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INVESTMENT-RELATED ISSUES IN VIETNAM: A CASE STUDY OF THE AUTOMOTIVE AND ELECTRONIC INDUSTRIES

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Abstract

This paper points out some remaining problems of investment in Vietnam. Firstly, it is hard to identify the leading industry due to the huge amount and overlapped legal documents for the long time in Vietnam. Secondly, after conducting the in-depth interview for three specific cases of foreign firms in Vietnam, the paper finds that the capability of Vietnamese firms is weak. Consequently, Vietnamese firms are unable to compete and/or cooperate with foreign counterparts.

Keywords: Automobile industry, Electronic industry, Vietnam, Investment.

1 INTRODUCTION

Investment is one the most important factors that could effectively boost economic growth. Total investment capital in Vietnam has accounted for a significant proportion of Gross Domestic Product (GDP). However, this ratio has decreased since 2011. Regarding the investment structure, the proportions of the foreign direct investment (FDI) sector, as well as the state and non-state sectors, remained relatively unchanged between 2008 and 2013. The largest proportion was the state sector, followed by the non-state sector and then FDI (Vu, 2012). Nevertheless, the bigger proportion does not always relate to better efficiency. Investment in the state sector was insufficient, with a high score on the incremental capital-output ratio (ICOR) index of 8.7 (in 2013), while the non-state sector is the most effective, with the lowest ICOR score of 4.9 (2013). However, the economy as a whole underwent an improvement in investment efficiency, with increasingly smaller ICORs. In the period 2008-2010, the average ICOR score of Vietnam was 6.7, but in the period 2011-2013, it went down to 5.53. (Tran, Pham & Vu, 2014). Even so, the ICOR index is unable to entirely reflect the current state of the Vietnamese economy. Instead, it is necessary to look at the disaggregate numbers at the industrial level to better understand the reality.

It is argued that the domestic sector should be the developing engine of economic growth. In other words, if an economy grows by over-relying on foreign investment, it could become easily stuck in the middle-low income trap. Therefore, this study attempts to examine the current state of the domestic sector in relationship with the FDI sector to figure out the basis of economic growth of Vietnam. It seeks to determine whether the industrial development of Vietnam is stable or not by analyzing investment-related issues at the industrial level. The study focuses on two essential industries of Vietnam: automotive and electronics.

2 THEORETICAL FRAMEWORK

Investment is a vital factor for the economic development at both firm level and national level. At national level, it could be categorized into domestic investment and foreign investment. Domestic investment could be a good source for public infrastructures, utilities and economic activities. In fact, the neo-classic growth model and endogenous growth model are the popular school that appreciate the importance of domestic investment in boosting the economic growth (Mankiw, Romer & Weill, 1992, Lucas, 1998 and Barro & Sala-i-Martin, 1999). For example, the the A-K endogenous growth model, the government expenditure is defined as the domestic investment that contributes significantly to economic development (Barro, 1990). Similarly, the importance of foreign direct investment is well documented in many studies. It is an important source for developing countries in the world. Therefore, there are substantial papers find the positive relationship between FDI and economic growth of host nations (Nair-Reichert & Weinnhold, 2001, Vu, Gangnes & Noy, 2008, Duasa, 2007 and Singh & Liew, 2013). At firm level, it could be investment in physical capital, human capital or technology infrastructure. One of the most well-known theory related to investment at firm level is business cycle theory. Investment is considered the essential part which could affect consumption, employment and other factors. Investment is endogenous element and it directly influence on the performance of firm (Haavelmo. 1960).

This paper examines the investment-related issues at firm-level. It is believed that both investment of domestic firms and foreign firms are the catalyst for development, however, one of them could crowd out the other (Aiken & Harrison, 1999 and Hu & Yun, 2016). Therefore, the paper seeks to recognize the phenomenon in Vietnam.

In fact, one problem with investment in Vietnam concerns the stage of selecting prioritized industries. The government has spent many years identifying which ones should be the leading industries. However, the documents on leading industries are overlapped and still unclear, and therefore it is difficult to identify which ones are top priorities. Hence, the paper firstly reviews all strategies and master plans on selecting leading industries over time before analyzing the automotive and electronics industries. The two industries were chosen because they are two *identified leading industries* that were increasingly important in Vietnam between 2001 and 2013. The framework of the paper is in the Figure 1 as follow:

3 METHODOLOGY

The study exploits the secondary data analysis and in-depth interview method.

Instead of analyzing all industries, the study chooses the automotive and electronics industries based on their importance and contribution to the development of the manufacturing sector. More specifically, investment structure and efficiency are examined. The data of the two industries are collected and processed from annual enterprise surveys from 2001 to 2013. They are from the official database of the General Statistics Office of Vietnam, which includes most firms in Vietnam. Note that the automotive and electronics industries are the 3-digit industries. However, due to the constraint of data availability, the study only exploits 2-digit industry data. Hence, the automotive industry is analyzed via data of the manufacture of motor vehicles, trailers and semi-trailers (of which the largest proportion is the automobile). Similarly, the electronics industry is analyzed via data from the manufacture of computer, electronic and optical products.

Finally, the study also includes in-depth interviews with two FDI firms in the automotive industry (Honda and Toyo Denso) and one firm in the electronics industry (Samsung) to identify the cooperation between FDI firms and the domestic sector. These in-depth interviews were conducted in Bac Ninh province in 2013. The interviewees are the top managers and the Director of these companies and the discussion is based on the prepared questionnaires to collect all necessary information.

4 ANALYSIS AND DISCUSSION

4.1 Strategies and master plans on selecting the prioritized industries

An economy needs some leading industries but in Vietnam, there are a huge amount of sectors have been named as leading ones such as mechanics, technology communication, textiles or energy etc. In other words, the selection of leading industries in Vietnam is quite unclear. Consequently, investment incentives are scattered and inefficient.

In fact, the selection of leading industries has been mentioned from 1995, however, after 30 years it has not been clarified yet. In 2007, the Prime Minister issued Decision No 55/2007/QD-TTg on standardizing prioritized industries or sectors to invest. The Decision indicated 07 prioritized industries and 03 leading industries. However, until 2014, these industries are unable to take a leading role for the economy. Note that, Vietnam is targeting the goal that Vietnam will become an industrialized country by 2020, but until 2014, it is unlikely to answer the question what the leading industries of Vietnam is. Therefore, Vietnam restarts the process by re-selecting the leading industries in 2014.

In 2014, the Government approves the Strategy on the industry development of Vietnam to 2025, vision to 2030 that amends the previous strategy and points out 03 groups of prioritized industries and 12 prioritized sectors (Table 1). Note that, in this Strategy, the term "leading industries" is no longer appeared. At the same time, the Prime Minister also issues the Decision 880/QD-TTg on the Master plan of the industry development of Vietnam to 2020, vision to 2030 that shows 10 prioritized industries including (1) mechanical-metallurgical industry; (2) chemical industry; (3) The electronics, information technology; (4) The textile, leather & footwear; (5) processing of forestry, fisheries, food and beverages; (6) Manufacturing of construction materials; (7) mining and mineral processing; (8) The power; (9) The coal industry; (10) oil and gas. It also mentions to the orientation to develop the supporting industry for mechanical-metallurgical industry; the electronics, information technology and textile, leather & footwear. The selection of prioritized industries of the new Strategy and the Master plan bases on the agreement between Japanese consultants and Vietnam state agencies could be a good choice for industry development. However, it takes too much time for Vietnam to identify prioritized industries. Consequently, after 30 years, foundation of Vietnam industry is quite poor.

Table 1 Prioritized industries in Strategy on industry development of Vietnam to 2025, vision 2035

Group	Period to 2025	2025-2035
Processing and Manufacturing industries	(1) machinery and equipment for agriculture (2) automobile and mechanical parts (3) fabrication steel (4) basic chemicals (5) plastics production - technical rubber (6) petrochemicals (7) agricultural products, seafood and wood processing (8) materials and sub-materials serving the	(1) shipbuilding, nonferrous metals and new materials (2) pharmaceutical sector (3) fashion clothing, luxury shoes

	domestic production and exports	
The electronics, information technology industries	(9) Phones (10) Computer equipments (11) Accessories	(4) software development, digital content, IT services and medical electronics
New energy and renewable energy industries	(12) wind, solar, biomass	(5) energy for peaceful purposes

Source: The Decision 879/QĐ-TTg

Experience from the past show that nothing can make sure that the new Strategy and Master plan will not be replaced in the future. However, assume that the new Strategy and the Master plan on the industry development in 2014 are appropriate and concrete. Then, let us analyze the current state of investment of two important industries: automobile and electronic in order to realize the weak developing foundation of them.

1.2. Intra-industry problems

Automobile and electronic industries are two of 12 prioritized industries in the next development period. Simultaneously, they are on the list of products that will be entitled to investment incentives (the Investment Law 2014 (article 16)). The ultimate objective of these policy incentives is to create a sound automobile and electronic industry for Vietnam. However, these industries need a large number of initial capital and high level of technology that is unable to provide by the Vietnamese firms. Therefore, the appearance of multinational corporations (MNCs) is necessary. It coupled with many policy incentives to attract foreign investor into these industries leads to the fact that there are variety of MNCs operating in automobile and electronic industry such as Sam Sung, Intel, LG, Nokia or Ford, Toyota, Honda.

However, is an achievement in attracting FDI the same with benefits for domestic firms?

In 2014, automobile and electronic industries contribute significantly to Vietnam economic growth. More specifically, products of phone, automobile and television increases 67%, 29% and 18% respectively.

Table 2: Phone, TV and automobile in 2014

	Unit	Accumulated 11 months /2013	Estimated 12^{th} /2013	Accumulated 12 months /2014	12^{th}/2014 compared to 12^{th} /2013(%)	Compare 2014 to 2013 (%)
Phone	Million	156,1	19,7	175,8	285,0	167.5
Television	Thousand	3188.5	444.4	3632.9	154.4	118
Automobile	Thousand	114.8	13.5	128.3	131	129

Source: General Statistics Office (2014)

The first impression from these numbers is that these industries could be an engine for the industrial development in the future. In the period 2001-2013, these industries positively contribute to the economic growth. Value added of electronic industry rises from VND 4,300 billion in 2001 to VND 19,000 billion in 2013. Similarly, value added of automobile industry rises from VND 2,700 billion in 2001 to VND 41,000 billion. Regarding to gross output, the electronic industry reaches the number of VND 770 trillion revenue and this number of automobile industry is VND 145 trillion in 2013. However, they are only the surface numbers that could blur intra-industry problems. Hence, it is necessary to look further into each industry.

Automobile industry.

As above-mentioned, the numbers of value added and gross output of automobile industry show the positive features. However, if looking at investment structure within industry, we could realize some risks.

Firstly, investment capital into automobile industry has increased significantly from 2001 to 2013 (45 times bigger). Similarly, numbers of gross output and value added also have risen gradually over years (Figure 2)

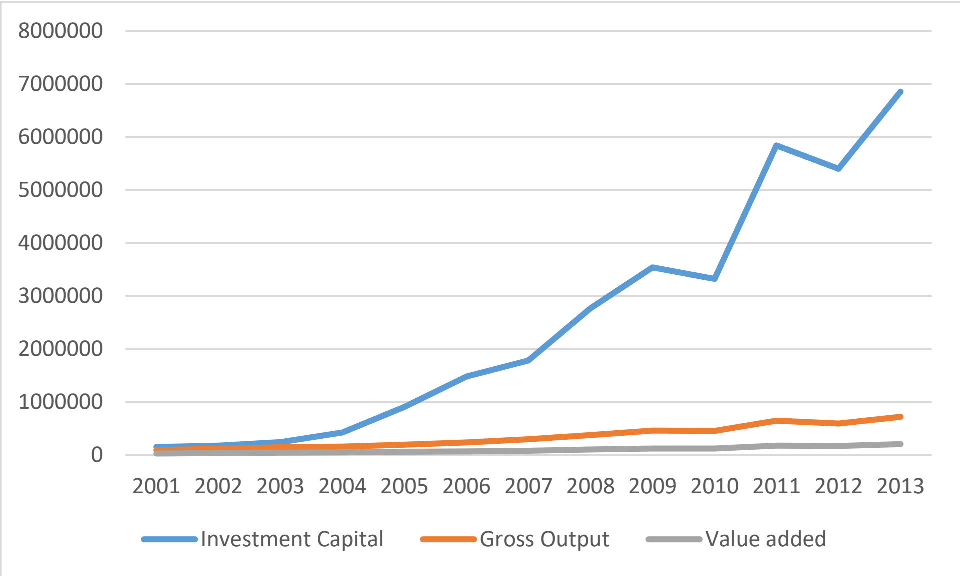

Figure 2: Investment capital, gross output and value added of automobile industry

Source: Annual enterprises survey from 2001 to 2013

From the Figure 2, we could see that, an increase in capital flow into automobile industry is much higher than an increase in gross output and value added. From 2001 to 2013, total investment in this industry rank 17th over 99 industries in Vietnam, accounting for 2% of total investment in Vietnam. Respectively, value added of automobile industry also creates an impressive rise. Between 2001 and 2012, average rank of automobile industry in terms of value added only stand at 27th place. However, in 2013, value added reach USD 4,100 million and it is ranked at 20th place over 99 industries.

What is the motivation of this positive situation? First, let consider investment structure. FDI sector accounts for a large proportion in total investment into automobile industry (Figure 2). From 2011 to 2013, proportion of FDI is more than 76%. The domination of FDI also implies the poor performance of the domestic sector, especially is the state sector. Although in the period of 2010-2013, the absolute number of state investment increase significantly (from VND 4500 million in 2010 to more than VND 165000 million in 2013), the proportion does not change much. In addition, cumulative capital of FDI in the period 2001-2013 accounts for 99% total cumulative capital in automobile industry.

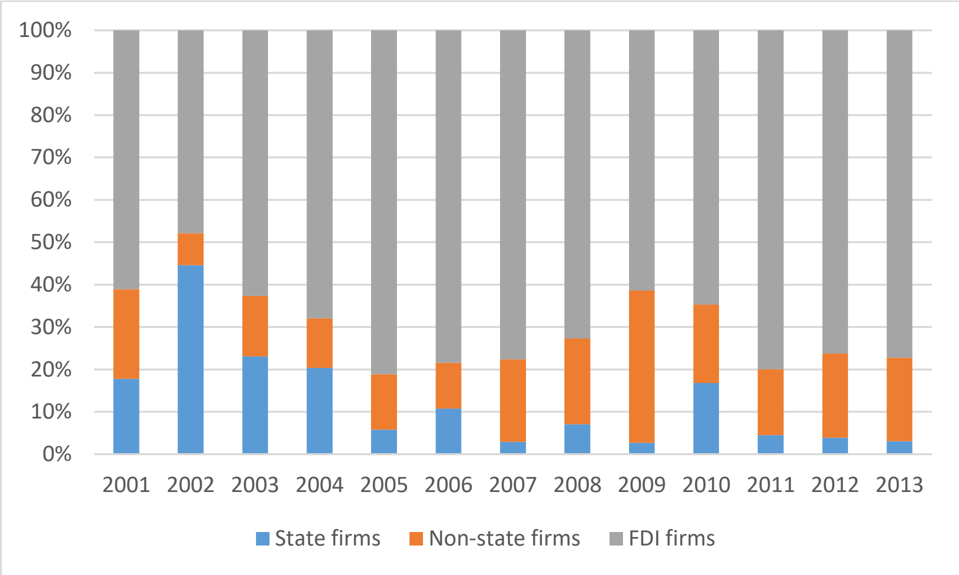

Figure 3: Investment structure in automobile industry

Source: Annual enterprises survey from 2001 to 2013

Additionally, the FDI sector also dominates in creating value added for this industry. Figure 3 shows contribution of economic sectors in creating value added in automobile industry. From 2001 to 2009, domestic contributions tend to increase and reaches the peak in 2009 with the proportion of more than 40%. However, by 2010, the contribution of domestic sector starts decreasing while contribution of FDI sector is larger and larger. Remarkably, between 2001 and 2013, proportion of non-state sector increases gradually which is opposed to a decrease in proportion of state sector.

Generally, FDI sector absolutely dominates the automobile industry in terms of investment capital, gross output and value added. In addition, is it a positive sign for the development of the industry? In the short term, the automobile industry could develop with the contributions of foreign sector, but in the long term, if domestic sector cannot improve their capability, the industry could become over-dependent on FDI. Theoretically, attracting FDI (especially MNCs) can bring direct benefits and spillover effects to domestic firms. Consequently, foreign capital not only facilitate the industry development but also indirectly enhances the domestic capability via competing or cooperating with foreigners. However, current state of automobile industry seems to be far from this expectation.

It is the fact that domestic firms are unable to compete with FDI firms. Illustratively, the number of FDI firms is bigger than this of domestic firm. In 2013, number of FDI is 182 compared to 178 of non-state firms and 14 of state firms. Remarkably, number of FDI firms with initial capital of more than VND 200 billion is only 67 while this of non-state and state firms is 24 and 8 respectively. It is argued that the bigger number of big-sized FDI firms is understandable because it is the way to create spillover effects to domestic firms. However, the number of smaller firms of FDI with initial capital of VND 10 million to VND 20 million is still higher than this of domestic ones. Domestic firms only outweigh FDI firms in terms of number of very small firms with initial capital of less than VND 10 million. Regardless to the fact that capability of domestic firms is too weak to compete with FDI firms, assume that the capability of FDI and domestic firms are fair, the domination in number of FDI firms must be the viable proof for the disadvantage of domestics firm in competition. However, making conclusion from the difference in number of firms could be not precise. Therefore, the study continues to analyze the case study of two FDI automobile firms to figure out current state of cooperation among FDI and domestic firms and whether the latter were benefited from the former or not.

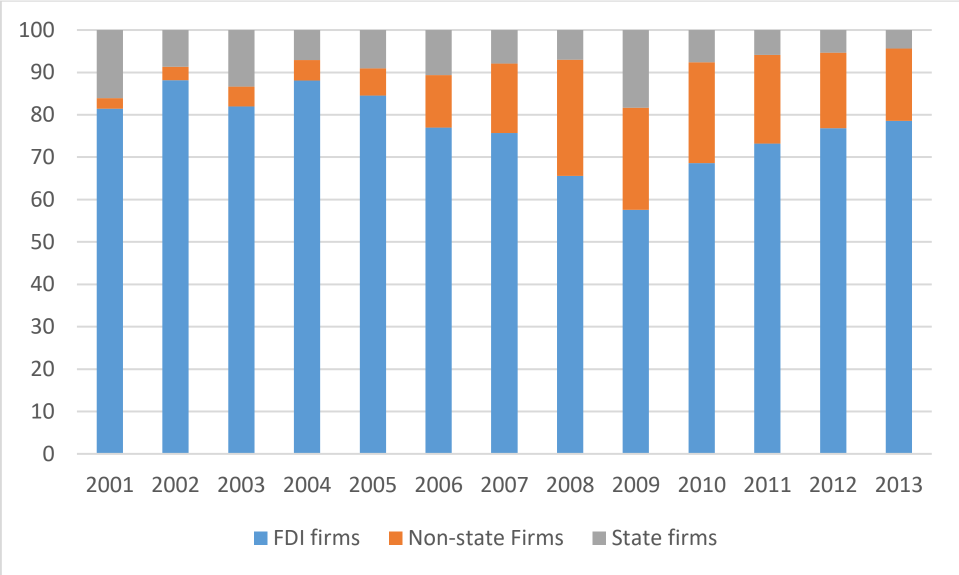

Figure 4: Contributions of economic sectors in creating value added for automobile industry

Source: Annual enterprises survey from 2001 to 2013

Honda Vietnam

Honda is certified to invest in the automobile industry in Vietnam in 2005. However, until 2013, the localization rate of Honda is very low, only 10% (based on revenue)[1]. Although the rate is low, it is not even "Vietnamization". Honda reveals that they have bought 100% of components from Japanese manufacturers located in Vietnam. Moreover, these components were not produced in Vietnam. Instead, these Japanese manufacturers imported spare parts outside and only assembled them into components in Vietnam. It reveals that the domestic firms are unable to take part in the production chain of Honda, hence managerial and technological diffusion is unlikely to happen. There are two reasons given by Honda for this situation. Firstly, Honda is a big corporation and already has their own first-tier and second-tier-component producers. Therefore, Honda tends to make use of the existing network to reduce costs. Moreover, clients of Honda are also the big corporations who requires some specific manufacturers must produce the specific components. However, this process happens at any countries where Honda investing in. Hence, the second reason is more important. Honda reveals that the Vietnamese producers are unable to meet the requirements on time delivery and quality of products. In addition, Honda also shows that market size of Vietnam is not big enough for Honda to expand their operation. Consequently, domestic firms cannot participate in the production chain of Honda and unable to learn officially anything from Honda.

Some might argue that because Honda is a big brand and it is impossible for Vietnamese firms to be their first tier due to poor capability and technology level. Thus, the study shows the case of Toyo Denso – the first tier of Honda to examine the potential cooperation with the domestic

[1] Information is taken from the in-depth interview

firms. Toyo Denso is established in 2001 at Vietnam and Honda is their biggest partner over the world. From 2001 to 2013, the localization rate of Denso is 40% in which Denso have bought 18% of components from Japan, 17% from Thailand, 30% from China, 5% from Indonesia and 40% from Vietnam[2]. Nevertheless, once again, localization rate is not "Vietnamization rate" when the number of 40% from Vietnam is totally foreigners located in Vietnam. Unlike Honda, Denso states that they want to find Vietnamese producers to minimize their costs but no Vietnamese firms could meet their requirements on quality of products. Denso also reveals that they are ready to support Vietnamese firms in terms of financial fund and technology as long as Vietnamese firms can meet their minimum requirements. However, so far, there are no firms could satisfy Denso.

From the two cases, we can see that Vietnamese firms are unable to take part in production chain of a big brand name (Honda) or the first tier of Honda (Toyo Denso). Therefore, technology diffusion or labor skills transferring is limited.

Generally, the development of automobile industry depends too much on FDI sector. Domestic sector is totally dominated in terms of investment capital or gross output. Moreover, the domestic firms are unlikely to benefit from FDI firms because of weak capability. Hence, it seems that the development of automobile industry in Vietnam is quite unstable.

Electronic industry

The contributions of electronic industry to the economic growth are even greater than the contributions of the automobile industry. Total investment capital into electronic industry has increased significantly from VND 810 billion in 2001 to 37000 billion in 2013 (based year is 2001). In addition, gross output and value added of electronic industry also go up impressively. Particularly, gross output rises from VND 178 billion in 2001 to almost VND 4 billion in 2013. Value added increases from VND 92 billion in 2001 to VND 720 billion in 2013 (Figure 5).

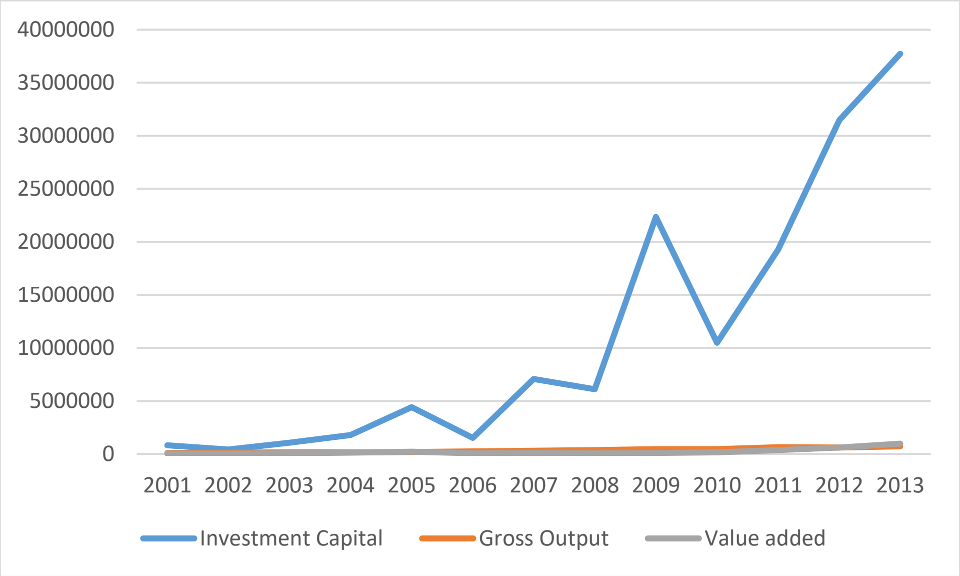

Figure 5: Investment capital, gross output and value added of electronic industry

Source: Annual Enterprises Survey from 2001 to 2013

[2] Information is taken from the in-depth interview

In the period 2001-2013, total investment capital flow into the electronic industry ranks the 10^{th} over 99 industries. Remarkably, value added of this industry show the great contribution from 2010 to 2013. By 2010, the contribution in terms of value added only stands at the 33^{rd} position, but it climbs to the 11^{th} and the 3^{rd} position in 2011 and 2013 respectively. It is a great development of the automobile industry in such a short period.

Similar to the automobile industry, however, the engine of electronic industry development is FDI sector. Even the impact of FDI sector in this industry is bigger than the impact of FDI sector in the automobile industry.

Regarding to investment structure, FDI sector always accounts for more than 90% of total investment capital into electronic industry from 2001 to 2013 (Figure 5). More specifically, the appearance of Samsung Vietnam recently pushes the domination of FDI sector over domestic ones. By 2013, investment capital of FDI sector account for 98% of total investment capital. In addition, Samsung Vietnam continues to expand their operation in Vietnam, coupled with the fact that there have been many other big companies in Vietnam such as LG, Nokia etc, it will be true to argue that the domination of FDI sector in electronic industry will be continue in the future.

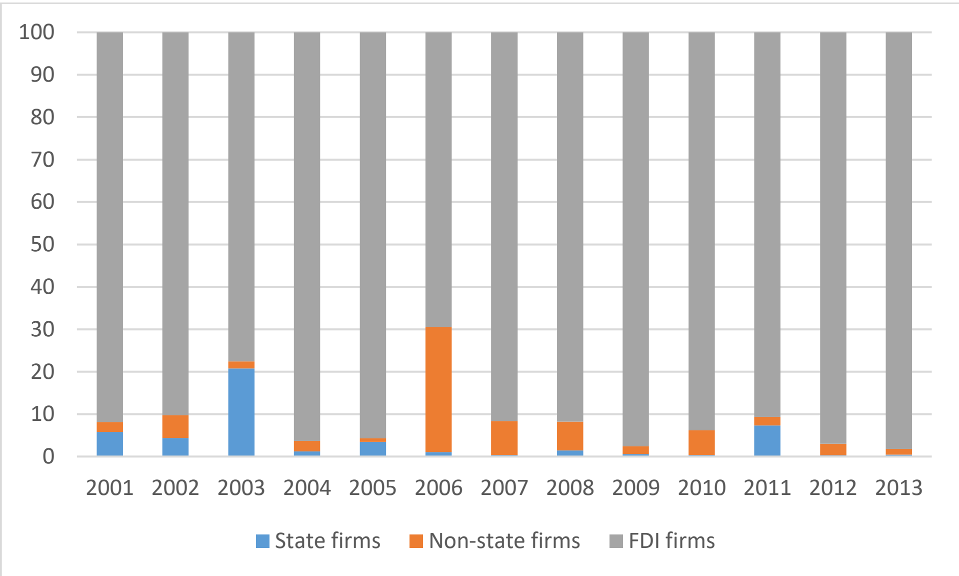

Figure 5: Investment structure in electronic industry

Source: Annual Enterprises Survey from 2001 to 2013

Regarding to value added creation, the FDI sector is also the dynamic force of the industry. We can see from the figure 9 that, FDI sector always creates more than 86% of value added in electronic industry. Particularly, from 2006 to 2013, the proportion of FDI sector is increasingly larger and reaches the level of 98% in 2013 (Figure 6).

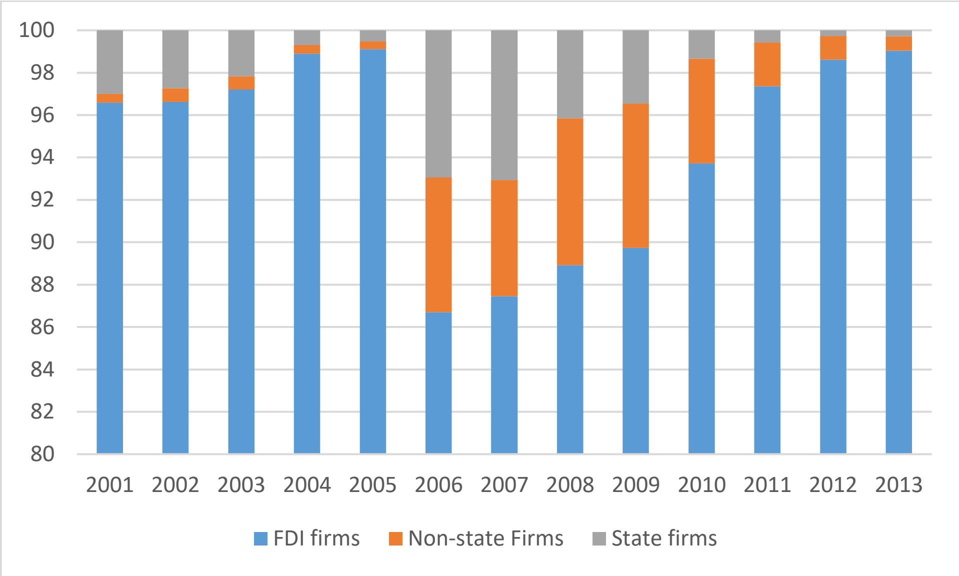

Figure 6: Contribution of economic sectors in creating value added for electronic industry

Source: Annual Enterprises Survey from 2001 to 2013

Additionally, the number of job created of FDI sector is also bigger than this of the domestic firms. In 2013, number of worker in FDI sector is 310 million while this of domestic sector is only 14 million people. More importantly, labor productivity of FDI sector is also higher than domestic ones. From 2001 to 2013, there are some specific periods when labour productivity of state firms is higher than FDI. However, from 2010 on, value added per head of FDI firms starts growing rapidly (Figure 7).

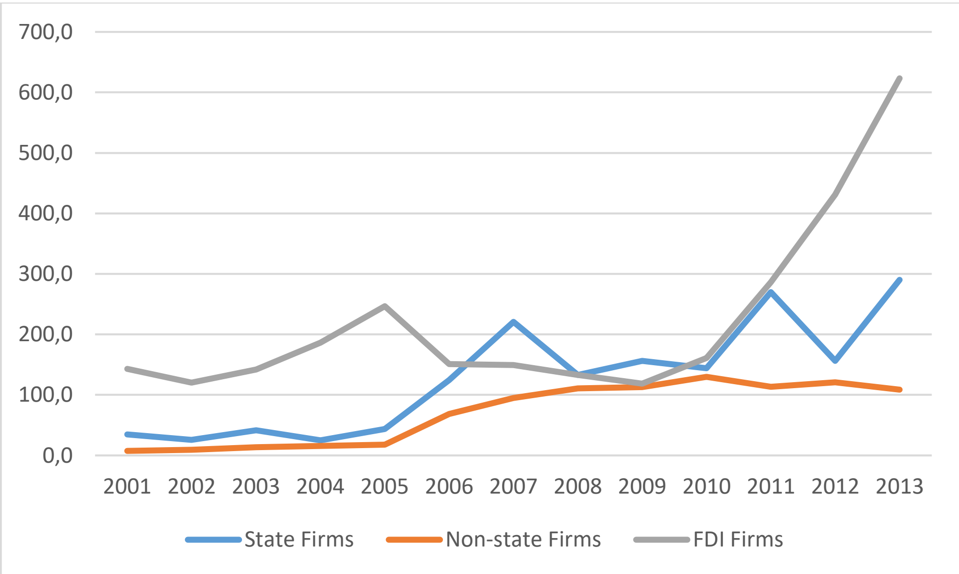

Figure 7: Average value added per head in electronic industry

Source: Annual Enterprises Survey from 2001 to 2013

In general, the electronic industry witnesses the remarkable development in Vietnam recently, however, the engine of this development is FDI sector with great contribution in raising capital, creating gross output as well as value added. FDI performance could be a good addition for industrial development. Additionally, it is expected that FDI appearance must create positive effects on domestic firms with technology and managerial diffusion. Consequently, domestic firms could improve their capability via operation of FDI sector. However, how is the current state in the electronic industry? Let us take a case of Samsung into consideration.

Samsung is authorized to operate in Vietnam from March, 2008 at Bac Ninh. In 2012, Samsung exports USD 12.6 billion which accounts for 11% of total exports. In 2014, Samsung continues to export, and the number of exports reaches a level of more than USD 28 billion. Moreover, Samsung will expand its operation in Vietnam by building other facilities at Thai Nguyen province focusing on smart phones and accessories. Total investment capital at Thai Nguyen province is more than USD 2 billion. Therefore, in 2014 and 2015, estimated revenue from exporting of Samsung will be more than USD 8 billion and USD 12 billion respectively[3].

Samsung has performed well with the impressive statistic numbers. However, how Vietnamese firms could participate in production chain of Samsung? In fact, the case of Samsung is similar to other big corporations located in Vietnam. Most Samsung's component providers are FDI firms locating in Vietnam. More specifically, among 52 component providers of Samsung, there are only 4 Vietnamese firms. Moreover, these Vietnamese firms only provide the low value-added inputs for Samsung. Samsung indicates that the weakness of Vietnam is the poor supporting industry, hence domestic firms are unable to join in production chain of Samsung and unlikely to be the first tier producers. Even when attempting to be second or third tier producers, Vietnamese firms must compete with a large number of FDI firms locating in Vietnam with higher level of technology and human capital (Figure 8)

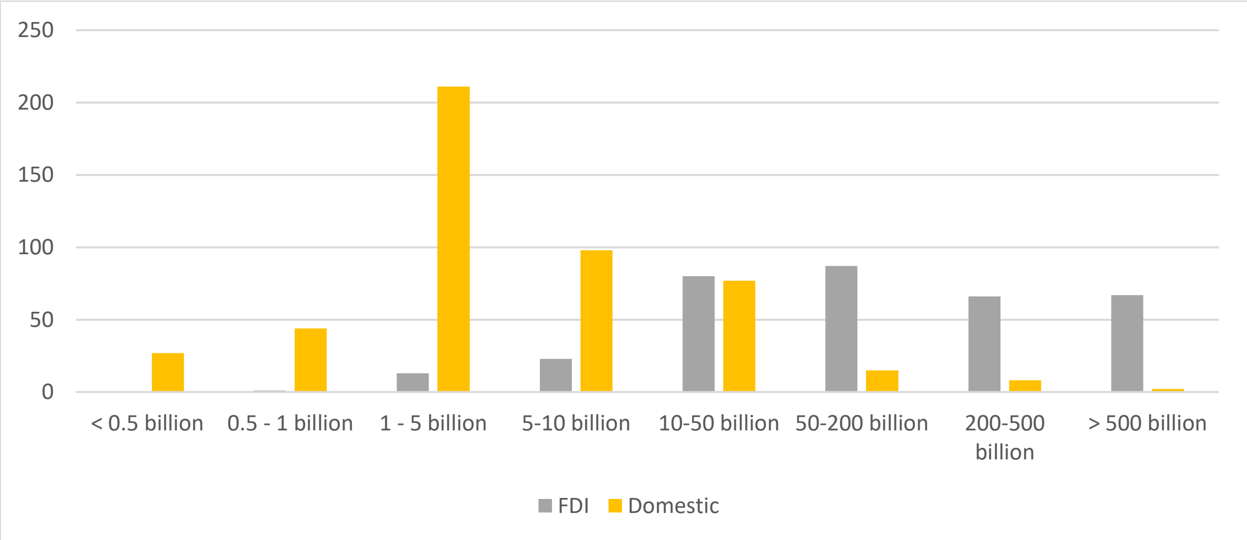

Figure 8: Number of firms in electronic industry (2013)

Source: Annual Enterprises Survey from 2001 to 2013

In general, automobile and electronic industries are two among prioritized industries in Vietnam. Nevertheless, the development engine of the two industries are FDI sector, not domestic one. This study ignores the negative effects of FDI on domestic firms and only looks at the potential impacts of FDI via spillover effects within- industry. However, even when ignoring negative impact of FDI, we only see small benefit for domestic firms in the two industries. FDI firms totally dominate and domestic firms are unable to benefit from

[3] Data are collected from the in-depth interview.

cooperating with FDI firms because the former cannot take part in production chain of the latter. The most important reason is that the supporting industry of Vietnam is poor and domestic firms cannot meet the requirements of the big corporation such as Samsung or Honda. Consequently, the development of these industries might be an achievement of FDI sector only.

5 CONCLUSION

Investment-related problem of Vietnam starts from the stage of selecting prioritized industries. It takes too much time to choose the leading ones. In fact, it is not clear to answer the question that what will be the leading industries of Vietnam in the future.

Then, the problem also occurs within prioritized industries. The study chooses automobile and electronic industry to analyze. The result is that: within these industries, FDI sector totally dominates with a large proportion of investment capital and value added. Domestic firms are not only dominated by FDI but also unable to take part in the production chain of big corporations locating in Vietnam. Consequently, the domestic firms are unlikely to compete and cooperate with FDI. Hence, positive effect of FDI from competition and cooperation is limited. The reason is that the technology gap among FDI and domestic firms is quite big, and the domestic ones cannot fulfill the demand of the foreign partners. Another reason is the difference in human capital among FDI and domestic firms. Therefore, it is time-consuming and costly to learn and adopt new technology and managerial skills (in case they could be diffused). Thirdly, the supporting industry of Vietnam is weak, and it leads to a huge gap unable to fill in the short term among FDI and domestic firms. For all reasons, it is the fact that the engine for development of Vietnam industry is FDI sector, not domestic one. In the short term, it could not be a serious problem, but in the long term, if domestic sector cannot play the leading role, Vietnam economy could be easily stuck into the low-value production trap.

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