Issue 41 • April 2020

VIETNAM BRIEFING

From Dezan Shira & Associates

A Guide to Vietnam's Supply Chains

www.vietnam-briefing.com

Introduction

ALBERTO VETTORETTI
Partner
Dezan Shira & Associates

Vietnam's supply chains have significantly evolved from how they were a decade ago. Today, supply chain shifts to Vietnam are ongoing, helped in some part by the US-China trade war, as a growing number of businesses seek out ASEAN or alternate markets to invest in. Among the countries competing for investment, Vietnam has emerged as a highly effective alternative for relocation in Southeast Asia.

Vietnam's pursuit of foreign investment, competitive costs, trade agreements, and liberal investment environment have made it an ideal location for China-based investors seeking to reduce costs and diversify supply chains. Nevertheless, foreign investors considering the Vietnamese market need to have a clear understanding of the capacity and limitations of Vietnamese production.

Despite its advantages, Vietnam is not without its share of challenges. Manufacturers need to figure out how to realign their supply chains, establish which production elements to relocate, what is the market entry strategy, and understand the rules and regulations that govern Vietnam's several trade agreements.

In this issue of Vietnam Briefing magazine, we examine Vietnam's supply chain network. We look at ways to plan supply chain shifts while using Vietnam as a China plus one investment destination. We then look at Vietnam's free trade network, the advantages and disadvantages of investing in the country along with rules of origin guidelines. We conclude with the status of Vietnam's supply chains and how they are developing as manufacturing in the country matures.

This magazine is based on Dezan Shira & Associates' years of experience in supporting foreign enterprises in Vietnam, including facilitating supply chain shifts during an infectious disease outbreak, such as COVID-19.

Best regards,

Alberto Vettoretti

ASIA BRIEFING
www.asiabriefing.com

Asia Briefing Ltd. Unit 507, 5/F, Chinachem Golden Plaza, 77 Mody Road, Tsim Sha Tsui East Kowloon, Hong Kong.

DEZAN SHIRA & ASSOCIATES
www.dezshira.com

ASEAN BRIEFING
www.aseanbriefing.com

CHINA BRIEFING
www.china-briefing.com

INDIA BRIEFING
www.india-briefing.com

VIETNAM BRIEFING
www.vietnam-briefing.com

RUSSIA BRIEFING
www.russia-briefing.com

SILK ROAD BRIEFING
www.silkroadbriefing.com

Reference

Vietnam Briefing and related titles are produced by Asia Briefing Ltd., a wholly owned subsidiary of Dezan Shira Group.

For queries regarding the content of this magazine, please contact:
editor@asiabriefing.com

Credits

Publisher / Asia Briefing Ltd.
Lead Editor / Melissa Cyrill
Editor / Pritesh Samuel
Contributor / Trent Davies
Designer / Aparajita Zadoo

This Issue's Topic

A Guide to Vietnam's Supply Chains

Table of Contents

The China Plus One Strategy

By Dezan Shira & Associates

As manufacturing in China contracts, Vietnam is experiencing continued and unprecedented growth relative to other low-cost countries. Foreign investors are increasingly choosing Vietnam as a China plus one destination to combat rising costs in China and other unpredictable scenarios such as trade shocks.

This strategy has acquired new value amid the US-China tariff conflict and most recently the COVID-19 outbreak, which have both impacted manufacturers in China and in global markets. Such events are not entirely unforeseen but have a global fallout. Naturally, it makes sense that investors diversify to better manage their risks.

In this context, investors should be able to assess the right sourcing model for a successful sourcing strategy in Vietnam. In addition to its geographic proximity, Vietnam offers several advantages for manufacturers planning to move outside China.

How to plan a supply chain shift

Vietnam is not without its share of challenges. In the short-term, manufacturers may find the production shift daunting as supply chains have to realign. Companies often struggle to decide what to relocate, how they plan to enter the Vietnamese market, and where they will establish operations within the country.

Those that understand these issues will not only have a leg-up over their competition in the immediate term, but they will also make more informed decisions that will position their operations for success over the first few years of in-country business operations.

Step 1: Choose production elements to relocate

Companies should approach Vietnam with a clear understanding of the production that they intend to carry out in this market. For most companies, an alternative location is chosen to improve the economics of their business.

Those targeting more complex manufacturing should conduct a thorough review of Vietnam's available labor force, sourcing networks, and infrastructure to ensure that this production will prove feasible.

Step 2: Pick your entry strategy

Vietnam provides three main options for market entry – engaging local contractors to fulfill elements of production, establishing a new manufacturing facility, or conducting a mergers and acquisition (M&A) deal with an existing factory.

Representative office plus local supply partner

Finding local partners is a fast solution for companies seeking to restructure supply chains as quickly as possible. Under this model, the foreign company enters into a contract with a local factory to manufacture a set amount of goods meeting the foreign company's specifications.

Ordering from a local supplier does not require the presence of a local entity. Depending on the supplier in question, it may be possible to find a partner with a good understanding of local logistics and customs clearance.

Companies seeking to work with multiple suppliers on a long-term basis often choose to set up a representative office (RO) to oversee production within these facilities and act as a liaison between the parent and suppliers. This is particularly popular in the garments industry.

100 percent foreign owned enterprises

Foreign owned enterprises (FOEs) provide the greatest level of access and maneuverability within the Vietnamese market, allowing investors to engage in profit generating activities across all unconditional investment sectors.

100 percent FOEs let foreign investors maintain full control of their Vietnamese entity. Companies that are listed, have strong supplier networks in China, or are targeting Vietnam as a long-term investment opportunity tend to prefer this method of entry.

The time to set up a legal entity for a 100 percent FOE takes between 4 to 6 months, while full production can take up to a year to get off the ground.

M&A

An M&A allows investors to gain access to established business and operations in the market by acquiring business licenses, factories, workforce, and connections of a local company.

The second potential benefit of an M&A strategy lies in the knowledge of the local company, since local partners can provide greater access to suppliers, customers, and sometimes improve a foreign brand's reputation within the domestic market.

Step 3: Identify an optimal location for investment

Vietnam has three key economic regions (KERs) that host the majority of foreign investment and industrial activity within the country. Each KER provides a unique set of production conditions that lend themselves to different investment strategies. Companies should develop a clear understanding of each zone, the specific provinces within this zone, and where industrial activity is carried out. The cluster of industries, businesses, and skill sets is important to selecting the right region.

Choosing the right sourcing model

While Vietnam has several legal structures that can be used as a necessary building block for a successful Vietnam sourcing strategy, it can often be difficult for companies (particularly those new to Vietnam) to decide on the optimal solutions needed to support their mainland sourcing activities.

With so many quality control and trading agents available offering one-stop sourcing services and business-to-business (B2B) online platforms that allow direct contact with suppliers, many will argue that it could be just as effective to utilize a subcontracting agreement and intermediate parties to get the job done.

Although this can be true and is a perfectly workable option, to be more competitive in global supply chains, many small and medium enterprises (SMEs) require an on-the-ground presence either to gain better control of their supply chain or to be able to continue servicing their international customers who have also entered the Vietnamese market.

Therefore, to select the most suitable business model, it is important to carefully balance the capability of each option against the primary needs of the sourcing activities.

For example, foreign SMEs that consider Vietnam an unknown market may prefer the low capital risks associated with an RO. However, at the same time, the wider business scope and operational flexibility that a Limited Liability Company (LLC) offers may also be tempting.

On the other hand, an overseas company that has been purchasing directly from Vietnam for many years may wish to take full control of the supply chain through a trading company, but may be deterred by the complexity of such an entity – a trading company involved in exporting goods is directly involved with Vietnam's complex Value Added Tax (VAT) system and has to comply with customs requirements.

Since Vietnam does not require a set amount of money to be invested, SMEs usually do not put a large amount of registered capital into the subsidiary company. However, companies must ensure that they put in enough money to handle any business expenses arising from operations. The main question is what scale the business scope will take and what level of capital is required to fund this?

Supply chain control vs human resources risks

To obtain a comfortable level of control and assurance over the quality and delivery of products, foreign investors would need to employ reliable staff on the ground to manage quality control, supplier liaison activities, price negotiations, supplier selection, and market research.

As Vietnamese markets mature and price competition intensifies, foreign companies not yet in Vietnam will need to continually assess whether it is still affordable to function via long-distance relationships with their Vietnamese suppliers, or whether more substantial operational control is needed to ensure that competitive pricing is achieved. In particular, adequate control of local HR risks is usually one of the main concerns for companies hoping to strengthen their supplier networks in Vietnam.

Another factor that affects the determination of the scope of the supply chain is the product the supplier wishes to source in Vietnam. Some types of products will necessarily require more complex supply chains than others. LLCs are thus the model of choice for projects with longer and more complex supply chains. An RO is best for those companies which have small and simple supply chains.

Under the laws of Vietnam, an RO, a service company, and a trading company can hire foreigners and local staff as long as the procedures to hire them are well documented and accepted by the competent authorities. A key consideration for any business is the amount of staff required to ensure a smooth operation of the supply chain and keep HR risks to a minimum.

However, it is not always easy to hire foreigners to work in local entities since the Vietnamese government has strict regulations controlling the employment of foreign employers and employees.

Many companies may also require staff to be based at multiple locations around the country (for example, on-site at the factory or traveling for quality control purposes). These types of practical issues must be fully addressed before committing to the appropriate structure.

Key takeaways

The optimal choice of structure comes down to two key factors: local hiring needs and cost-effectiveness. If it is not a requirement to have employees based in Vietnam, then dealing from overseas is likely to be the most tax-efficient option for SMEs sourcing from Vietnam.

However, this approach also has the highest risks in terms of quality and price control. If employees are needed on the ground, then (assuming that the total number of employees needed is still relatively low) an RO becomes a very relevant structure due to its simplicity and low compliance requirements.

For companies that need more flexibility from their Vietnam office, the trading company model would typically be the best option for businesses that are focused solely on sourcing activities.

Your business can be structured as simply as an RO or as elaborately as a multinational company, that uses a combination of the above mentioned legal structures. The most appropriate strategy may be a progression between the different models over time.

Regardless of the strategy, to ensure that the chosen structure adds sufficient value, parent companies will need to regularly monitor the performance of their sourcing offices and continually develop existing and new supplier sources to remain competitive.

Industries primed for relocation

Textiles and garments

The textiles and garments sector are one of Vietnam's major areas of export. For example, Vietnam is the second largest textile and garment supplier to South Korea after China. Industry observers also anticipate that Vietnam will soon take the top spot.

In recent years, multinational retail giants, such as Nike and Adidas, have broadened their manufacturing bases to Vietnam because of cheaper labor costs. Nike began to manufacture more of its product line in Vietnam than China starting in 2009, and Adidas soon followed in 2012.

Electronic equipment

Vietnam's high-tech boom in recent years has paved the way for the country to begin producing more higher-end goods. This is seen in the recent trend of electronics goods factories making the shift to Vietnam.

Most notably, China's Goertek – the assembler for AirPods, Apple's wireless headphones – has confirmed plans to shift production into Vietnam. Amid global tensions due to the uncertain outcome of the US-China trade war, in addition to the hefty tariffs placed on high technology, Vietnam has become a leading alternate manufacturing choice.

Recently, Google announced that it would manufacture its Pixel series phones in Vietnam, while Microsoft would move its production of surface tablets due to the COVID-19 outbreak.

Major electronics firms, such as Samsung, which moved most smartphone production to Vietnam, Cheng Uei, a Taiwanese firm that specializes in manufacturing equipment for iPhones, and Petragon, an assembler of iPhone equipment – are also scaling their options outside of China, with Vietnam as one of the leading alternate countries.

Machinery

Most machinery that is used in the local Vietnamese market is imported from other countries. As Vietnam's industrial sector integrates globally, demand for machinery is booming. To compete and meet demands of foreign customers Vietnam will have to invest in machinery to process products.

As Vietnam expands as a manufacturing hub, it relies on imported machinery mainly from China. However, analysts have warned that the country may become a landfill for outdated machinery. To combat this, the government passed regulation banning the use of imported used machinery and equipment and production line technology that is more than 10 years old, from June 15, 2019.

This presents significant opportunities for investors. Particularly as Vietnam moves towards high-tech manufacturing, the demand to develop this type of machinery is set to increase. The government has also been proactive, organizing machinery and industry fairs to support enterprises.

How does Vietnam compare to its regional peers?

Vietnam has benefitted from the US-China trade war but absorbing all of China's manufacturing is too big a task to take on given Vietnam's size. This has resulted in manufacturers moving to different countries to supplement their China operations. See table below for how following countries compare.

Thailand

Aside from uncertainty regarding its political climate, investment concerns for Thailand generally relate to how the country's strong currency affects its overbearing tourism industry, as well as a slowing economy in the face of China's economic slowdown. While Thailand's infrastructure is better developed, labor costs are higher than Vietnam's.

Indonesia

Indonesia benefits from being close to Singapore and getting investment from business placed there. However, it needs to better establish its trade network to attract foreign investors. Indonesia's infrastructure, bureaucracy, and red tape are still behind Vietnam at the moment, but things are changing fast and investors have to play the long game.

Cambodia

Cambodia is seeing significant investment from China. The government has unveiled several pro-investment policies in a bid to attract investment and this seems to be paying off. However, Cambodia's transport infrastructure remains underdeveloped. In addition, its few ports are burdened with long processing at ports and customs delays. Nevertheless, it has attained a high GDP. The garments, textiles and footwear industry give direct competition to Vietnam.

Philippines

While Philippine's growth has not been as strong as Vietnam's, it is expanding at a respectable pace and has an English speaking population superior than Vietnam's. The country has some of the latest technology in places like Manila with an educated workforce. Nevertheless, labor and electricity costs are higher than Vietnam and infrastructure is still not up to western standards.

Bangladesh

Bangladesh is the world's second largest readymade garment exporter, behind China. Bangladesh's advantage is its low-cost labor. It also enjoys duty free market access or reduced tariffs to many developed and developing nations globally. However, Bangladesh's infrastructure has not been able to keep up and traffic in cities such as Dhaka is significantly congested causing delays. In addition, factory conditions are poor which have led to protests and deaths.

Myanmar

Myanmar has emerged as a popular production base for labor-intensive industries. Several Chinese companies have set up light manufacturing facilities as Myanmar undergoes economic liberalization and implements pro-investment policies. While Myanmar has low labor costs and minimum wages, its infrastructure is still developing and remains inadequate. Electricity remains prone to blackouts, while traffic can be notorious. In addition, due to human right abuses, some sanctions on Myanmar continue to remain in place, while the UN has called for further sanctions against businesses linked to the Burmese army.

Laos

While the World Bank had stated that Laos may gradually be a key link in the regional value chain, the land locked nation still suffers from an inadequate business environment. These include a shortage of skilled labor and infrastructure constraints. Services such as electricity, water, and logistics need to be more developed and lengthy duration for business registrations have hampered its growth, though the government is working on such factors.

An Effective Supply Chain Network

By Dezan Shira & Associates

Importance of an efficient supply chain network

It is crucial to develop a sustainable supporting industry system by increasing the localization rate and maintaining a stable supply of raw materials, components, and spare parts for industrial sectors. A high dependence on imports for supporting industries will lead to higher risks and increase the costs for enterprises.

For example, Vietnam's garment and textile industry is expected to grow by 10 percent up to 2030. However, fabric production only meets 15-16 percent of the domestic demand due to lack of domestic cotton suppliers. Every year, Vietnam needs to import cotton at a rate of 80-90 percent of total demand.

According to Deloitte, supply chains can generate up to 90 percent of overall business costs. An effective supply chain network is important for riding out economic fluctuations and act of God instances, such as a typhoon or pandemic, such as the ongoing COVID-19 outbreak.

Customer satisfaction is ultimately dependent on the supply chain. Businesses must manage their supply chains with this in mind. Factors such as long delivery times, inventory shortages, on time delivery performance, and quality of materials can affect customer satisfaction.

In this context, we highlight four issues in the supply chain particular to Vietnam.

Vietnam's logistics and transport infrastructure

This is still behind China's. While the government has invested in upgrading its transport network, Vietnam continues to depend on an inadequate road network and an outdated and slow railway system. The largest road connections consist of two lanes, but are not the norm resulting in traffic jams. In addition, major cities, such as Hanoi and Ho Chi Minh have run out of space, resulting in serious congestion. Nevertheless, Vietnam already spends up to 5.7 percent of its GDP on infrastructure. A total investment value of US$120 billion has been planned for PPP projects in the road and power sectors.

Vietnam's port infrastructure

This is also lacking compared to its peers. Vietnam has 320 ports, though full container load shipping to Vietnam is not fully established. According to the World Economic Forum, Vietnam ranks 80 among 139 countries in the quality of port infrastructure with an average score of 3.80 on a sale of 1 (lowest) to 7 (highest) between 2006 and 2018. This means Vietnam ranks lower than countries like China, India, Thailand, and Sri Lanka. In addition, the road and rail network around ports remains underdeveloped leading to increased costs.

Customs procedures

When importing or exports goods, customs is one of the most vital considerations in the supply chain network. Goods that are imported and exported are subject to the relevant customs clearance standards. Businesses should be aware of the relevant duties to avoid unexpected price shocks. Businesses should also consider applying for priority customs treatment to ensure minimal delays in their supply chains.

Suppliers

Vietnam's supplier market is still developing. Products that require a high level of technical precision, like aerospace parts, might be harder to source in Vietnam. A simple search for suppliers of plastic, for example, on an online website yields a small number of potential Vietnam manufacturers as compared to China. Businesses in Vietnam must understand the capacity of the local market to support their production needs.

Vietnam's supply chain network can be further augmented using its free trade agreements. We study this concept below.

Vietnam's free trade agreements

Free trade agreements (FTAs) are when two or more countries agree on the terms of trade between them. They determine the value of tariffs and duties that countries impose on imports and exports.

Vietnam's Key Free Trade Agreements	
In effect	**Upcoming or under negotiation**
ASEAN - (AFTA)	Regional Comprehensive Economic Partnership (RCEP)
ASEAN-Australia-New Zealand (AANZFTA)	Vietnam and EFTA (Liechtenstein, Norway, and Switzerland)
ASEAN-China (ACFTA)	Vietnam and Israel FTA
ASEAN-India (AIFTA)	Vietnam-Pakistan FTA
ASEAN Japan Comprehensive Economic Partnership (AJCEP)	Vietnam-Ukraine FTA
ASEAN Korea (AKFTA)	Vietnam-EU (EVFTA)
Vietnam-Eurasian Economic Union (VN-EAEU)	-
Japan-Vietnam Economic Partnership Agreeemnt (VJEPA)	-
Vietnam-South Korea (VKFTA)	-
US-Vietnam Bilateral Trade Agreement (BTA)	-
Vietnam-Chile (VCFTA)	-
ASEAN-Hong Kong, China	-
Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)	-

In 2007, Vietnam's ascension into the World Trade Organization (WTO) facilitated its integration with world trade, subsequently entering into several free trade agreements.

Over the past few years, Vietnam has been active in signing bilateral trade agreements with countries throughout the world. Additionally, due to its membership in the Association of Southeast Asian Nations (ASEAN), Vietnam has become a party to several FTAs that the regional trade bloc has signed.

FTAs: The benefits

The benefits of the free trade agreements will enable Vietnam's economic development to continue to shift away from exporting low-tech manufacturing products and primary goods to more complex high-tech goods like electronics, machinery, vehicles, and medical devices.

This can be done in two ways – first, through more diversified sourcing partners through larger trade networks and cheaper imports of intermediate goods from partner countries, which should boost the competitiveness of Vietnam's exports.

Second – through partnership with foreign firms that can transfer the knowledge and technology needed to make the jump into higher valued-added production.

Vietnam is touted as a low-cost manufacturer with several companies, such as Samsung and Nokia, setting up shop to manufacture and then export electronics, but this also illustrates how Vietnam can develop its own products from the transfer of know-how technology.

Such sophisticated business practices and technology will help boost Vietnamese labor productivity and expand the country's export capacity.

With the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) in effect and the upcoming Vietnam – EU (EVFTA) – Vietnam is prioritizing international trade integration with trade partners outside ASEAN.

Once in effect, such trade agreements will allow Vietnam to take advantage of the reduced tariffs, both within the ASEAN Economic Community (AEC) and with the EU, to attract exporting companies to produce in Vietnam and export to partners outside ASEAN.

Vietnam's entry into these trade deals will also ensure alignment of national standards with international best practices ranging from employee rights to environmental protection. Both the CPTPP and EVFTA require Vietnam to conform to the International Labor Organization's (ILO) standards. The EVFTA will also offer better investment protection for investors through the EU-Vietnam Investment Protection Agreement (EVIPA).

Challenges posed by FTAs

The FTAs may also come with some downsides. Such agreements are likely to trigger aggressive competition from foreign rivals on local businesses – particularly in the agriculture sector, including meat and dairy products from the EU, Australia, and Canada.

If local firms do not adapt, make use of new market opportunities, and potential partnerships with foreign firms – they could find competing in the market challenging.

The Vietnamese government would also need to continue on its path of reforms – strengthening the banking sector, removing corruption, refining legal and tax structures, and improving trade facilitation.

Future growth from FTAs

Vietnam's Ministry of Planning and Investment forecast that the CPTPP could increase Vietnam's GDP by 1.3 percentage points by 2035, while the EVFTA could boost GDP by 15 percent. These trade deals along with already signed and upcoming FTAs are likely to ensure that Vietnam remains competitive in the short-to-medium term.

Finding one's way through the legalese that many of these FTAs use to spell out their rules and regulations can often be cumbersome. This often is one of the most cited reasons why businesses fail to take advantage of the benefits available to them. Therefore, it is strongly suggested that businesses and investors consult with a professional service firm with strong experience in the region. This will allow a business to have a reliable, and clear source of information before making an investment.

What are Rules of Origin?

To understand the specifics applied under a given agreement, one of the most important sections of an FTA is that of rules of origin. Rules of origin establish the method by which signatories of free trade agreements determine if goods entering their borders qualify for the benefits of the agreement.

In order for Vietnamese exports to qualify for tariff reductions under free trade agreements of which Vietnam is a participant, rules of origin requirements mandate varying degrees of the manufacturing process to be conducted within Vietnam.

The objective of these rules is to enforce the trade agreement and to prevent third parties from free-riding off of the concessions of FTA signatories.

Adapting to the complex and global nature of many corporate supply chains, rules of origin chapters have become increasingly complex and require careful due diligence to ensure compliance.

In order for a good to benefit from tariff reduction, it must "originate" from a country party to the trade agreement. The good can be "wholly obtained" from that nation or meet certain requirements in the event that the good is "not wholly obtained".

In the sections below, we describe the differences between wholly obtained goods and goods that are not wholly obtained.

Wholly obtained

Good must be sourced exclusively from within FTA zone or territory to qualify for tariff reductions.

Generally, refers to raw materials and other resources such as livestock and agriculture.

Under several FTAs a list of goods that must meet these requirements is specified.

Not wholly obtained

Goods from multiple jurisdictions that must meet certain requirements to benefit from tariff reductions.

The product has been sufficiently transformed within FTA zone.

Certain percentage of product is originating from that area.

Applicability of Rules of Origin

Although FTA agreements present a tempting way to lower export costs, the ability to tap into their benefits is largely contingent upon compliance with elaborate rules outlined within each agreement.

At hundreds of pages in length, agreements set out specific tariff concessions and compliance requirements at a product-specific level.

In order to ascertain the manner in which goods will be treated, it is first necessary to identify the Harmonized System (HS) code that will be designated to the finished product. This is to determine the applicable tariff.

From a compliance perspective, HS codes will also be used to determine the requirements that a good will be subject to under an FTA. Areas of compliance will often pertain to the manner in which a good is produced, how it is labeled, and the certifications that it requires to be exported and recognized.

There are two ways that a not wholly obtained product is generally classified as eligible for tax breaks:

- It has been sufficiently transformed within the FTA zone; and
- A certain percentage of the product is originating from that area.

The standard for each of these categories varies based on the agreement and the good in question. It is not uncommon for FTAs to require that a certain percentage of inputs be sourced from within the FTA zone and that the goods undergo a degree of change within the zone to qualify for reductions.

Furthermore, the technique by which the value for each category is evaluated differs based on the agreement and the good in question.

For companies attempting to benefit from tariff reductions, the challenge is not only to navigate complex rules that determine an originating product, but also to manufacture goods in a way that is suitable under several trade agreements. It is crucial to conduct a cost-benefit analysis of manufacturing in accordance with the complex FTA guidelines.

Status of Vietnam's Supply Chains

By Dezan Shira & Associates

As mentioned earlier, US-China trade tensions accelerated the movement of supply chains to Vietnam but have not been the trigger. Samsung has moved around 60 percent of smartphone production to the country in the past decade. Nike manufactures most of its footwear in Vietnam. Nintendo and Apple have also been doing the same.

While all this is great for the country, it has resulted in some constraints.

Raw materials and COVID-19

Vietnam's manufacturing sector still depends on raw materials from China. Most recently, the COVID-19 outbreak resulted in challenges for businesses to source locally. The virus has been a wake-up call for several international and local companies. This has not been limited to Vietnam, however. International automobile makers, such as Nissan and Toyota, have had to halt production at factories in Japan, due to lack of supply parts from China. Indian pharmaceutical companies have warned of disruption to their output due to Chinese sourced materials. Other western manufacturers have complained of the lack of Chinese circuit boards for their machines.

Therefore, every company must now look at ways to diversify and reduce its dependence on China as a production site or source of raw materials. While these changes are challenging, they are necessary and will require companies to adapt. Smart investors have already been working with suppliers to diversify and firms can negotiate for some items, but in the short-term costs are likely to increase. Investors have to look at Vietnam as a long-term investment to be able to manage risks. While Vietnam stands to be affected, its high overall growth rate of 7 percent in 2019, provides a partial buffer. Firms in the textile and footwear industry, for example, have already begun sourcing from South Korea, India, Bangladesh, and Brazil.

Supporting industries

As Vietnam moves from agriculture to industry and services, the availability of raw materials, spare parts, and components to manufacturing industries becomes a vital component of this shift. It is crucial for Vietnam to develop a sustainable supporting industry by increasing the localization rate and maintaining a stable supply of raw materials. A high dependence on imports for the supporting industries, will lead to higher risk and increase the cost of doing business.

According to the Japan External Trade Organization – JETRO, the localization for materials, components, and spare parts in Vietnam is at 34 percent, while the rates for Thailand and China are 57 percent and 68 percent, respectively. The involvement of Vietnam's supporting industries in the supply chain of FDI enterprises is assessed as low.

According to The Vietnam Chamber of Commerce and Industries, there are around 151,000 enterprises working under the industrial and construction sector in Vietnam; however, only 1,400 Vietnamese companies, mostly rated SMEs, are engaged in the supporting industries. Only 20 percent of them meet the criteria to engage in the global supply chain and 36 percent of them can join the export-oriented production. Outputs of Vietnam's supporting industries solely caters to 25 – 30 percent of the overall demand for the industrial sector.

Government support

In early 2017, the Vietnamese government issued Decision 68/2017/QĐ-TTg on the development plan for supporting industries over the 2016-2025 period. The Decision aims to promote, support, and attract domestic and foreign investments into supporting industries to create outputs that meet the demand of domestic production and exports and create a gateway for Vietnamese enterprises to step into the global value chain.

Under the program, the output should satisfy 45 percent and 65 percent of the input demand of domestic manufacturing by 2020 and 2025, respectively.

The development of supporting industries focuses on the following fields:

- Electronics and mechanical engineering industries;
- Garment and textile, leather, and footwear industries;
- Hi-tech industries; and
- Automotive industry.

Apart from this, tax incentives are also available for organizations and individuals manufacturing products from the list of prioritized supporting industrial products.

Infrastructure

In addition to presenting opportunities for investors and promising to increase wealth for Vietnam's growing middle class, the ramping up of global connections has increased strain on national infrastructure.

Despite these challenges, the current state of Vietnam's national infrastructure is standard for a country at its stage of development; however, if Vietnam wants to remain competitive, it must develop quickly. According to the World Economic Forum's Global Competitiveness Report 2019, Vietnam ranks 67 out of 141 in terms of overall quality of infrastructure, 103 in quality of roads, and 83 in quality of port infrastructure.

A quick look at the rest of ASEAN makes clear that improved infrastructure will be required if growth is to continue. Singapore, for example, with its more substantial import and export volume, has risen to its current position as a result of seamless logistical support.

The Vietnamese government is currently working to increase the efficiency and scope of infrastructure projects through foreign and private investment via public-private partnerships and equitization.

For the country to maintain its status as a manufacturing hub, the government is emphasizing transport and power projects in industrial zones. To decrease the traffic congestion in large cities, such as Hanoi and Ho Chi Minh City, major public transportation projects are also being undertaken.

The four infrastructure types – airports, roads, railways, and ports infrastructure are vital for supply chains to develop successfully.

In a bid to close the widening infrastructure gap and bolster the country's competitiveness, the government has invested in upgrades to its road and rail network as well as airport and port infrastructure. Vietnam is also in the process of constructing a metro network in two of its largest cities – the capital Hanoi and Ho Chi Minh City.

Vietnam's transport strategy 2020 with a vision toward 2030 envisions total cargo volume to reach 2.09 billion tons, of which 65-70 percent will be moved by road, 1-3 percent by railway, 17-20 percent by inland waterway, 9-14 percent by sea, and 0.1-0.2 percent by air.

Infrastructure in Vietnam

Airports
- International airport
- Domestic airport

Railroads

Ports
- Ports handling > 50,000 TEU*
- Ports handling up to 50,000 TEU*
- New ports planned

*TEU=20 foot equivalent unit container