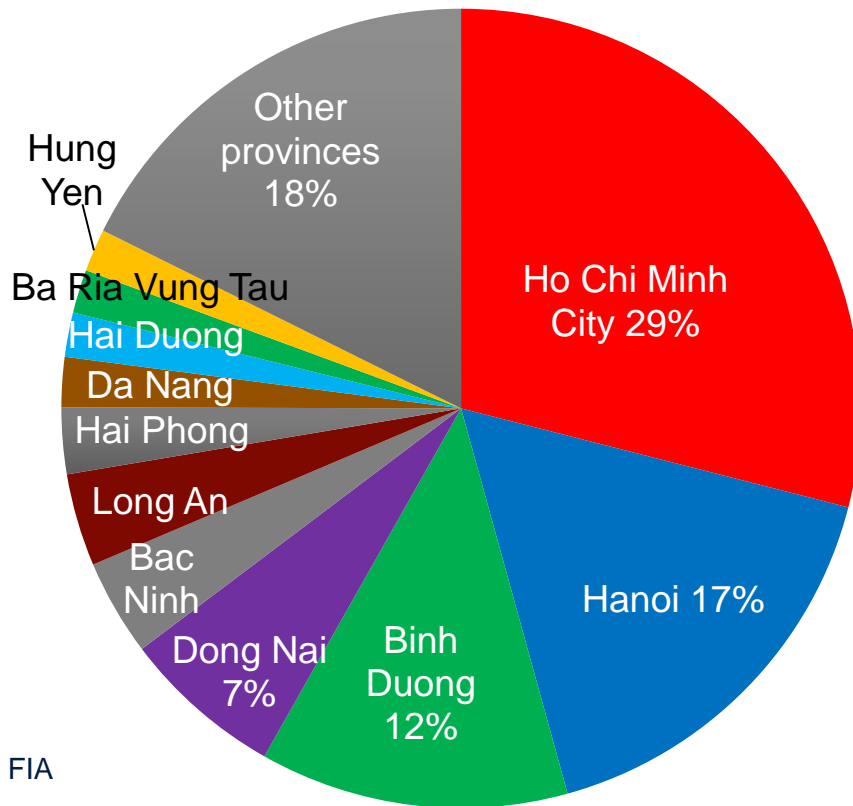
Manufacturing FDI by subsector
Total registered value, 2010-2016



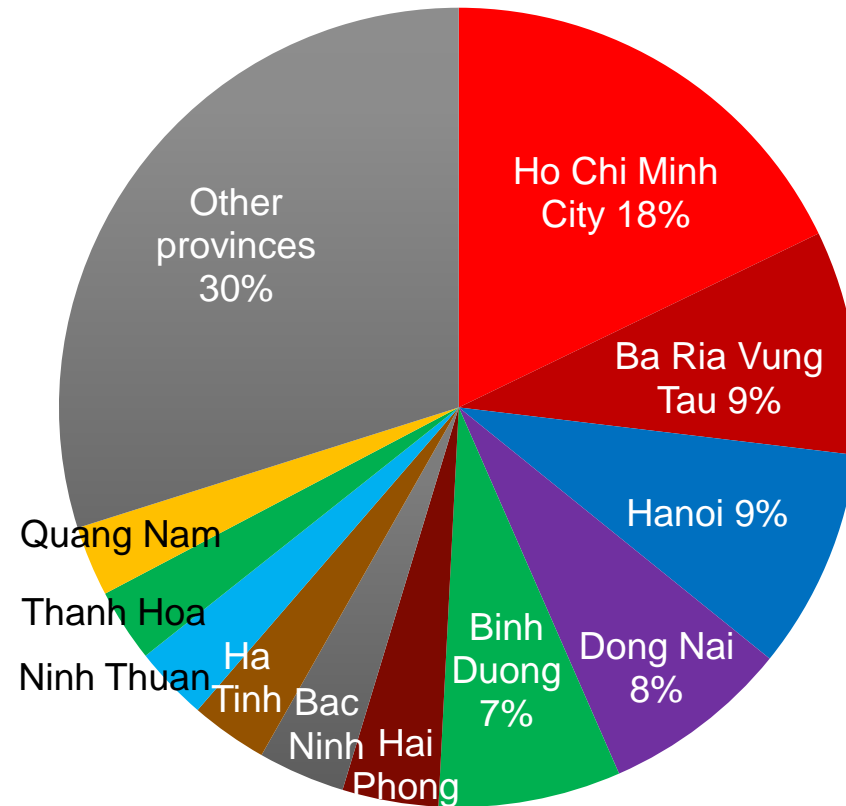


Where in Vietnam are the Opportunities for Suppliers?

Total FDI projects by province 1988-2016



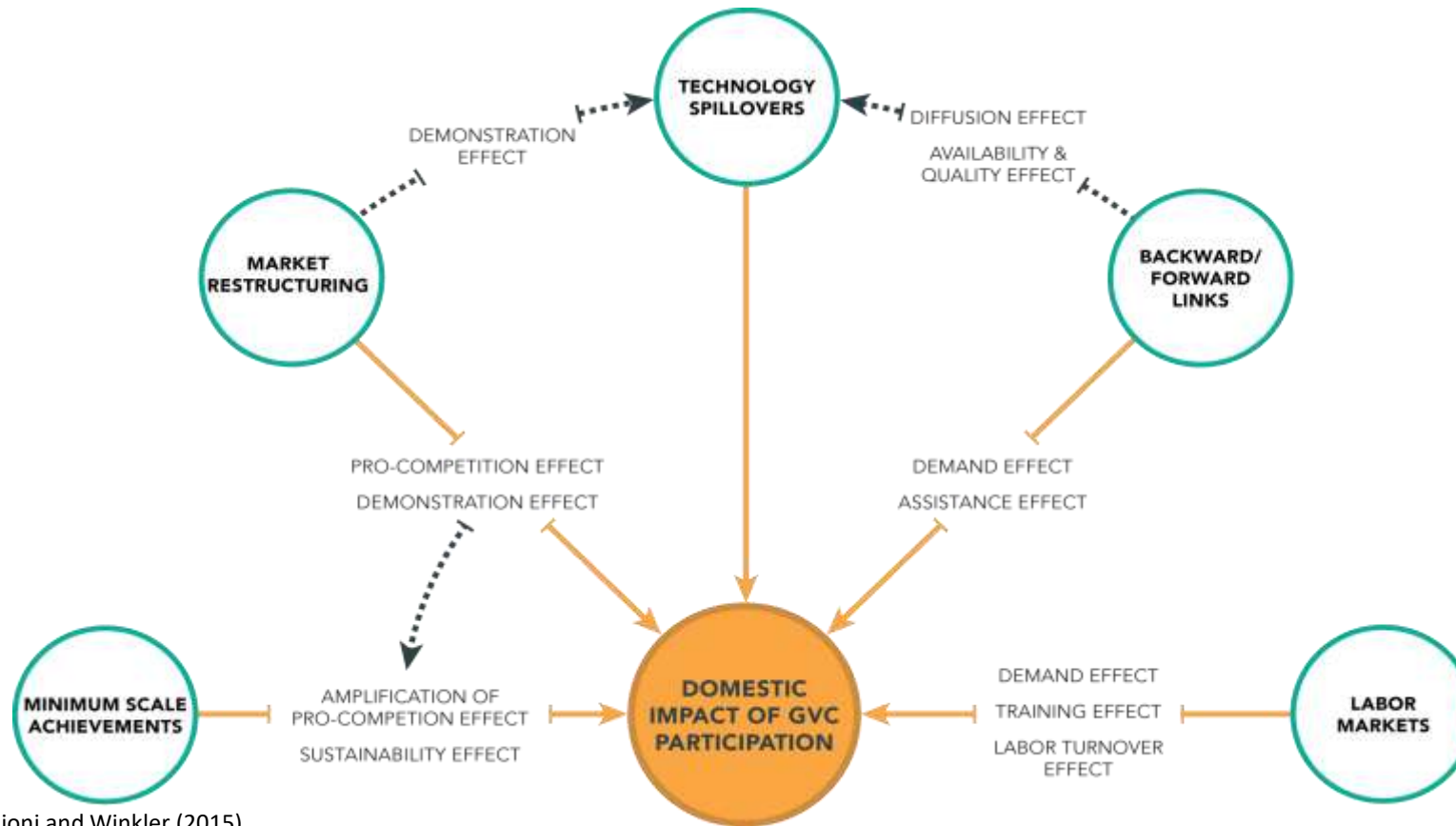
Total FDI registered capital by province 1988-2016



Source: FIA

Domestic policies influence the impact of GVC participation and economic upgrading in countries

National characteristics and absorptive capacity matter for the functioning of transmission channels of GVC participation to the domestic economy

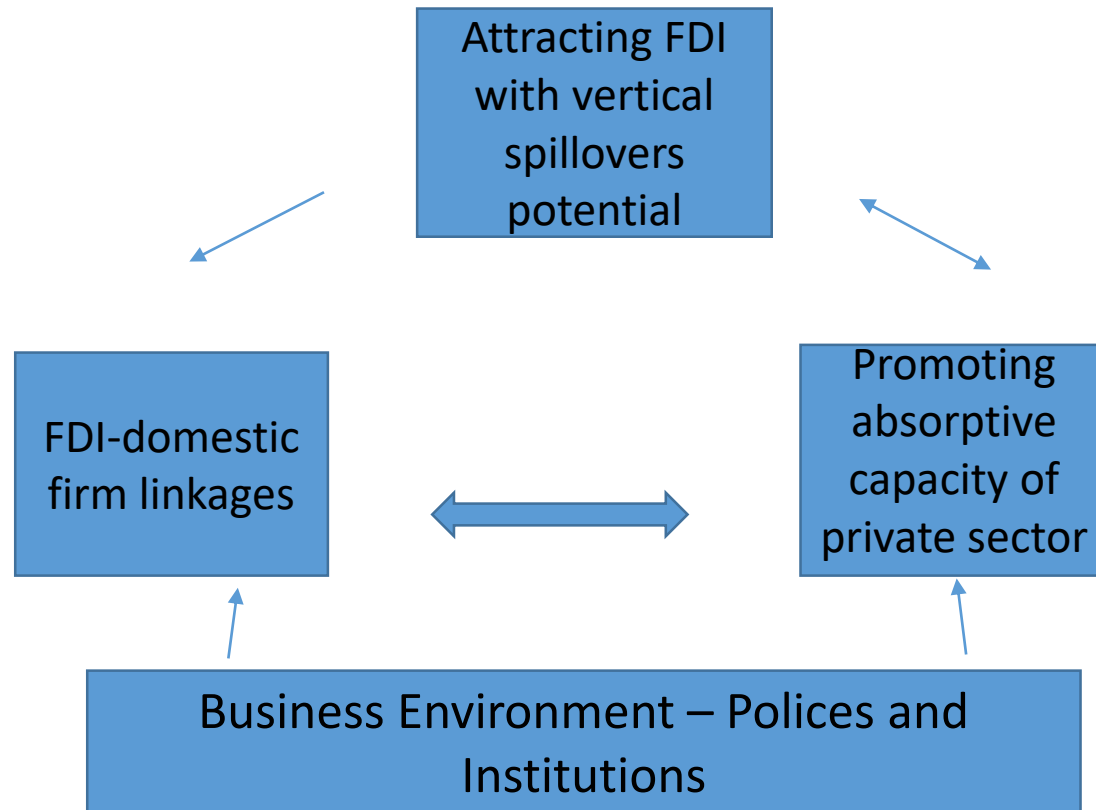


Source: WB, Taglioni and Winkler (2015)

SCOPE & FRAMEWORK OF ANALYSIS



FDI Spillover Potential, Domestic Private Sector Capabilities and Business Environment



3 areas of analysis:

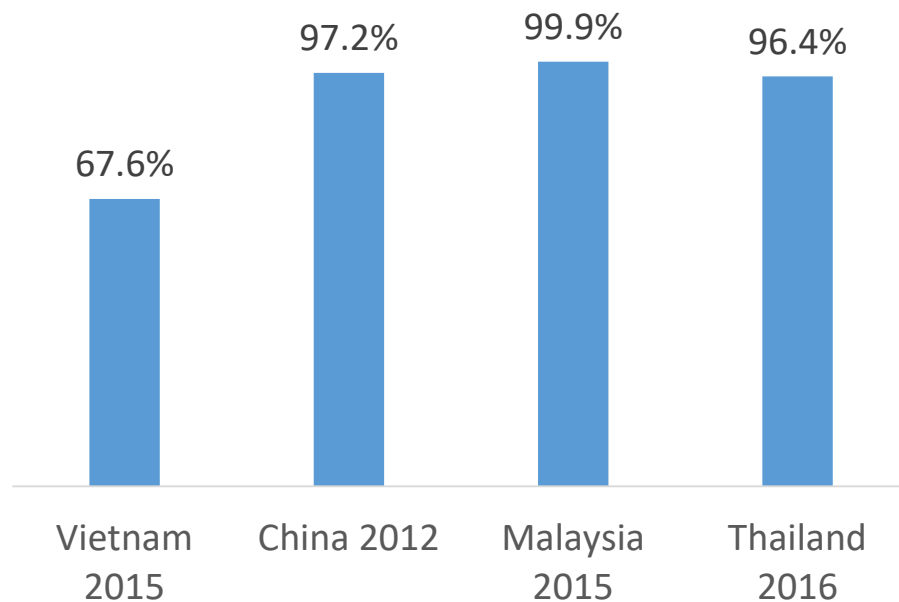
- Enterprise productivity and investment climate analysis
- Factors influencing FDI-SME Linkages
- Review of SME & Linkage programs



I. KEY FINDINGS: FIRM-LEVEL ANALYSIS (1)

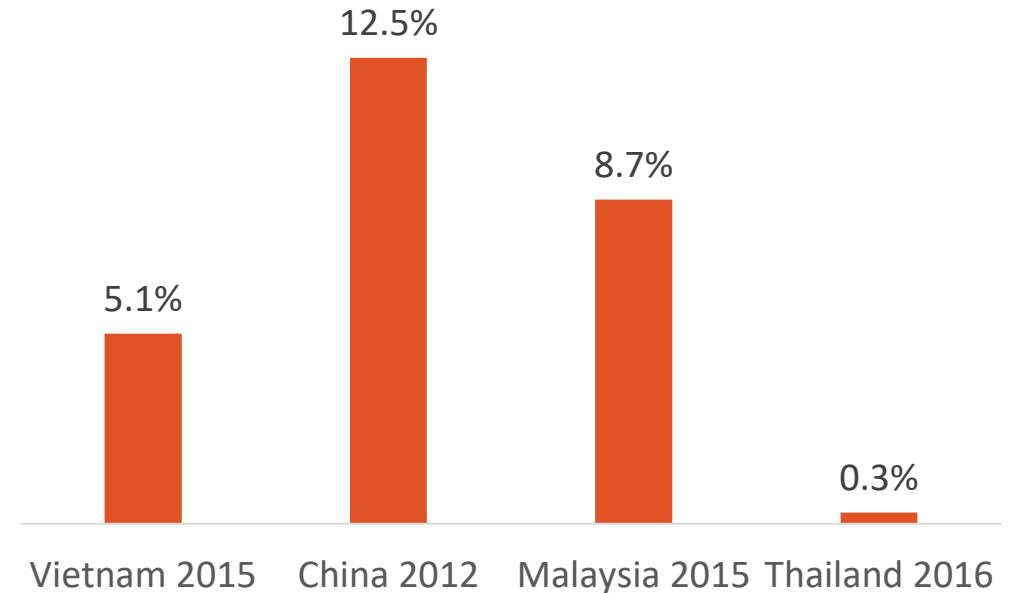
Demand-side: MNEs

Proportion of foreign-owned firms using domestic inputs is quite low in Vietnam.



Supply-side: domestic suppliers

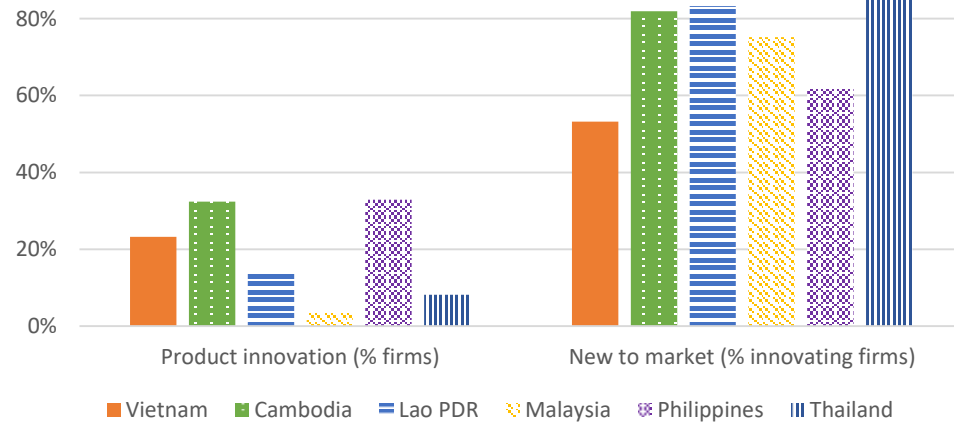
'Linked' domestic firms (exporting indirectly at least of 1 percent of their output) are smaller in Vietnam than peer countries (e.g., China and Malaysia).



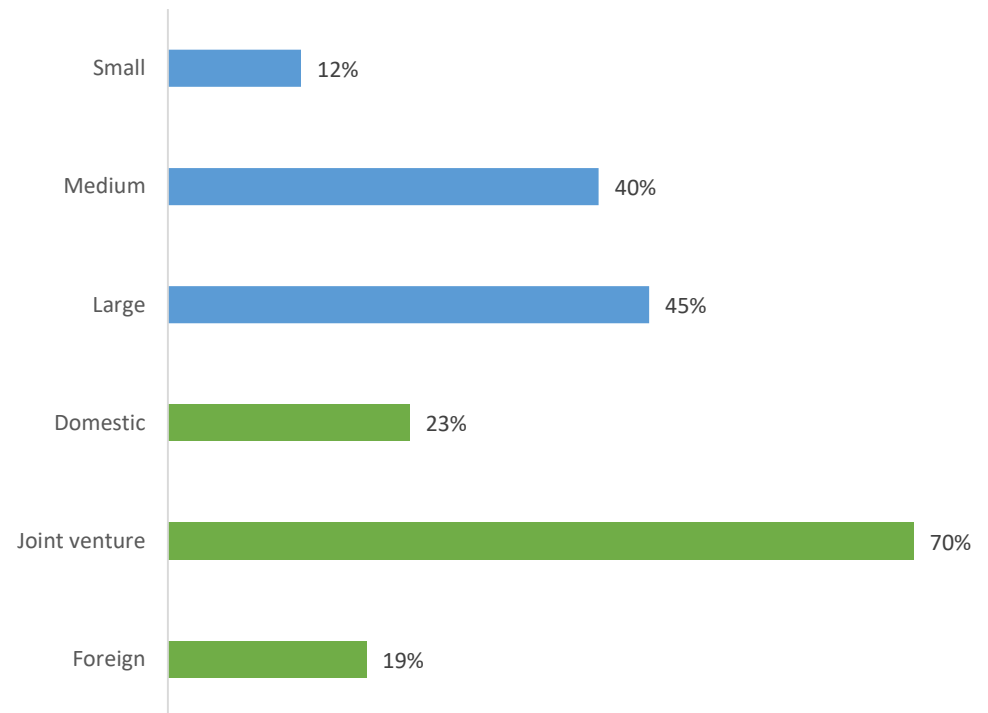
Source: World Bank, Enhancing Enterprise Competitiveness and SME Linkages Report

I. KEY FINDINGS: FIRM-LEVEL ANALYSIS (2)

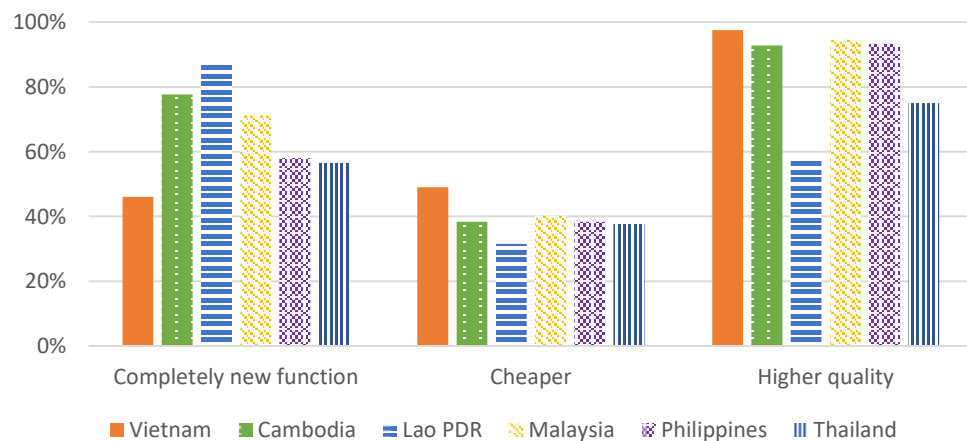
Product Innovation



Product innovation rate by firm size and ownership type



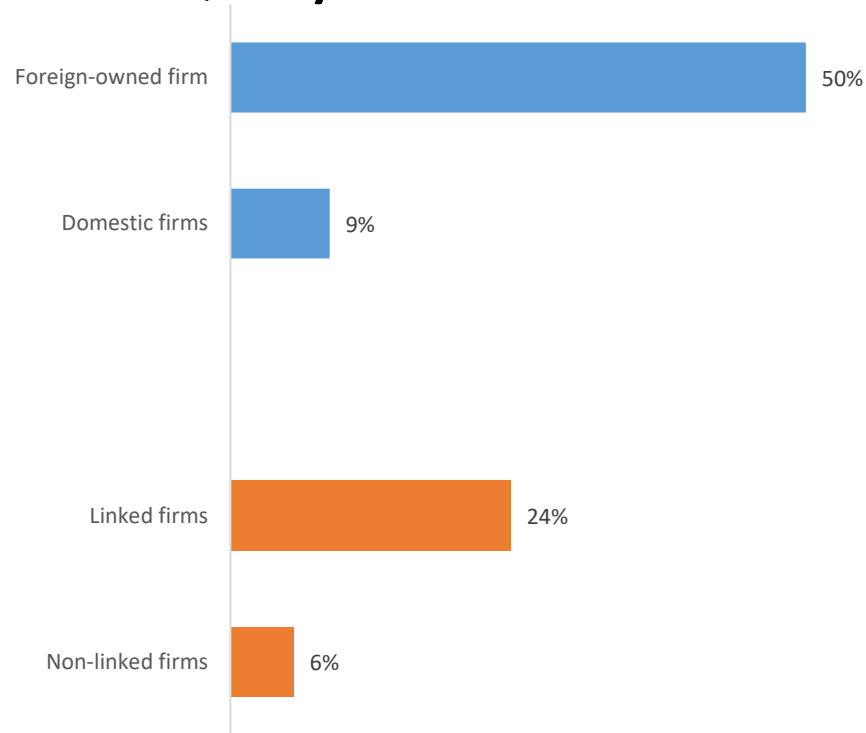
Characteristics of new products



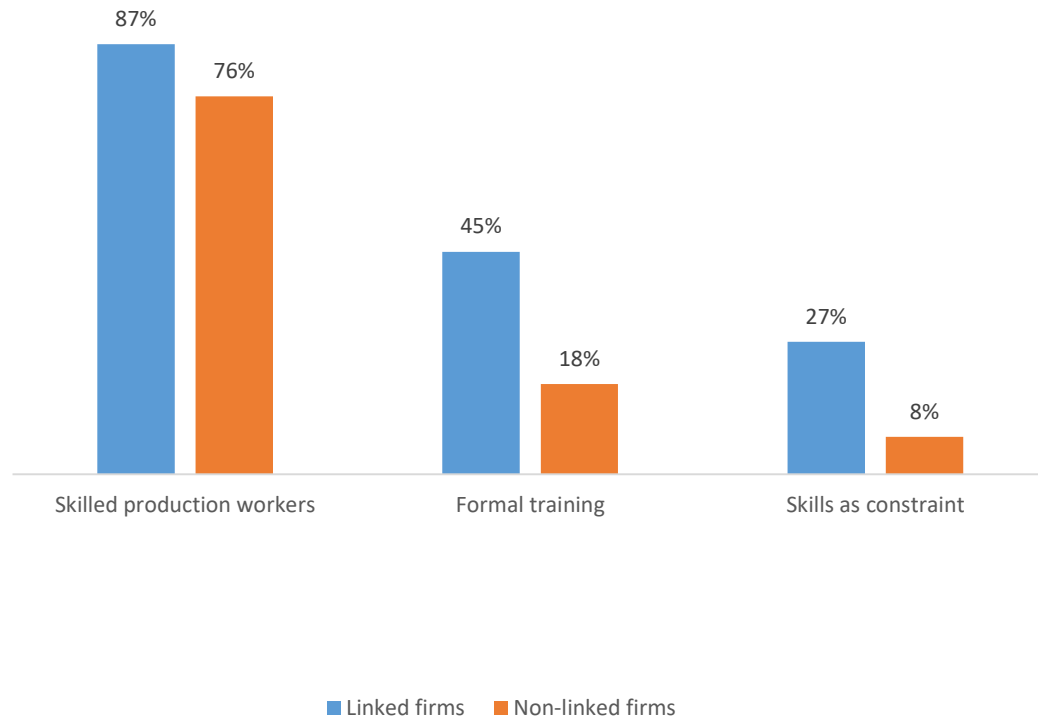
Source: World Bank, Enhancing Enterprise Competitiveness and SME Linkages Report

I. KEY FINDINGS: FIRM-LEVEL ANALYSIS (3)

Use of Quality Certification



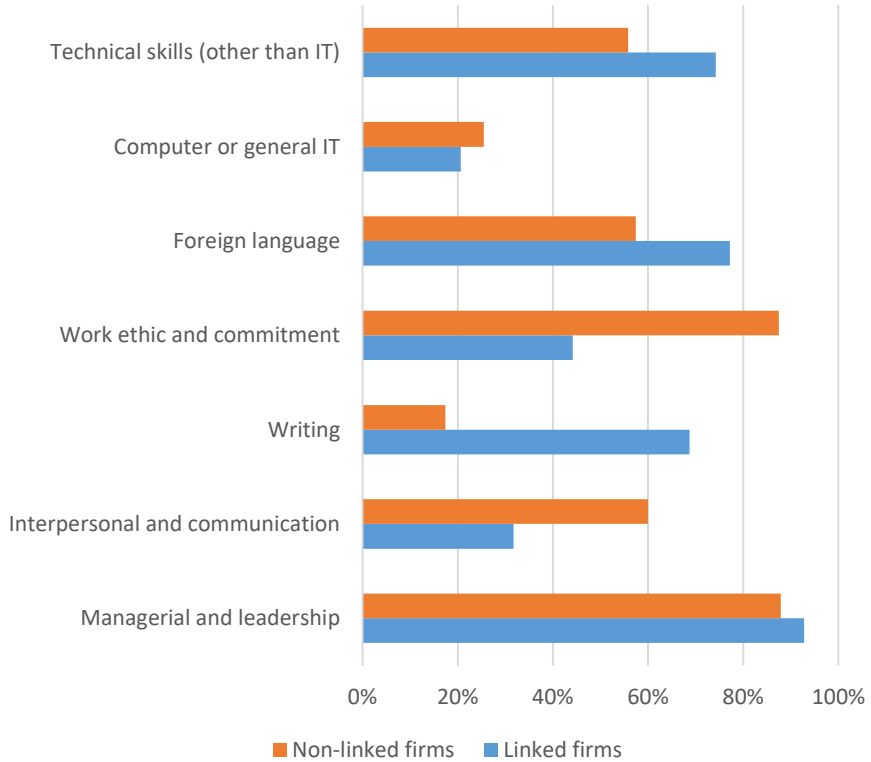
Skills



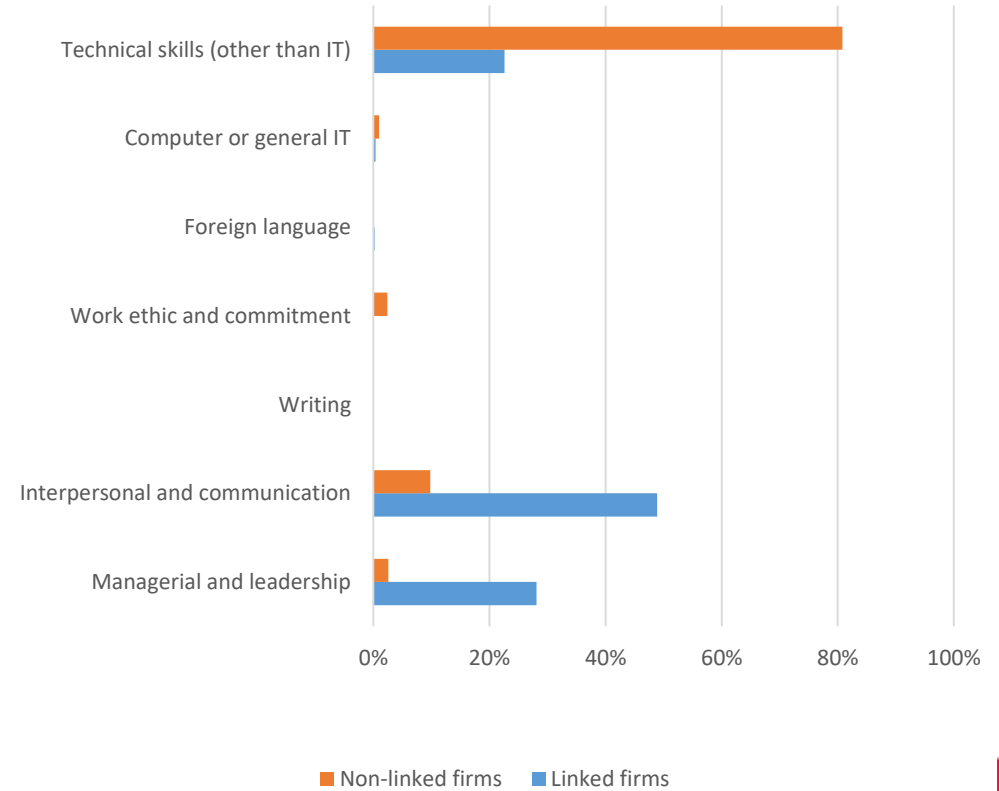
Source: World Bank, Enhancing Enterprise Competitiveness and SME Linkages Report

I. KEY FINDINGS: FIRM-LEVEL ANALYSIS (4)

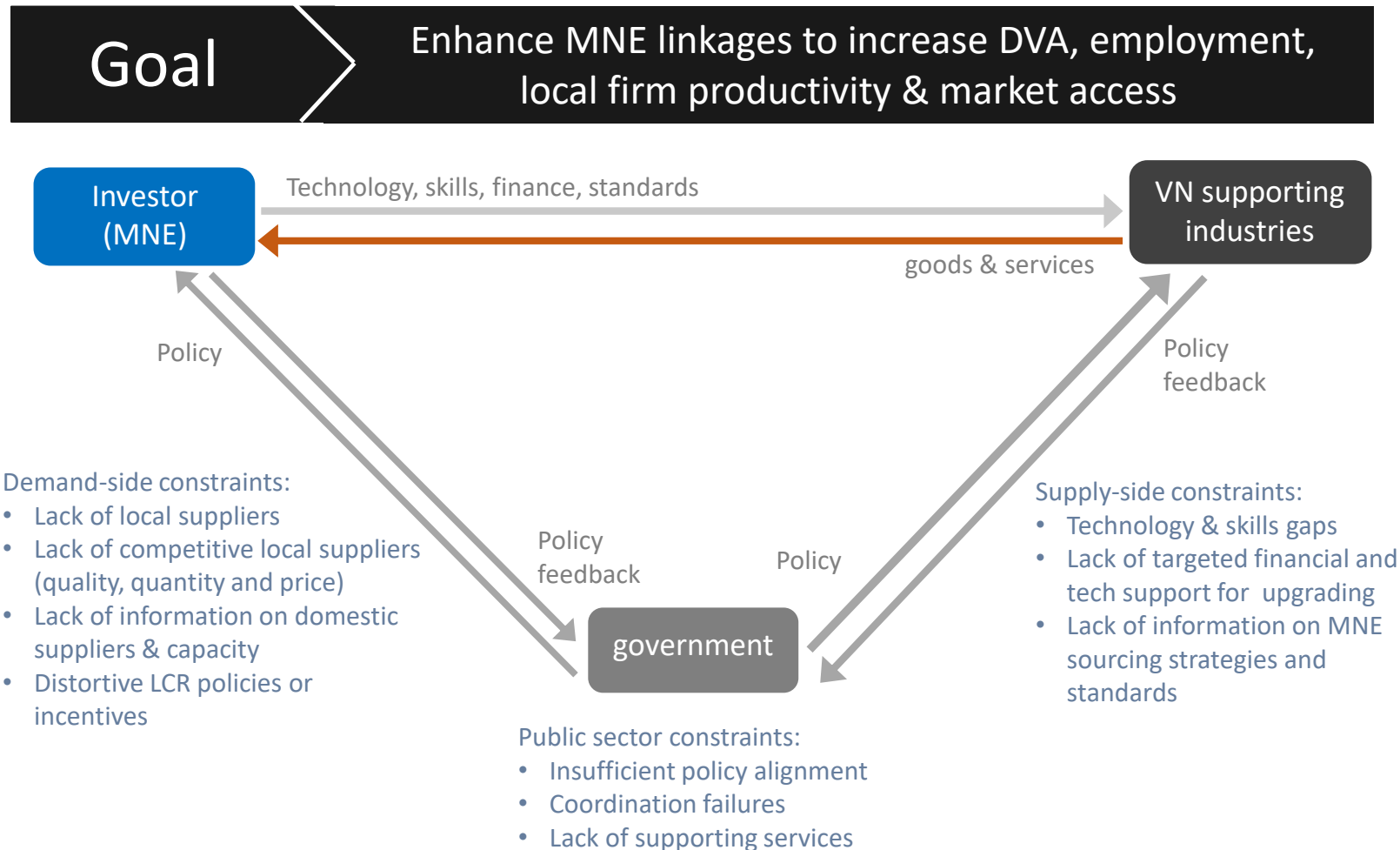
Proportion of firms finding it difficult to find different types of skills



Primary focus of formal training programs



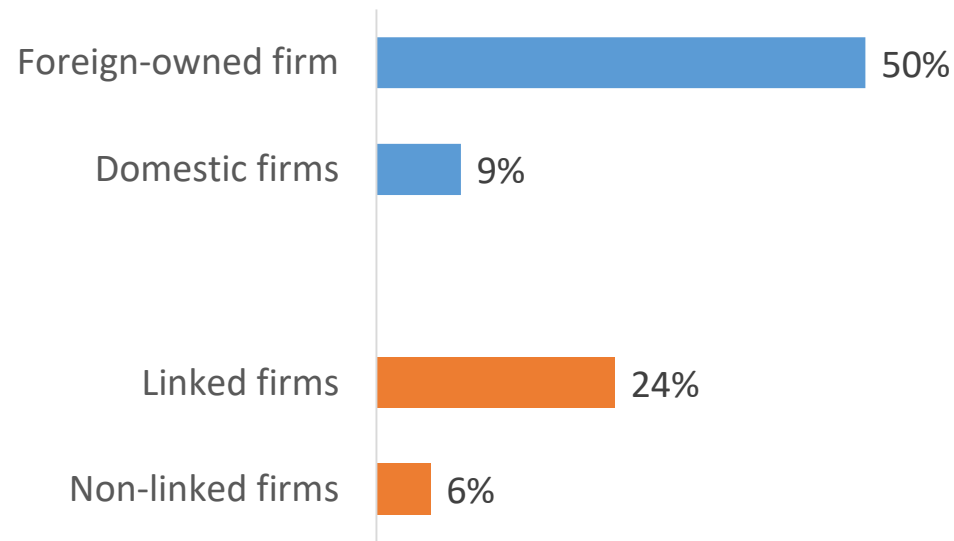
CONCEPTUAL FRAMEWORK: What market failures deter the development of FDI-SME linkages?



II. KEY FINDINGS: KEY MARKET FAILURES IN LINKAGE PROGRAMS

Lack of competitive local suppliers

More foreign-owned firms hold an internationally-recognized quality certification (e.g., ISO 9001) than linked or non-linked domestic firms.



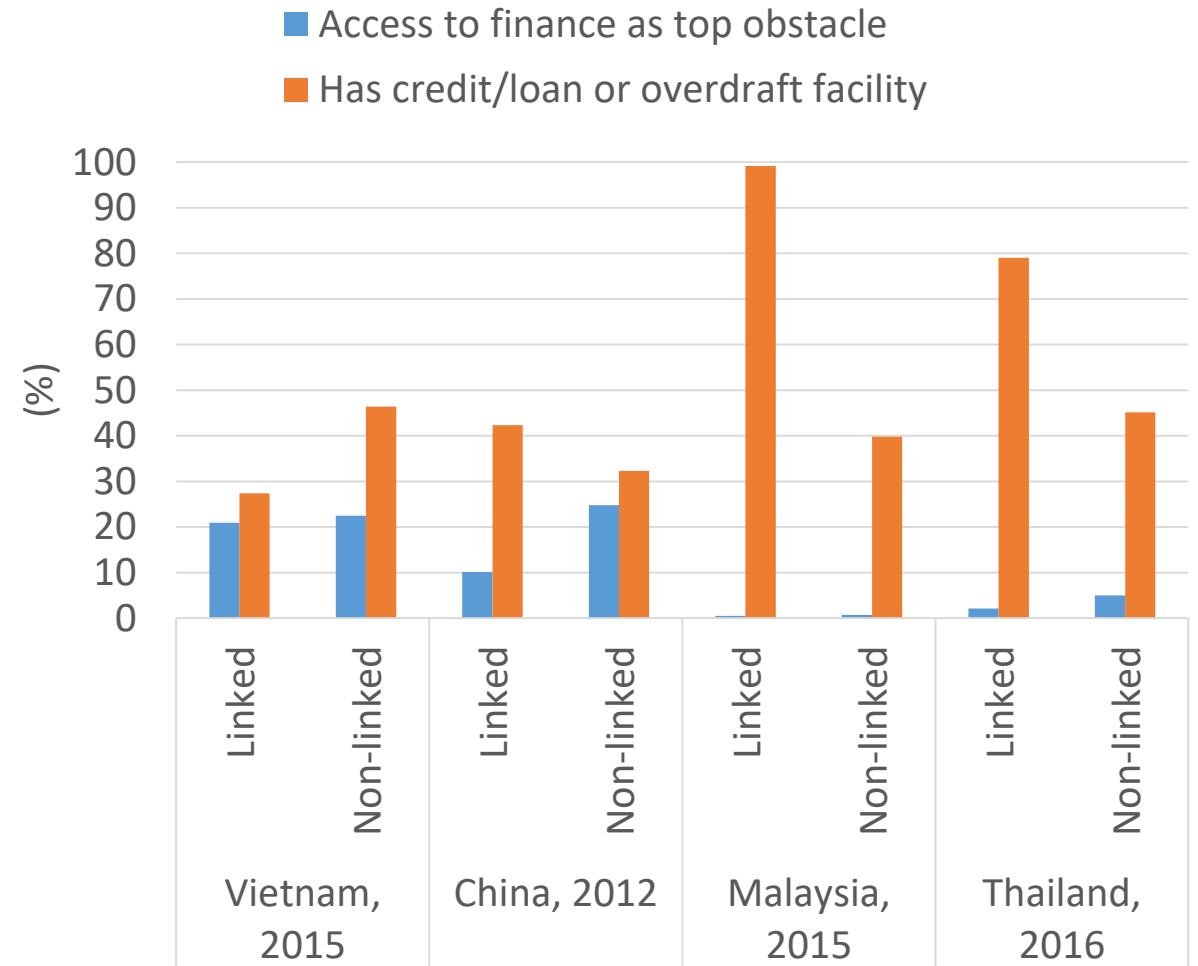
Source: World Bank, Enhancing Enterprise Competitiveness and SME Linkages Report

- Lack of competitive local suppliers means that foreign firms will look elsewhere and link with other firms which can provide consistent (in terms of quality, quantity, and price) and timely inputs needed to finalize production.
- However, qualitative interviews with firms in Vietnam suggest that there remains keen interest on the part of lead firms and first-tier suppliers in the **automotive and electronic sectors**, for example, to access globally-competitive local suppliers.

KEY FINDINGS (3): KEY MARKET FAILURES IN LINKAGE PROGRAMS

- **Lack of access to finance**

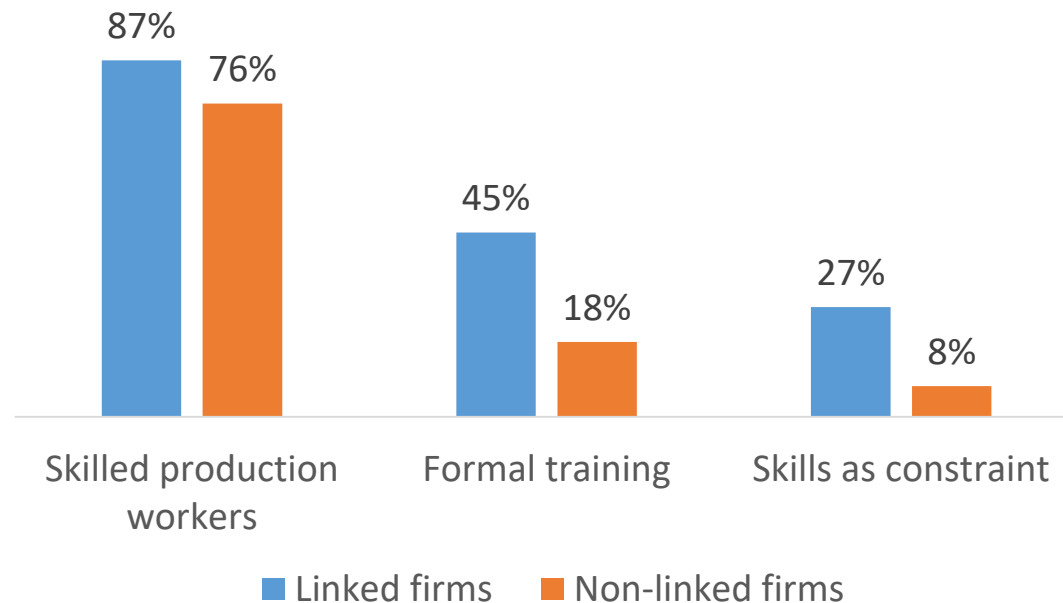
- Perceived as a **top business obstacle** by firms in Vietnam (21.8% in Vietnam versus 11.5% in EAP)
- More Vietnamese firms complaining about access to finance than firms from peer countries.
- Vietnam rate lower than Malaysia and Thailand in terms of firms with access to credit/loan or overdraft facility. However, there is no large difference between linked and non-linked domestic firms in Vietnam.
- Sectoral focus: In the **ICT sector**, lack of access to reliable risk capital is an identified key constraint that hinder start-up and scale-up.



KEY FINDINGS (4): KEY MARKET FAILURES IN LINKAGE PROGRAMS

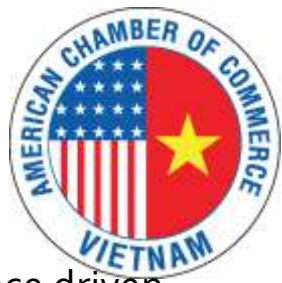
Lack of skilled workforce

Linked domestic firms in Vietnam have higher proportions of skilled workers and provide more formal trainings.



Source: World Bank, Enhancing Enterprise Competitiveness and SME Linkages Report

- **Lack of skills cuts across sectors**, although there are particular skillsets demanded for by particular sectors:
 - **Apparel sector:** technology (automated machines), marketing, branding, fashion/design, and soft business skills related to sourcing and relationship management
 - **Textiles sector:** chemical-related skills such dyeing, finishing, synthetic production and processing
 - **ICT sector:** foreign language, management, and technical skills
- **Reasons** explaining the lack of skilled workforce: (i) governance structure of foreign lead firms (where OEMs perform high value-added activities overseas, leading to a lack of ‘learning-by-doing’ for domestic firms); and (ii) local education system not being able to keep up with the demands of a fast-paced business environment.



Examples of success with linkages in Vietnam

- Key sectors in Vietnam include **electronics** (very dynamic growth in recent years, fueled by FDI and exports. Performance driven by large foreign companies, largely relying on own foreign suppliers) and **automotive** (also dynamic, with domestic value-added growing in some sub-sectors (e.g. two-wheelers, commercial vehicles) but not so much in others such as passenger cars, for which it is significantly lower than in Thailand)
 - Despite supply-side challenges, the report showcases examples of successful domestic suppliers in these sectors (e.g. Thanh Long Electronics Production Company, Tam Hop Company), and highlights relevant lessons:
 - The linkage process takes quite a long time and involves trial-and-error
 - Access to and willingness to learn from foreign technologies, skills and management practices were important, including through informal exchanges and formal cooperation agreements with current suppliers
 - Establishing linkages with lead FDI is gradual and often start by supplying MNCs with less complex requirements or lower-tier suppliers
 - Support from lead firms/tier-1 suppliers, as well as relevant TA from public sector, can play an important role
- Overall, indicates the importance of private sector bottom-up approaches for linkages.



International experience on what works and what doesn't

- The report reviews the experience from linkages programs in several countries (e.g. Czech Republic, Malaysia, Chile and Costa Rica) and derives lessons on what works and what does not work:

Area	Do's	Don'ts
Governance and institutional set-up	<ul style="list-style-type: none"> • Ensure high-level political commitment and ownership • Identify lead agency, with sufficient mandate, autonomy and capacity • Establish interministerial coordination mechanism 	<ul style="list-style-type: none"> • Large number of agencies involved with overlapping responsibilities and weak coordination
Strategy and targeting	<ul style="list-style-type: none"> • Select priority sectors based on sound evidence and understanding of value chains (including MNE's sourcing strategies), and analysis of both supply and demand sides • Focus on domestic firms with most potential, identified through objective and transparent criteria 	<ul style="list-style-type: none"> • Aim at providing support to all SMEs, even smallest/least productive ones • Picking winners through uninformed means or providing support based on arbitrary criteria
Connecting MNEs and local firms	<ul style="list-style-type: none"> • Provide both sides with accurate and up-to-date information about potential opportunities • Consider private sector role in establishing/maintaining databases • Include certification and reputation-building features for suppliers 	<ul style="list-style-type: none"> • Provide information that is not specific enough or does not correspond to MNE's needs
Upgrading local capacities	<ul style="list-style-type: none"> • Actively involve lead/tier-1 suppliers in management and operation of supplier development programs • Strive to develop local business development services (BDS) providers • Establish incentives and support for local suppliers to invest in skills, technological and managerial upgrading 	<ul style="list-style-type: none"> • Attempt to force backward linkages (e.g. LCR) without due concern for upgrading local supply capacities • Provide support to local suppliers not targeted to address binding supply-side constraints

A COMMITTED POLICY APPROACH TO FDI-SME LINKAGES

Example: Malaysia



PROGRAM

Assistance provided under ILP:

- **Fiscal incentives for lead firms:**
 - 100% tax exemption for 5 yrs, or
 - Investment Tax Allowance of 60% on expenditures incurred within 5 yrs
- **Business Matchmaking**
- **Support packages for SMEs:** technology development, skills upgrading, export & market development, provision SME industrial sites, etc.
 - Global Supplier Program (see Annex)
 - Factory Audit Scheme
 - Annual Showcase
 - Enterprise 50 Program
 - SME Expert Advisory Panel

KEY LESSONS

- **Linkage programs must have two pillars:**
 - Business matchmaking programs
 - Capacity building of domestic support industries
- **Unrealistic sourcing demands** without upgrading local SMEs drives FDI away (see VDP)
- There is not single model but **government** needs to take **coordinated and committed approach => long-term effort**
- Can be started by with support from donors/foreign investors but gov needs to focus on **owning and institutionalizing such programs**
- **NPOs and private organizations** can play important role: Penang Skills Development Centre (PSDC)



A Hands-on Supplier Development Program

Example: Czech Republic

CHALLENGE

- After 1990, Czech Rep. attracted lots of FDI, but the local economy did not feel the potential benefits since MNEs sourced little from Czech suppliers
- Need to strengthen local suppliers' capacities so they could become internationally competitive
- Barriers: lack of developed support infrastructure for SME and limited management capacity of SMEs

SOLUTION

National Supplier Development Program (SDP)

- Focus: promote MNE-SME linkages
- Aim: support SMEs to attain the capacity required to link to MNEs & develop a world-class supplier base
- Participants: 12 MNEs, 45 SMEs
- Program: targeted training align with MNE needs and focused on weaknesses uncovered in business reviews
- Implemented by CzechInvest with support from international advisors, EU, and WBG

PROCESS



A Hands-on Supplier Development Program

Example: Czech Program



RESULTS

Performance improvement (initial 21 months):

- companies' internal & external performance improved measured against international benchmarks (EFQM & MNE checklist)
- 80 % of improvements attributed to the program

Bottom line (18 months on):

- 15 companies gained new contracts of \$18m annually
- Only 4 of 45 participating companies reported no direct business benefits from the program



KEY LESSONS

- **Government** leadership and a strong implementing agency is essential
- Work in close partnership with **MNEs** during design and implementation - MNEs should press for such programs as a positive alternative to local content policies
- Focus on **suppliers** based on potential not need and ensure management is committed to the process
- Establish a **business review process** to identify individual priority needs and allow benchmarking
- Customize, coordinate and simplify access to assistance and **provide hands-on, in-house mentoring support**

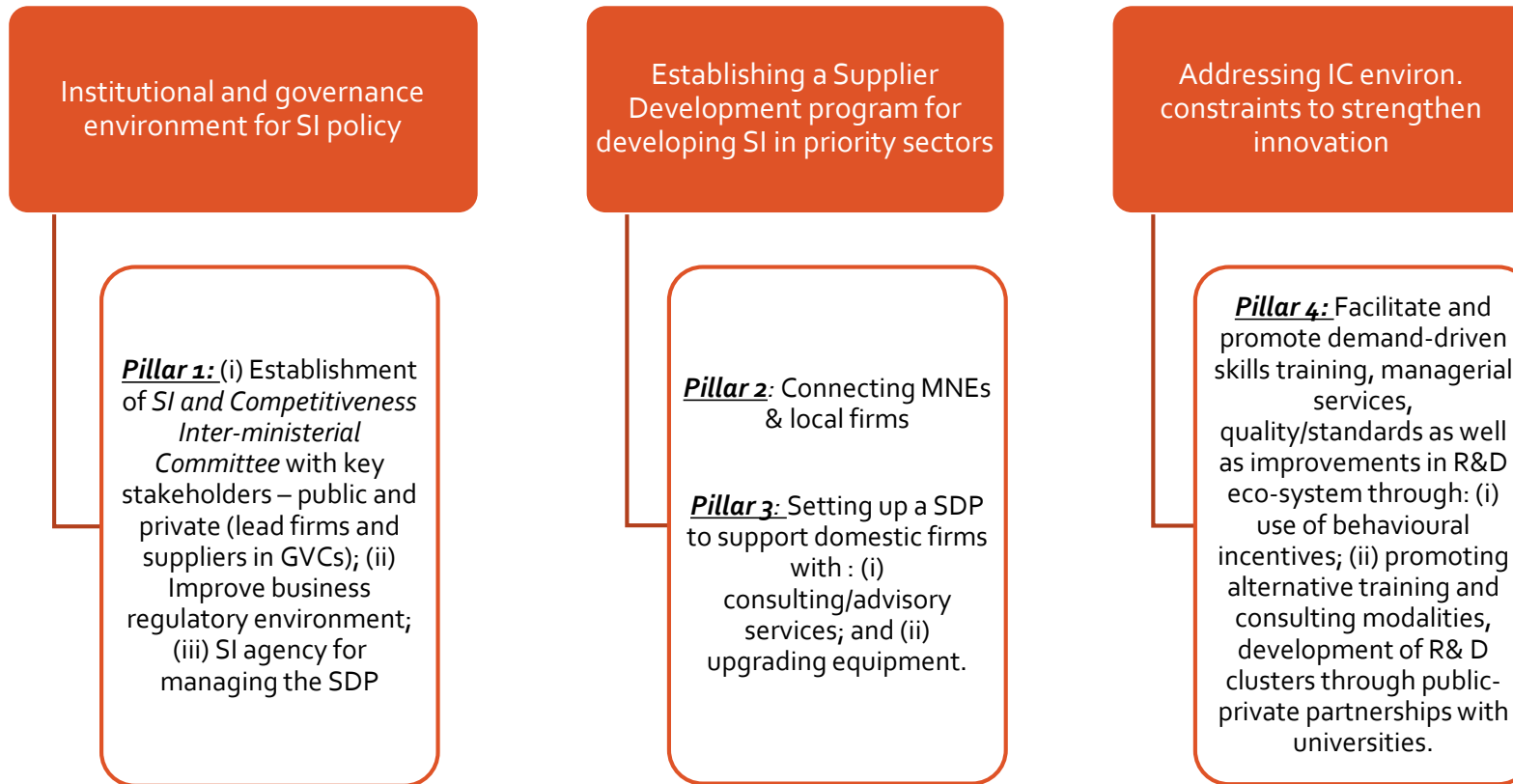
What is WBG Doing on Enhancing Enterprise Competitiveness and SME Linkages?



- (1) Supporting Government with Roadmap for Implementing the Supporting Industries Program and Strengthening SME Competitiveness, e.g.**
 - a) IFC Private Sector Competitiveness Program and Advisory Services – that is piloting the SME linkages study in two sectors**
 - a) Support to Supporting Industries Agency of MoIT to design Supplier Database**
- (2) Ongoing Analytical work and SME Support (Cluster Competitiveness and Connectivity Analysis and Mapping e.t.c)**

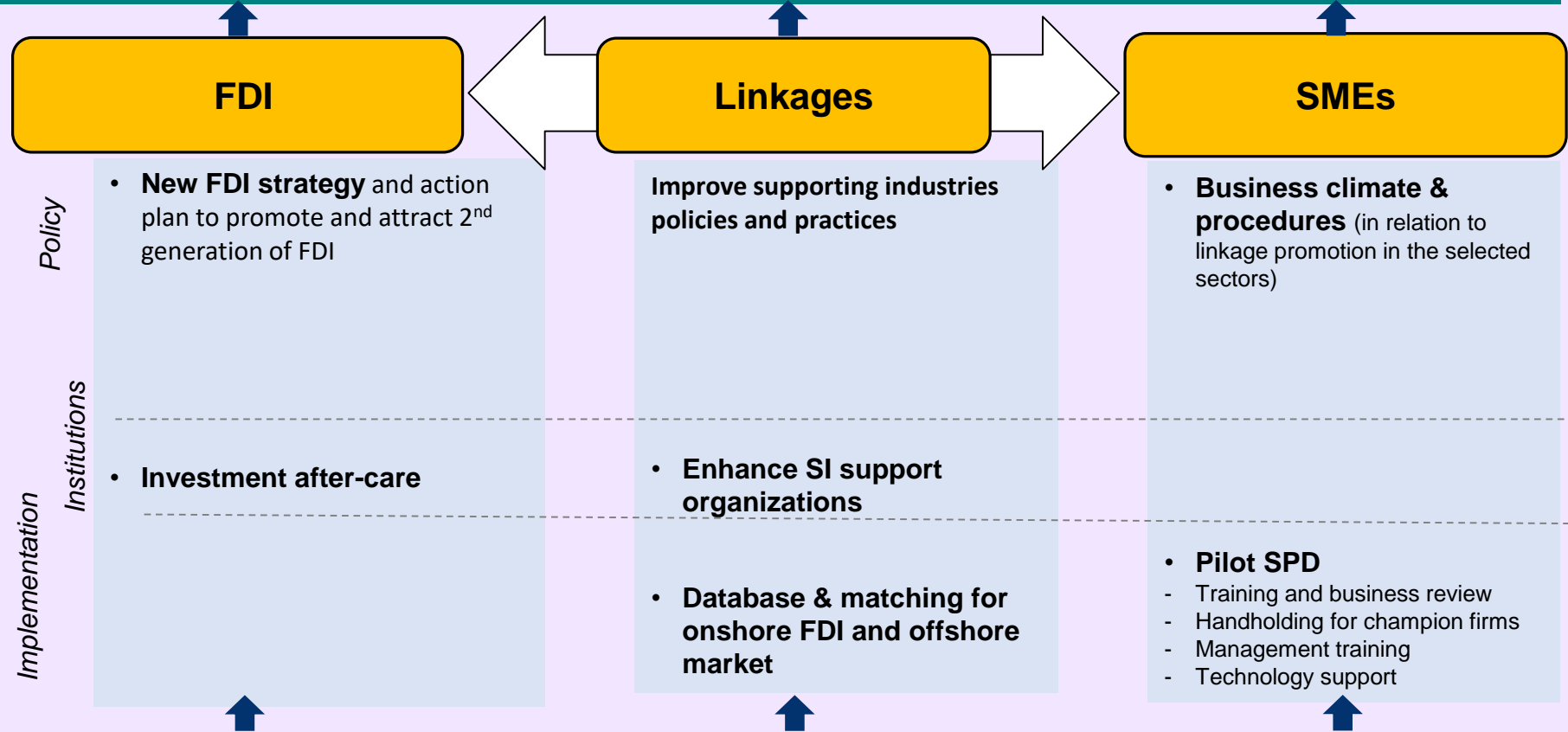
Operationalizing the Supporting Industries agenda

Based on the diagnostic, the report proposed a ‘Roadmap for Implementing the Supporting Industries Program and Strengthening SME Competitiveness’, based on four pillars:



IFC Private Sector Competitiveness Program : Objectives

Improving the competitiveness of Vietnam's private sector and expand the integration of local SMEs into GVCs through specific investment policy and business regulatory measures and fostering linkages between domestic firms and FDI



Challenges and opportunities

- **Low productivity**
- **Weak linkages between FDI and domestic firms**
- **Lack of productive domestic companies capable of meeting MNCs' requirements**
- **Significant barriers in the investment climate to hamper VN firms to upgrade within global value chains and increase domestic value addition.**
- **New FTAs offer opportunities for VN to become a global manufacturing hub to attract FDI and stimulate SMEs-FDI linkages/ "move up" to value chains.**



THANK YOU!

Full Report: World Bank, Vietnam: Enhancing Enterprise Competitiveness and SME Linkages (2017)

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