Enhancing Cooperation with FDI Enterprises

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Abstract: The paper presents an overview of key issues in the process of strengthening effective relationship with foreign direct investment region. Based on that, the author offers some suggestions for Vietnam to switch from growth model of volume to the growth of quality through FDI technology transfer and determine policy priorities.

Key words: Foreign direct investment, businesses, Vietnam.

1. The expectation of attracting foreign direct investment

Like many countries in the world, Vietnam expects to attract foreign direct investment (FDI), including job creation and income, transfer of technology, participation in international production networks, contribute to the tax revenue and reduce financial difficulties.

Creating jobs and income is one of the positive impacts of FDI. For a country with young population and growing new workers each year like Vietnam, the presence of labor-intensive FDI is welcomed because it creates jobs and income for new employees, reduces the problems of unemployment and underemployment. This situation is common in a low-income country with a large number of unskilled workers. Most ASEAN countries such as Malaysia, Thailand has adopted such policies in the previous period. Job creation remains the overall policy objectives in India today. However, when the countries overcome low-tech production, wages began to rise and shortages of skilled labor have appeared, policies need to move from creating any job to the high salary jobs.

Technology transfer is a benefit that the host country expected most from FDI. Attracting multinational corporations (MNCs) with both capital and technology will create favorable conditions for technology transfer and business know-how, make contribution to increasing the productivity and competitiveness of domestic enterprises. Actually, there are two types of spillovers: horizontal (within one industry) and vertical (interdisciplinary). Horizontal spread occurs when MNCs and local firms belonging to the same industry, interdisciplinary occurs when there is an interaction between domestic and foreign companies under different industries (backward or forward link).

Spillover effects can be developed through the implementation of best demonstration projects, then deployed on a large scale of building production linkages between foreign

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and domestic firms. Accordingly, domestic enterprises will become suppliers or customers, or the movement of experienced engineers and workers from foreign firms to domestic firms. The involvement of MNCs can also increase competition in the industry and forcing domestic firms with less competitive to withdraw from the market and existing domestic enterprises to imitate and be creative.

Joining the global value chain is a potential advantage of attracting FDI. Global and regional production networks are quickly developing in automotive, machinery, electronics and apparel industries. Domestic enterprises, especially small and medium enterprises, could indirectly involved in the global network by becoming the supplier of spare parts or outsourcing services of MNCs. Joining the network can provide domestic companies more knowledge and experience of accessing directly to export markets.

Another advantage of FDI relates to financial resources. In the countries short of capital, the financial strength of MNCs making large investments is beyond the capacity of domestic firms. The investment in heavy industry, such as petrochemical complexes, integrated steel plants or power plants are specific examples.

Due to the above mentioned positive effects, FDI is now generally regarded as a very positive factor for the economic development of developing countries, some are competing fiercely to attracting FDI. This phenomenon can be partly explained by the undeniable fact that FDI plays an important role for the success of industrialized and economic transformation process in the East Asia (flying geese model). From perspective of the developing country governments, it is important to have mechanisms and policies to guide and regulate the activities of FDI enterprises to maximize the positive impacts and minimize the negative ones.

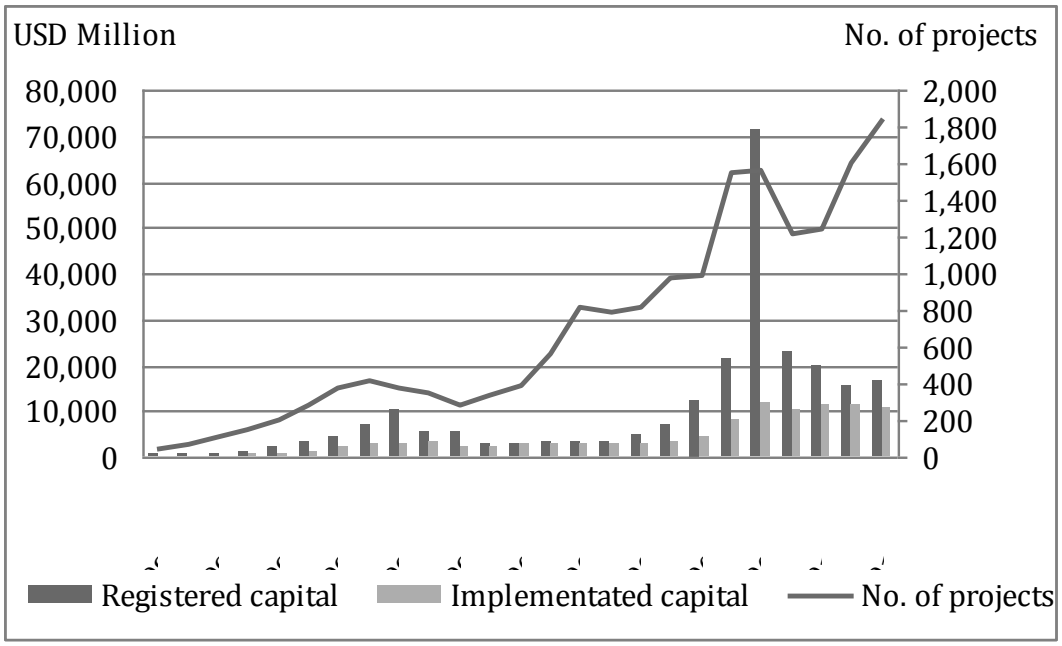
2. Current status of foreign direct investment in Vietnam

Since the early 1990s, attracting foreign direct investment or allowing foreign companies to conduct business in Vietnam is one of the resources for the process of industrialization besides the other factors as liberalization of the economy, enterprise reform, official development assistance (ODA) and participation in bilateral, multilateral and regional trade agreements. During the last two decades, from a backward agricultural country, Vietnam has become a newly industrialized country with low average income. These changes and reforms of attracting FDI policies contribute an important part to turn Vietnam into a major attraction of FDI. This contributes to improved product structure, labor and trade.

In the period from 1988 to 2013, FDI inflow to Vietnam tended to increase in the long term and fluctuated slightly in the short term. In the period 2004 – 2008, the number of registered capital and the number of projects increased significantly. Number

of realized capital increased at a slower rate so the ratio of realized capital / registered capital tended to decrease. The number of FDI surged in 2008 reflected the strong growth of the world economy as well as the great interest of foreign investors after Vietnam became an official member of the World Trade Organization (WTO) in 2007. Registered FDI in 2008 included major projects such as petrochemical complexes, steel mills, software technology parks and tourist complexes. However, the world economy was badly affected by the financial crisis in late 2008, therefore most of these projects were delayed or withdrawn. The capitalization rate in 2008 was done in the lowest level of 16%. Accordingly, the operations attracting FDI in the period 2009 - 2012 slowed though remained high with total capital of approximate 10-11 billion dollars. However, the ratio of realized capital / registered capital increased to 70% in 2011.

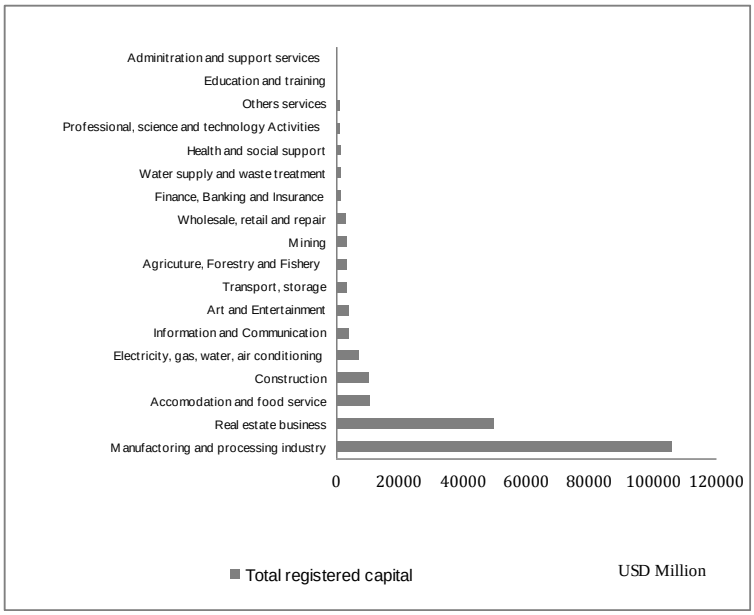
Figure 1: Number of Projects, Registered and Implemented Capital in Vietnam



Source: General Statistics Office.

Figure 2 shows the classification of FDI by industry. FDI in Vietnam is mainly focused on manufacturing and real estate. In 2012, FDI in manufacturing sector accounted for the highest position in terms of FDI project numbers and registered capital. However, this is not the highest registered capital on one project sector, but real estate. Real estate also has the largest fluctuation. Within a few years, Vietnam real estate market was "frozen" due to the FDI decline in this sector with a total registered capital decreased from 34.3% in 2010 to 5.8% in 2011.

Figure 2: FDI in Economic Sectors
(Total registered capital by 5/2014)

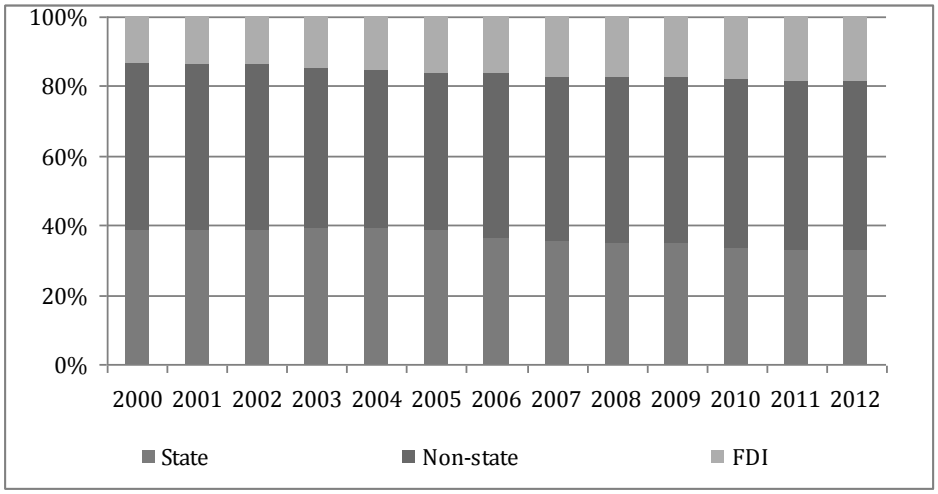


Source: General Statistics Office.

Most FDI comes from Asian countries. By the end of May 2014, 8 out of 10 largest investors in Vietnam are Asian countries. Total number of registered capital from these countries accounted for about 82% of all FDI flows into Vietnam.

Vietnam's success in attracting FDI contributes positively to the economy. Figure 4 shows that in the period 2000-2012, the contribution of FDI in GDP increased from 13.3% in 2000 to 18.1% in 2012.

Figure 3: Comparison of GDP Contribution among Economic Sectors



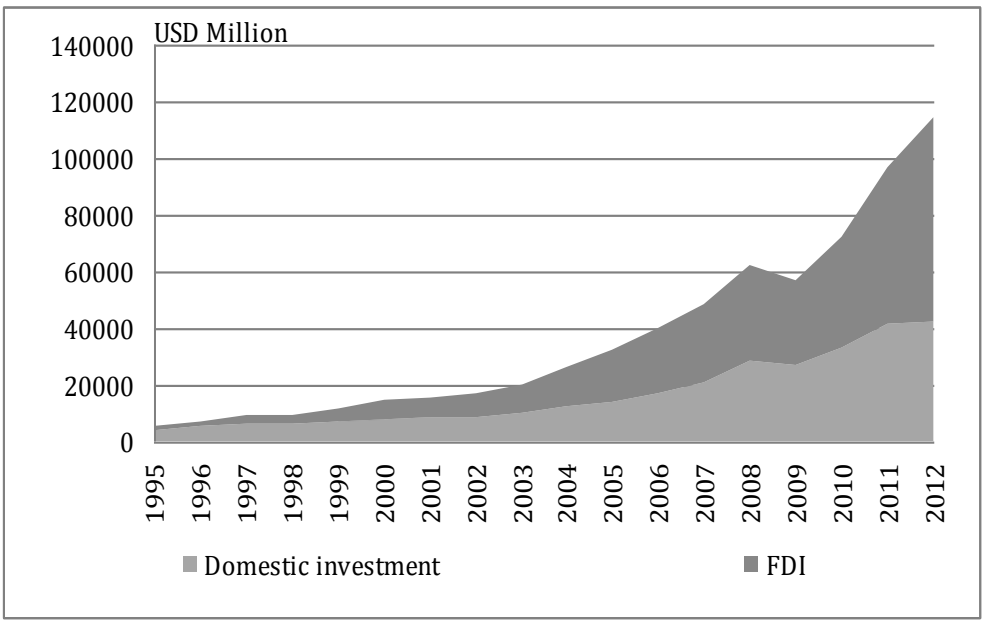
Source: General Statistics Office.

The contribution of FDI on job creation, though relatively small, tends to increase. FDI sector directly generated about 3.4% of total employment in 2011 compared to 1.0% in 2000 and 2.6% in 2005. If we add the number of indirect jobs created, the rate of FDI contribution on employment will be much larger.

Despite the absolute value increases, the contribution of FDI inflows in total social investment fell from 30.4% in 1995 to 14.2% in 2004 primarily due to increased public investment. Then, the proportion of FDI in social investment rose to 14.9% in 2005 and reached 23.3% in 2012. Meanwhile, the proportion of public sector decreased after 2001, partly due to state enterprises reform activities and public spending decrease.

FDI enterprises contribute significantly to increase exports. In 2011, FDI reached $ 55 billion exports, or 49.5% of the country's total exports. Figure 4 shows the trend of FDI export growth from 1995 to 2011 at a faster pace than domestic enterprises. Exports decreased in 2009 due to the world economic slowdown but increased steadily in the following years. This confirms the fact that FDI makes important contribution to trade activities and economic structure in Vietnam.

Figure 4: Exports of Different Economic Sectors



Source: General Statistics Office.

On the net exports (exports minus imports), the role of FDI is quite important. Many industries import a large amount of machinery, equipment and materials. This reduces the contribution of FDI sector in generating foreign exchange earnings. For a long time, FDI has been seen as a net exporter and the domestic sector is still a net importer.

FDI contributes significantly to revenue and macroeconomic balances. Although enjoying more preferential investment policies through free/reduced corporate income tax and export-import tax, the revenue contribution of FDI increased from 5.2% of total revenues in 2000 to 11.0% in 2011.

Despite such positive contribution, FDI flows into Vietnam have yet to achieve national expectations for technology transfer and direct Vietnam enterprises more deeply involved in international production networks.

Table 1: Production Link with FDI Enterprises

Input Sources	Percentages
Importing through parents company	20,4
Direct importing	38
Buying from domestic manufacturers	26,6
Buying from foreign manufacturer branch in Vietnam	12,5
Importing from importer/ distributor in Vietnam	2,5

Source: Vietnam Industrial Investment Report, 2011.

Basically, FDI enterprises in Vietnam imported material for production primarily through direct imports (Table 1). Although the proportion of the supply input of Vietnam ranked second after direct import channels (26.6% versus 38%), this also suggests Vietnam businesses have not taken advantages of home soil to meet the needs of input material for FDI enterprises. In other countries, this ratio is usually above 50%, even 90% for some specific industries. Even for Honda Vietnam with 90% localization rate, the number of domestic suppliers was only 19% in 2009.

In general, the high economic growth of Vietnam in the past two decades associated with the funding and operation of FDI in Vietnam. FDI tends to increase its contribution to macro-economic indicators, such as GDP, investment, employment, exports, government revenue which are evidence to show its important role for Vietnam. Despite significant achievements in the early stages of the industrialization process, Vietnam is facing new challenges. To achieve higher level of income and technology, the old style growth model based on number and trade liberalization should be replaced by new growth models capable of increasing domestic value by enhancing skills, productivity and innovation.

In this context, policies attracting FDI seen as a pillar of development must also complete. The changes/reforms of legal procedures and processes to attract investors have been carrying out. But they will not be enough to put Vietnam on further technological level. Moving from a simple industry with cheap and low skilled labor-intensive to modern industry with adequate high income levels requires FDI policy be customer-

oriented, selective and consistent with the industrialization strategy of the country.

Firstly, there are at least two prospects for Vietnam economy.

Vietnam has easily completed the first phase of industrialization and is facing slow growth condition; therefore, the objective of the policy is to create momentum new growth that does not depend solely on the mere quantity of labor input, the number of businesses, trade opportunities, domestic investment, FDI, ODA or financial flows. The elements of the shift from quantity to quality are described.

In this context, two new engine of growth for Vietnam should be clearly identified, namely (i) prioritizing, focusing on productiveness; and (ii) transferring technology, promoting FDI links. The next section focuses on discussing the second content.

3. Strengthening links with FDI

3.1. Technology transfer

It must be emphasized that FDI does not automatically raise the level of technological and industrial capacity of the country. Only the manufacturing FDI enterprises can contribute significantly to improve industrial capacity of a country, rather than the mining company, the real estate developer, or the large infrastructure project builder. The huge investments mentioned above either from public or private sector can help build infrastructure or bring money to the country, but little hope of knowledge accumulation, skills and technology in general.

Even with manufacturing FDI, technology transfer does not take place spontaneously. The presence of the high-tech global enterprises such as Intel, Samsung, and Canon, etc. does not mean that new technology will be automatically transferred to Vietnam. These multinational companies often seek developing countries to implement the labor-intensive assembly, which generated the lowest value of the global supply chain and they cannot afford to implement it in developed countries. These FDI projects essentially are not different from FDI in the garment industry and food processing in the sense that they turn to Vietnam as the supply of unskilled workers and hope for additional offers (if available), not the place to transfer and receive high-tech.

While developing countries often desire high technology, the exclusive knowledge is company's secrets which are strictly protected by intellectual property rights and will not be transferred to developed countries without being paid high fees. Moreover, technology transfer will not occur unless the host country is considered to be capable of absorbing and is the best location for this purpose, and that the transfer will be beneficial to MNCs in their global business strategy.

Therefore, two points of FDI policy should be considered seriously if we want to promote technology transfer in a developing country. Firstly, we have to be aware that what we learn from FDI in the early stages of industrialization is neither high technology nor exclusive knowledge. They are globally accessible and free but have not been implemented domestically, such as knowledge

of management strategy, work discipline, plant maintenance and operation, marketing, productivity improvement through kaizen or benchmarks, in accordance with international standards of accounting, safety, labor, environment, etc. Secondly, there should be a mechanism/national policies that can benefit both the transferor and the transferee because this study does not automatically occur. This may include a national program of learning technology with the strong commitment of senior management, clear objectives and responsible agencies, organizational support strengthening, grants and funding for eligible activities, competition and awards to excellent individuals and business and mobilization of foreign technical assistance for Kaizen, Shindan, and other activities.

As mentioned above, in the present context of renovation, the most appropriate technology transfer model for low average income countries like Vietnam is learning the knowledge and general technology through foreign companies. The foreign companies pass on technology because they want to sell the improved equipment to received technology transfer companies after the teaching process. Technology transfer in this way is really useful, it avoids theoretical learning and forgotten soon after. Such teaching takes place completely automatic because the multinational corporations need reliable supplier to compete globally. Vietnam also had spontaneous cases like Colgate and Sanyo trained local plastic injection molding company, Honda trained state enterprises techniques of producing metal parts, Japanese seafood companies guided how to export quality, safety frozen shrimp to Japanese market, etc. However, the improvement of personal interests is often limited in scale compared to the size of the national economy and cannot produce significant results to accelerate the process of industrialization. There should have a policy to promote and expand teaching and learning activities in the direction of "mutually beneficial".

3.2. The prioritized field/operational

Three fields are proposed in FDI technology transfer links, including: (i) attracting FDI with orientation/selection, (ii) improving capacity for local businesses, and (iii) linking policies between FDI and domestic enterprises.

(i) *Attracting FDI with orientation/selection* is to attract foreign companies to transfer technology in consistent with the vision and industrial goals of the country. Policies to attract FDI have to move from massive to conditional and strategic direction. In this phase, we should focus to attract FDI enterprises having the ability to create value in the country, and reduce the labor-intensive enterprises. For countries having attracted a large number of FDI like Vietnam, changing policy from quantity to quality is very important.

To achieve that goal, we need to do FDI marketing to attract qualified FDI inflows besides improving the business environment, operational efficiency, screening and follow -up investment. FDI marketing needs to be strategic and different for each investor group to meet their own needs. For example,

some surveys show that Japanese small and medium manufacturing enterprises (especially supporting industrial enterprises) consider Thailand and Vietnam the most desired destination and they want to have existing workshops for rent, reliable one-stop service in Japanese language, marketing support in the domestic market and employment etc. to reduce early costs and risks. Investment seminars aimed at this group should focus on a few points to appeal with specific parameters, costs, statistics, maps, pictures etc., but the general provisions applicable for all groups. The conditions and incentives for concerned companies may be renegotiated if they are consistent with national development policies.

Another issue related to Vietnam's FDI marketing is dispersion and duplicated authority. Process and licensing procedures are decentralized in Vietnam, making each province and cities themselves can organize unions and investment promotion seminar. In addition, industrial parks also involved in this activity independently. At a certain level, local FDI marketing activity is natural and even laudable. But in the case of Vietnam, investors become weary of receiving too many investment promotion delegations with the same information. To solve this, each city and province needs to design a unique and specific campaign for target groups. Furthermore, there should be a mechanism of coordination among local unions at national level to share general information about Vietnam's economy, legislation, incentives, etc.

Another aspect of marketing FDI is offering attractive industrial land in the form of industrial park or other forms. Basically, this activity includes two steps: the first is industrial agglomeration, which industrial zones and support services are established to invite a leading company, the second is innovation with trilateral cooperation among industries, government and universities and research institutes to create high value. Agencies and organizations involved in the next steps are local and national authorities, non-profit organizations, semi- governmental institutions and private enterprises. This process indicates the importance of providing necessary institutional conditions for good coordination between stakeholders to attract FDI first and then create intrinsic value. It is not yet guaranteed to the successful industrial park construction with the arrangement of an area, priority and incentive announcement.

(ii) *Enhancing local enterprises capacity* is an important issue for a country to move into the real process of industrialization through the creation of local value. Vietnam has long been faced with the problem of underdeveloped supporting industries, which means domestic enterprises is too weak to participate in the global supply chain even with the presence of FDI enterprises. Businesses need to be supported to be a reliable FDI manufacturing partner to compete in global market. To enhance Vietnam local businesses capacity, a number of policy measures should be introduced as the starting point. These measures have been used in

many developing countries, but they have not used or even known in Vietnam. If properly applied, they may significantly facilitate the transfer of technology in FDI links.

Benchmarks is a standard procedure to set goals, in which competitors are identified, activity results are analyzed from many aspects, then specific objectives are built. This process is applied at both corporative and national level. Setting targets with specific numbers using benchmarks is very important, instead of vaguely concluding "capacity needs to be improved" or "quality must be strengthened". For example, some new ports such as Lạch Huyện and Cái Mép Thị Vải ports in Vietnam have to set goals such as power, speed and cost of processing, electronic customs, operation hours, entrance points to the city, the storage facilities etc. and compare with the world's top ports, such as Singapore, Hong Kong, Kaohsiung etc. Similarly, FDI incentives, industrial parks, service area and other factors can also be compared with rivals in the region and standardized.

Expanding the scope of a pilot project - it is a common practice in development assistance when the pilot projects are required to expand geographically and / or by industry. Because funding is relatively limited, development projects in agriculture and industry are usually done on a small scale such as upgrading a technical college, two villages, 30 companies, etc. These projects may at best have only a minimal impact on the national economy. The objective of the technical assistance will not stop there; it should be seen as a model for other fields and areas until it becomes a national model.

Moreover, the expansion must be carried out by the initiative and resources of developing countries, not funding from donors. Donors can teach how to fish, but training fishermen and building fishing boats across the country should be done in each locality, each business. There are two conditions for this strategy to be successful: first, the government must have a plan and commitment to expand the scale since starting; and second, in the pilot project, residents/businesses have to work directly alongside the foreign experts to obtain practical knowledge to replace them immediately after the pilot project ends.

Kaizen - a Japanese method to improve productivity in the late 1950s with some contributions from the United States. Characteristics of Kaizen are small improvement but continuity, bottom up teamwork and no investment in new machinery or technology. The main goal is to eliminate Muda (any unnecessary action, transportation, waiting that does not bring benefit). Kaizen is not a tool but the mindset change towards life and work. Understanding kaizen does not require a degree or professional skills but daily practice such as saying hello loudly, morning meeting, cleaning toilets, removing unnecessary things from the plant, tools to help find places. The initial lessons usually start with

5S and Quality Control Circle (QCC).

Today, Kaizen has been implemented worldwide. Countries and territories apply Kaizen seriously are Taiwan, Korea, Singapore, Thailand, Malaysia, India, Argentina, Mauritius, Tunisia and Ethiopia. Currently, many African countries including Ethiopia, Zambia, Ghana, Tanzania and the African Union are interested in popularizing this approach. Some argue that Japanese Kaizen based on bottom up team spirit will not be valid in the society with different cultural traditions, such as individualism and top down hierarchy. Theoretically, such criticism is justified, but in reality there has not any report – no matter in Africa or Latin America – showing that Kaizen not improved the production situation. There are no cultural barriers in the elimination of Muda or keep the plants clean and tidy.

The link between FDI policy with local businesses to promote the formation of relationships and additional production for over two policy areas. In addition, there are two policy areas that should also be strengthened: the efficiency of logistics operations and human resources in industry. These policies not only contribute to technology transfer links in FDI but also bring positive benefits for other industrial activities.

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