Enhancing Enterprise Competitiveness and SME Linkages in Vietnam

AmCham Supplier Day 2018
Thursday, October 4th, 2018
White Palace, 194 Hoang Van Thu, Phu Nhuan District, HCMC
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

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

Challenges

- 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
- 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

- Manufacturing 56%
- Hospitality & Retail 14%
- Real estate & construction 16%
- Other Svcs
- Fin Svcs
- Mining
- Transport
- Agriculture, forest, fish
- Power & Utilities
- Health & Educ

Manufacturing FDI by subsector
Total registered value, 2010-2016

- Vehicles & transport products
- Machinery
- Chemicals
- Metals
- Hi Tech & Electronics
- Paper & printing
- Furniture & wood products
- Rubber & plastics
- Apparel, textiles & leather prods

Source: FIA
Where in Vietnam are the Opportunities for Suppliers?

Total FDI projects by province 1988-2016
- Ho Chi Minh City 29%
- Hanoi 17%
- Binh Duong 12%
- Other provinces 18%

Total FDI registered capital by province 1988-2016
- Ho Chi Minh City 18%
- Ba Ria Vung Tau 9%
- Hanoi 9%
- Dong Nai 8%
- Binh Duong 7%
- Quang Nam 7%
- Bac Ninh 7%
- Hai Phong 6%
- Thanh Hoa 5%
- Ninh Thuan 5%
- Ninh Binh 4%
- Long An 4%
- Da Nang 4%
- Hai Duong 4%
- Hung Yen 4%
- Other provinces 30%

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

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

- Small: 12%
- Medium: 40%
- Large: 45%
- Domestic: 23%
- Joint venture: 70%
- Foreign: 19%

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

Characteristics of new products

- Completely new function
- Cheaper
- Higher quality

Vietnam | Cambodia | Lao PDR | Malaysia | Philippines | Thailand

Source: World Bank, Enhancing Enterprise Competitiveness and SME Linkages Report
I. KEY FINDINGS: FIRM-LEVEL ANALYSIS (3)

Use of Quality Certification

- Foreign-owned firm: 50%
- Domestic firms: 9%
- Linked firms: 24%
- Non-linked firms: 6%

Skills

- Skilled production workers:
  - Linked firms: 87%
  - Non-linked firms: 76%
- Formal training:
  - Linked firms: 45%
  - Non-linked firms: 18%
- Skills as constraint:
  - Linked firms: 27%
  - Non-linked firms: 8%

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

- Technical skills (other than IT)
- Computer or general IT
- Foreign language
- Work ethic and commitment
- Writing
- Interpersonal and communication
- Managerial and leadership

Primary focus of formal training programs

- Technical skills (other than IT)
- Computer or general IT
- Foreign language
- Work ethic and commitment
- Writing
- Interpersonal and communication
- Managerial and leadership

Source: World Bank, Enhancing Enterprise Competitiveness and SME Linkages Report
CONCEPTUAL FRAMEWORK: What market failures deter the development of FDI-SME linkages?

**Goal**
Enhance MNE linkages to increase DVA, employment, local firm productivity & market access

**Investor (MNE)**
- Technology, skills, finance, standards
- Goods & services

**VN supporting industries**
- Policy feedback

**Demand-side constraints:**
- Lack of local suppliers
- Lack of competitive local suppliers (quality, quantity and price)
- Lack of information on domestic suppliers & capacity
- Distortive LCR policies or incentives

**Supply-side constraints:**
- Technology & skills gaps
- Lack of targeted financial and tech support for upgrading
- Lack of information on MNE sourcing strategies and standards

**Policy feedback**

**Public sector constraints:**
- Insufficient policy alignment
- Coordination failures
- Lack of supporting services

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

<table>
<thead>
<tr>
<th>Type of Firm</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign-owned firm</td>
<td>50%</td>
</tr>
<tr>
<td>Domestic firms</td>
<td>9%</td>
</tr>
<tr>
<td>Linked firms</td>
<td>24%</td>
</tr>
<tr>
<td>Non-linked firms</td>
<td>6%</td>
</tr>
</tbody>
</table>

- 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.

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

Source: World Bank, Enhancing Enterprise Competitiveness and SME Linkages Report
Lack of skilled workforce
Linked domestic firms in Vietnam have higher proportions of skilled workers and provide more formal trainings.

- 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.

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

<table>
<thead>
<tr>
<th>Area</th>
<th>Do’s</th>
<th>Don’ts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Governance and institutional set-up</td>
<td>• Ensure high-level political commitment and ownership</td>
<td>• Large number of agencies involved with overlapping responsibilities and weak coordination</td>
</tr>
<tr>
<td></td>
<td>• Identify lead agency, with sufficient mandate, autonomy and capacity</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Establish interministerial coordination mechanism</td>
<td></td>
</tr>
<tr>
<td>Strategy and targeting</td>
<td>• 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</td>
<td>• Aim at providing support to all SMEs, even smallest/least productive ones</td>
</tr>
<tr>
<td></td>
<td>• Focus on domestic firms with most potential, identified through objective and transparent criteria</td>
<td>• Picking winners through uninformed means or providing support based on arbitrary criteria</td>
</tr>
<tr>
<td>Connecting MNEs and local firms</td>
<td>• Provide both sides with accurate and up-to-date information about potential opportunities</td>
<td>• Provide information that is not specific enough or does not correspond to MNE’s needs</td>
</tr>
<tr>
<td></td>
<td>• Consider private sector role in establishing/maintaining databases</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Include certification and reputation-building features for suppliers</td>
<td></td>
</tr>
<tr>
<td>Upgrading local capacities</td>
<td>• Actively involve lead/tier-1 suppliers in management and operation of supplier development programs</td>
<td>• Attempt to force backward linkages (e.g. LCR) without due concern for upgrading local supply capacities</td>
</tr>
<tr>
<td></td>
<td>• Strive to develop local business development services (BDS) providers</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Establish incentives and support for local suppliers to invest in skills, technological and managerial upgrading</td>
<td>• Provide support to local suppliers not targeted to address binding supply-side constraints</td>
</tr>
</tbody>
</table>
A COMMITTED POLICY APPROACH TO FDI-SME LINKAGES

Example: Malaysia

PROGRAM

Assistance provided under ILP:

• Fiscal incentives for lead firms:
  o 100% tax exemption for 5 yrs, or
  o 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.
  o Global Supplier Program (see Annex)
  o Factory Audit Scheme
  o Annual Showcase
  o Enterprise 50 Program
  o SME Expert Advisory Panel

KEY LESSONS

• Linkage programs must have two pillars:
  o Business matchmaking programs
  o 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)
After 1990, the Czech Republic attracted a lot of FDI, but the local economy did not feel the potential benefits since MNEs sourced little from Czech suppliers. To strengthen local suppliers' capacities so they could become internationally competitive, it was necessary to develop a supportive infrastructure for SMEs and improve their management capacity.

**National Supplier Development Program (SDP)**

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

1. Institutional and governance environment for SI policy

   **Pillar 1**: (i) Establishment of SI and Competitiveness Inter-ministerial Committee with key stakeholders – public and private (lead firms and suppliers in GVCs); (ii) Improve business regulatory environment; (iii) SI agency for managing the SDP

2. Establishing a Supplier Development program for developing SI in priority sectors

   **Pillar 2**: Connecting MNEs & local firms
   **Pillar 3**: Setting up a SDP to support domestic firms with: (i) consulting/advisory services; and (ii) upgrading equipment.

3. Addressing IC environ. constraints to strengthen innovation

   **Pillar 4**: Facilitate and promote demand-driven skills training, managerial services, quality/standards as well as improvements in R&D eco-system through: (i) use of behavioural incentives; (ii) promoting alternative training and consulting modalities, development of R&D clusters through public-private partnerships with universities.
Vietnam PS Competitiveness through GVCs and linkages

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.

FDI
- New FDI strategy and action plan to promote and attract 2nd generation of FDI

Linkages
- Improve supporting industries policies and practices
- Enhance SI support organizations
- Database & matching for onshore FDI and offshore market

SMEs
- Business climate & procedures (in relation to linkage promotion in the selected sectors)
- Pilot SPD
  - Training and business review
  - Handholding for champion firms
  - Management training
  - Technology support

Policy
- Investment after-care

Implementation
- Enhance SI support organizations
- Database & matching for onshore FDI and offshore market

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!


**Contacts:**
Brian Mtonya: bmtonya@worldbank.org
Asya Akhlaque: aakhlaque@worldbank.org
Lien Anh Pham: panh1@ifc.org