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Market overview

Vietnam is enjoying key advantages to promote its industrial development: stable and substantial foreign direct investment (FDI) flow and a young healthy yet low-cost labour force. As a result, the country’s manufacturing industries have been witnessing a dramatic growth. Being aware of global integration, Vietnamese policy makers are welcoming international companies, and trying to give them the same opportunities as the local ones. Vietnam will potentially become the next “manufacturing hub” in Asia as China, the former “factory of the world”, is gradually moving away from high-volume manufacturing and labour costs are increasing.

1. Development background

After the “Doi Moi” reform, building a market economy has been one of the priorities in Vietnam. Policy makers are fully aware of how important industrialization is, thus making constant effort to build a strong industrial base and also attract investment from overseas. The deregulation process in Vietnam is taking place with at a remarkable pace as the government has privatised a large number of previously state-owned businesses. In 1999, the government passed the Law on Enterprise, eliminating bureaucratic hurdles which used to be a serious challenge to foreign investors and for the first time recognising the Vietnamese Private Sector. Moreover, with the signing of numerous bilateral and multilateral trade agreements, there has been a significant ongoing growth in private businesses. In 2007, Vietnam was admitted to World Trade Organisation (WTO), its progress towards international economic integration has been accelerating since.

In terms of industry structure, most emerging industrial countries have a low-skilled and labour-intensive industries. Vietnam is no exception. Among the manufacturing sectors, footwear and textiles have created hundreds of thousands of jobs within Vietnam although in recent years electronics has moved to the forefront and is now the leading export product, overtaking garments and footwear.

2. Current situation

In 2017, GDP growth in Vietnam was recorded at 6.8%, exceeding the 6.7% target set out by the government. This figure jumped to 7.1% in the first half of 2018. Fundamental to Vietnam’s economic growth was the significant rise in manufacturing output. Manufacturing production increased 14.4% last year. The first half of 2018 witnessed Vietnam’s continuing manufacturing boom at 12.9%, coupled with industrial and construction sector growth in the economy at 9.1% (Deloitte, 2018). The manufacturing and processing industries are top choices for foreign investors, making up 44% of FDI capital inflow into Vietnam in 2017. 2017’s FDI figure reached $35.88 billion - the highest since 2007 (Shira, 2018). Since its accession to WTO, Vietnam has received $108 billion of FDI in total, while the country’s trade in 2017 has risen to 190% of GDP from 70% of GDP in 2007 (The Economist, 2018).^{1}

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Vietnam has steadily turned into a manufacturing hotspot in Asia, particularly with electronics, due to its relatively large and low-cost labour force, attractive tax regime, stable political environment, geographical advantages, and open trade policies. The liberalisation of Vietnam’s economy comes at the perfect time when China is attempting to ascend the manufacturing value chain to higher value added manufacturing. Vietnam is now considered a potential alternative by many multinational corporations based in China. Already, many have relocated their manufacturing facilities across the border.

The rise of labour costs in China is working in Vietnam’s favour. Vietnam is now able to offer a healthy labour force at a relatively low cost, less than half of China and a fraction of Mexico. 70% of Vietnam’s population is currently at working age. This guarantees an abundant supply of local workers into the future, regardless of a projected decrease of 10% in working-age percentage (The World Bank, 2018). The income gap between manufacturing workers in China and those in Vietnam was $1 per hour in 2009, but this figure has seen a dramatic increase to $2.5 per hour in 2015 (Oxford Business Group, 2017). Another considerable advantage for Vietnam is its regulatory regime. China is having more and more complex regulatory compliance requirements. By contrast, with its accession to WTO, Vietnam has turned into a receptive and open investment environment. Vietnam currently stands at 68 out of 190 countries in World Bank’s Ease of Doing Business ranking, ahead of China, India, Philippines, and Bangladesh.

As multinational corporations try to find their way out of the reliance on “the manufacturer of the world”, ASEAN countries stand a good chance as they bear certain similarities. Nonetheless, Vietnam does offer many competitive advantages in comparison with its ASEAN counterparts. One prominent advantage is its low minimum wages. The widest minimum wage gap in 2018 between Vietnam and Thailand is approximately $50 per month.

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4 Business Monitor International, Economic Analysis - Manufacturing Boom To Be Sustained
## ASEAN Minimum Wages

<table>
<thead>
<tr>
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<tbody>
<tr>
<td><strong>Vietnam</strong></td>
<td>2,580,000 to 3,750,000</td>
<td>114.29 to 166.13</td>
<td>2,760,000 to 3,980,000</td>
<td>122.27 to 176.31</td>
<td>In effect 1st January 2018</td>
</tr>
<tr>
<td><strong>Philippines</strong></td>
<td>7290 to 15,360</td>
<td>140.26 to 295.53</td>
<td>7680 to 9300 (only for Region I – Ilocos)</td>
<td>147.76 to 178.94 (only for Region I – Ilocos)</td>
<td>In effect 25th January 2018</td>
</tr>
<tr>
<td><strong>Thailand</strong></td>
<td>9000 to 9300</td>
<td>285.39 to 294.90</td>
<td>9240 to 9900</td>
<td>293 to 313.39</td>
<td>In effect 1st April 2018</td>
</tr>
<tr>
<td><strong>Malaysia</strong></td>
<td>920 to 1000</td>
<td>233.83 to 254.16</td>
<td>Same as 2017</td>
<td>Same as 2017</td>
<td>Government working on revised rates for 2018</td>
</tr>
<tr>
<td><strong>Indonesia</strong></td>
<td>1,337,745 to 3,355,750</td>
<td>99.80 to 250.35</td>
<td>1,560,000 to 3,920,000</td>
<td>109.20 to 274.40</td>
<td>In effect 1st January 2018</td>
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(Das K., Vietnam Briefing, 2018)

Being close to major global supply chains, Vietnam’s strategic geographic location undoubtedly brings specific convenience to businesses seeking a new manufacturing base. For those already with an established base in China, Vietnam can be an ideal supplementary high-volume manufacturing point with low-cost input. Thanks to its shared territorial border with China, manufactured goods in Vietnam can easily be incorporated into existing supply chains. Northern Vietnamese cities such as Hai Phong are only 865 km away from Shenzhen – China’s major manufacturing site. Such distance is much closer compared to other options in the region such as Bangkok (2,750 km), Jakarta (3,300 km) or Kuala Lumpur (3,025 km) (Dezan Shira & Associates, 2018). This would reduce costs of transportation and relocation expenses for China-based businesses. Additionally, resemblances in weather conditions, culture and social aspects between the two countries are also factors giving Vietnam an edge compared to other ASEAN countries.

The embracing of trade liberalisation also makes Vietnam an attractive destination for foreign investors. In 2015, the government opened 50 industries to foreign competition and loosened
regulations in over 100 other areas (The Australian Financial Review, 2015). Less FDI restrictions and requirements for local ownership in manufacturing increases Vietnam’s competitiveness as this has been a huge problem for investors in neighbouring ASEAN nations such as Thailand.

More importantly, for a country at this point on the value chain, Vietnam’s strength lies in its network of trade agreements that extend to major markets across the globe. At present, Vietnam is a signatory to 16 bilateral and multilateral free trade agreements in various stages of development.

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<th>Signed and In Effect</th>
<th>Signed But Not Yet In Effect</th>
<th>In Negotiations</th>
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<tr>
<td>FTAs</td>
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<tr>
<td>Vietnam-Korea,</td>
<td>ASEAN-Hongkong,</td>
<td>Vietnam-EU</td>
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<td>Vietnam-Japan,</td>
<td>China</td>
<td>Vietnam-European Free</td>
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<td>Vietnam-Chile,</td>
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<td>Trade Association</td>
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<td>Vietnam-Eurasian</td>
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<td>Vietnam-Israel</td>
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<td>Economic Union,</td>
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<td>Regional Comprehensive</td>
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<td>ASEAN,</td>
<td>ASEAN-China,</td>
<td>Economic Partnership</td>
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<td>ASEAN-China,</td>
<td>ASEAN-Korea,</td>
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<td>ASEAN-Korea,</td>
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<td>ASEAN-Japan,</td>
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These trade agreements dramatically cut down tariffs and opened much of the economy to foreign investment. More than 10,000 foreign companies - including big global players such as Samsung, Microsoft, Intel, and LG - are currently operating in Vietnam today, mostly in labour-intensive, export-oriented manufacturing.

(Source: Brookings)

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3. Sector performance

*Electronics & computers*

Vietnamese manufacturers’ ability to secure new export orders is central to its growth. Among Vietnam’s key exports, electronics & computers took the top spot as the fastest growing sector, up 37% in 2017. The Central Institute of Economic Management (CIEM) has ranked Vietnam in the top 12 electronics exporters in the world, since 2015. Last year, mobile phone exports reached $45.27 billion while exports of computers and other electronics reach $25.94 billion. Electronics sector in Vietnam has attracted a large amount of FDI. South Korean electronics giant Samsung has invested a total of $17.3 billion, including 8 factories and a research and development centre in the country. Canon produces more than 50% of its computer printers in Bac Ninh – a city north-east of Hanoi. Other FDI enterprises include Intel with a $1 billion factory outside Ho Chi Minh City; Hon Hai, a Taiwanese company producing devices for Apple and computers for Dell; and HP, which opened a $1 billion factory near Hanoi.

*Textile and garment*

In 2017, Vietnam’s textile and garment industry observed a 10% y-o-y growth with exports reaching $31 billion, second only to that of mobile phones. The first half of this year witnessed export turnover for this sector reaching $16.5 billion – a 16.5% increase compared to the same period last year (Tran, 2018). The upward trend is likely to continue as export turnover for 2018 is expected to total $35 billion (Thu, 2018). By 2035, this number is forecast to grow further to $200 billion. Since Vietnam opened its doors to foreign investors, its textile and garment industry has attracted a total investment of $15.7 billion from 26 countries around the world. South Korea is the biggest investor with over $4.4 billion, followed by Taiwan ($2.5 billion), Hong Kong ($2.1 billion) and Japan ($789 million) (Vietnam Economic News, 2018). Some recent foreign investments include large-scale projects such as Ramatex Nam Dinh - the $80-million textile and garment factory (Singapore), and YKK Ha Nam – a factory specialising in manufacturing zippers and garment-related products with a capacity of 420 million products per year (Japan). The localisation rate for raw materials in this industry is high - 80% for fiber, 60-65% for polyester fiber, 50-57% for woven fabric.

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7 *IHS Markit*, Manufacturing sector leads strong growth in Vietnam’s GDP, 2018
8 *Viet Nam News*, 2017
Footwear

Footwear is one of Vietnam’s key export items, ranking 4th in terms of export turnover. Footwear export reached $14.6 billion last year – a 12.6% increase y-o-y (General Statistics Office, 2018). This figure is expected to increase to $20 billion this year. Currently, Vietnamese footwear products are exported to 45 markets around the world. According to statistics published early this year by World Footwear Magazine, Vietnam continued to rank second among the ten largest footwear exporters in 2017, with 1.02 billion pairs of shoes, equivalent to 7.4 per cent of the global footwear supply. Since 2014, there has been a wave of world-famous shoe and handbag manufacturers shifting their production to Vietnam from China. Specifically, global brands like Adidas, Puma, and Nike transferred 25% more orders from China and Bangladesh to Vietnam compared to the same period the previous year, according to the Vietnam Leather and Footwear Association (LEFASO). In 2017, Adidas made 44% of their footwear in factories in Vietnam, up 13% from 2012. Fast Retailing Co., Ltd., Uniqlo’s parent company, has moved operations from China to Southeast Asian countries, including Vietnam, to reduce labour expenses. The company currently only pays half as much on labour as in China.

Wood & wood products

Vietnam is one of the top exporters of wood & wood products in Asia. At present, there are about 4,000 wood processing factories in the country’s southern provinces, of which FDI enterprises account for 15% (mainly Taiwan, Korea, UK, Japan, China), the remaining domestic enterprises accounted for 85%. Export turnover for this sector reached $7.66 billion in 2017, up 10% from the previous year. The main export markets are USA, Japan, China and EU. One of the main drawbacks for this sector is that Vietnam still needs to import materials for processing finished products such as timber, glue, resins, paints, knives, screws, nails; which account for about 30% of the product value.
Setting up a company in Vietnam

Attractive as the destination appears, there are certain issues that multinational businesses need to note when venturing into Vietnam, including identifying a suitable business model and locating a manufacturing site.

1. Identify a suitable business model

In Vietnam, there are two main options for multinational companies establishing an entity here: Joint-Stock Company (JSC) and Limited Liability Company (LLC). JSC is the preferred choice for companies that plan to go public in the stock market. With the minimum of 3 founders and a board of directors required, this type of corporation can issue shares to attract investments. By contrast, LLCs cannot issue shares like its counterpart, while the number of owners has to be from 2 to 50. At the current time, LLC is still the more common form not only in Vietnam but around the world thanks to its simplicity compared to JSC.

Investors can easily establish an LLC in Vietnam. In some restricted sectors, the founder has to prove their background in the field and the relevance between the scope of the homeland business and what will be done in Vietnam. Otherwise, there is no restriction. Concerning proving financial capability, unless you operate in a country where you can get an audited statement quickly, your company is supposed to have been established for at least one year beforehand. However, this is not so challenging a requirement. Regarding government structure and management, there needs to be a members council under the leadership of a chairman whose management role is functionally equivalent to that of a board of directors. In terms of owners, each member can participate in the council themselves or have a point representative to manage investments and serve membership roles. To manage the day-to-day operation, a General director must be appointed. This person needs to be based in Vietnam and be a resident, though not necessarily a local. The director also assumes the responsibilities of a legal representative of the company.

2. Locating a manufacturing site

Industrial Parks and Export Processing Zones have played a major role in attracting foreign investments as well as the development of the country. Investing firms in these zones benefit from preferential government policies regarding land lease and tax incentives. Options can be narrowed down by geographical concentration of industries as some regions host more enterprises from a specific industry than others do. In the first half of 2017, a 39 per cent year-on-year rise to $384.3 million was witnessed in Investment in industrial parks (IP) and export processing zones (EPZ). In this impressive number, FDI contributed $159 million while the rest came from domestic investors (Shira Dezan, 2017)\(^\text{10}\). This upward trend resulted in an increasing number of industrial parks in Vietnam. As of September 2016, 220 out of 325 industrial zones set up across the country have been

According to the government’s plan, there will also be three special economic zones constructed in the near future.

Choosing a suitable industrial park to build a factory is not an easy task for any foreign-invested enterprise (FIE). A number of factors must be thoroughly considered before any decision is made.

First and foremost, the geographic location of the industrial park must be carefully studied. Generally evaluating, the 2016 Provincial Competitiveness Index ranked Da Nang, Quang Ninh, Dong Thap, Binh Duong, and Lao Cai the top industrial provinces. From another approach, enterprises of the same industry tend to cluster in a specific area. For example, garment and textile manufacturing is concentrated in both North and South Vietnam while footwear and furniture manufacturing are both concentrated in South Vietnam. Located in a specialised area, new companies are more likely to have their demands met thanks to the availability of specialised facilities and infrastructure networks. The notable point is that while the Northern part is closer to China, one the major suppliers and consumers, the Southern part is the largest commercial port itself.

Secondly, a suitable destination must provide proper infrastructure. As this has long been known as a weaker point in Vietnam, the government is making great effort to meet international standards. Issues concerning buildings, factories, the source of energy and water, wastewater treatment plants, garbage disposals, fire prevention systems, telecommunications, access to banks and post offices, logistics services and transportation are receiving much attention. With regards to this criterion, Binh Duong, Da Nang, Ba Ria Vung Tau, Dong Nai, and Vinh Phuc were highly appreciated in the 2016 Provincial Competitiveness Index.

Lastly, where to base a FIE also determines whether the business will be qualified for tax incentives like exemptions or reductions of Corporate Income Tax (CIT), Value-Added Tax (VAT) and import tariffs for specific periods. The standard CIT rate is 20%. Disadvantaged areas, industrial parks, export-processing zones, hi-tech zones, and economic zones are divisions or locations that are entitled to preferential tax rates. A tax holiday of up to 4 years and 50% tax reduction for up to 9 years are also available depending on project. Investing firms are eligible for import duty exemptions for goods imported for projects in encouraged sectors and intermediate goods for re-export.

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12 Ibid,
13 Ibid,
Challenges

Vietnam is one of the promising destinations for multinational companies to set up high-volume production factories. However, there still exist certain challenges that investors need to take into account.

1. Policies

Development’s over-reliance on FDI can cause structural problems in the future when FDI-intense sectors outperform the others. This issue can be attributed to two significant factors: the overwhelming number of wholly foreign-owned manufacturers, and the weak vertical linkages between these manufacturers and local firms due to the dependence on overseas sources for materials. Manufacturing industries in Vietnam are going strong, but they are not adding much to the supply chain. This leads to a situation where Vietnam might fall into the middle-income trap. This is what policy makers are trying their best to avoid through attempts to promote localisation and encourage companies to invest more intensely as well as import more advanced technology. Additionally, “rules of origin provisions” are included in most of the existing FTAs, which means if manufacturers cannot partner with local suppliers, only certain types of imported goods will be subject to tariff reductions. With a hope to boost the country growth up the value chain, Vietnam’s government tends to encourage businesses to be more integrated. The textile and garment sector is an example proving that companies that do actual producing, dying, and stitching are always prioritised

2. Infrastructure

A press release by IHS market stated that manufacturing costs are increasing due to the great delays of delivery caused by traffic congestion. Moreover, there are newly introduced tonnage rules that worsened the situation by forcing suppliers to make more delivery trips. Everything is especially difficult for companies having to transport products around the country. This is unavoidable as most manufacturers in Vietnam scatter plants across the nation to cater to consumers in different regions.

<table>
<thead>
<tr>
<th>Logistics Performance – Infrastructure constraints in perspective</th>
<th>Indonesia</th>
<th>Singapore</th>
<th>Malaysia</th>
<th>Thailand</th>
<th>Vietnam</th>
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<tbody>
<tr>
<td>Drivers of competitiveness</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Infrastructure</td>
<td>2.65</td>
<td>4.20</td>
<td>3.45</td>
<td>3.12</td>
<td>2.70</td>
</tr>
<tr>
<td>Logistics competence</td>
<td>3.00</td>
<td>4.09</td>
<td>3.34</td>
<td>3.14</td>
<td>2.88</td>
</tr>
<tr>
<td>Trading and tracing</td>
<td>3.19</td>
<td>4.05</td>
<td>3.46</td>
<td>3.20</td>
<td>2.84</td>
</tr>
</tbody>
</table>

(Unit of measurement: sufficiency point) (Shira Dezan, 2016)

The Vietnam government is willing to go to considerable lengths to fix these problems. The government plans to invest $48 billion in infrastructure improvements in a five years period from

2016 to 2020, including metro systems in Hanoi and Ho Chi Minh City that are currently under construction. At the same time, the main highway system is also being overhauled to meet the increasingly high transportation demands.

3. Other challenges

Apart from the above, common obstacles in emerging markets, such as administrative process, corruption, intellectual property rights are also factors to put into consideration.

- Administrative processes: The biggest challenge for new businesses in Vietnam is the administrative processes. The commercial law and overlapping regulations, to be specific, do create issues and challenges for multi-national in particular. As a result, it could take up to one year for everything to come into operation. This forces most investors from overseas to seek help from professional legal consultants to minimise possible delays.

- Corruption: A lack of transparency, uniformity, and consistency in policies and decisions is frequently witnessed in commercial projects in Vietnam. There are two main factors behind this issue. Firstly, regimes and commercial law in this country keep being updated to keep up with the ever-changing economy. Secondly, it is frequent for government ministries to have their jurisdiction overlapped with each other.

- Intellectual property: Despite numerous efforts made by policy makers, intellectual property in Vietnam is yet to be effectively protected. In 2017, the piracy software rate for the IT industry stood at 74 percent – a concerning record compared to other manufacturing destinations. (US Embassy, 2018)
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