

19 December 2024 (No. of pages:9 )

Japanese report: 20 Nov 2024

# Opportunity for Business Expansion and Growth in Vietnam

## *Significance of producing high value-added products and establishing a wider distribution network*

Economic Research Dept.  
**Qianmao Ted Zhu**

### Summary

- As a candidate location for the China Plus One (C+1) strategy, Vietnam, compared to other emerging countries, has lower wages and smaller political and diplomatic risks. These advantages make Vietnam a strong candidate for business expansion.
- For Japanese companies expanding their business in Vietnam, it is necessary not only to target local Japanese companies as customers but also to produce high value-added products based in Vietnam and establish a wider distribution network.
- Risk factors include territorial disputes with China in the South China Sea, additional tariff measures by the new Trump administration, domestic political uncertainties, and uncertainties due to economic reforms. When expanding into or growing business in Vietnam, it is essential to fully understand these risks.

## Contents

Vietnam is advantageous compared to other candidate countries for the China Plus One Strategy .....	3
Strategies for Japanese companies entering Vietnam .....	4
What if the bamboo breaks? Vietnam's Risk .....	8

## Vietnam is advantageous compared to other candidate countries for the China Plus One Strategy

To understand Vietnam's advantage, first we compare Vietnam with other China Plus One (C+1) candidate countries in terms of ease of doing business. Chart 1 compares Vietnam with various Asian countries which are C+1 candidates based on five criteria: wages, domestic politics, logistics, corruption, and skilled labor. Following the rankings published by various organizations, we grade the country with the highest evaluated score 6 points, and the country with the lowest evaluated score 1 point, so that a country with a high score indicates that it is attractive as a candidate location for the C+1 strategy. We can see from the chart that Vietnam's average wages are relatively low among Southeast Asian countries, and it has advantages in terms of domestic political stability and anti-corruption measures, as well as a large pool of skilled labor. In terms of logistics, it has an average score as of 2022, but there are ongoing plans for the construction of high-speed rail and a government plan to build 9,200 kilometers of highways by 2050, indicating that the logistics network is expected to improve further in the future. Since Vietnam has the highest total score across the five criteria, it can be said to be the most attractive destination among the C+1 candidate countries in Asia.

Comparison between Vietnam and other China Plus One candidate countries

Chart 1

Country/Item	Labor Cost	Domestic Political Stability	Logistics Infrastructure	Corruption Level	Skilled Labor Force	Total Score
Vietnam	5	5	3	5	5	23
India	6	2	4	4	6	22
Malaysia	1	6	6	6	1	20
Thailand	2	4	5	3	2	16
Indonesia	3	3	1	2	3	12
Philippines	4	1	2	1	4	12

Note: Countries with low labor cost, stable domestic politics, good logistics infrastructure, low corruption level, and a large pool of skilled labor are given high scores.

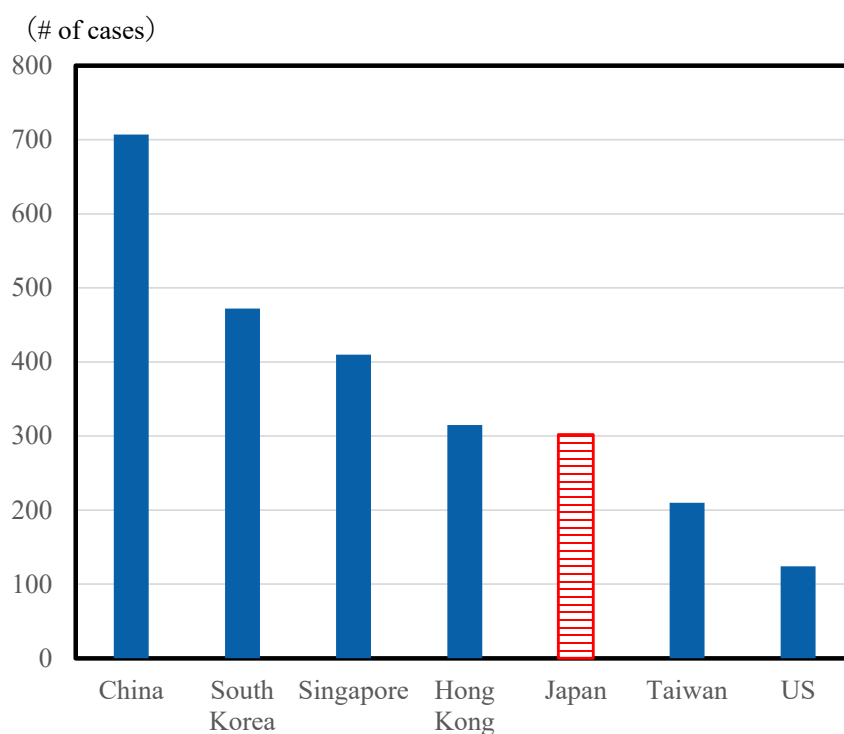
Source: OECD "Average Annual Wages 2023" (Labor cost, surveyed in 2022), World Bank "Political Stability and Absence of Violence/Terrorism: Estimate 2023" (Domestic Political Stability, surveyed in 2022), World Bank "Logistics Performance Index 2023" (Logistics Infrastructure, surveyed in 2023), "Transparency Corruption Perceptions Index 2023" (Corruption Level, surveyed in 2023), "U.S. News Best Countries rankings and Entrepreneurship subranking, Skilled Labor Forces 2023" (Skilled Labor Force, surveyed in 2023); Compiled by DIR.

## Strategies for Japanese companies entering Vietnam

Chart 2 illustrates the top seven countries and regions that invested the most in Vietnam in 2023. A notable share of the investment comes from the Greater China region and South Korea, with Japan securing the fifth position.

Top 7 countries and regions with the highest number of investments in Vietnam in 2023

Chart 2



Source: Haver Analytics, Vietnam Ministry of Planning and Investment; Compiled by DIR.

Chart 3 shows the top foreign direct investment (FDI) destinations from Japan and South Korea in 2023, where Vietnam ranks 8th for FDI from Japan, and 5th for FDI from South Korea. Considering that most of South Korea's investments in the Cayman Islands and Luxembourg are financial investments, Vietnam effectively ranks 3rd among South Korea's manufacturing investments. Additionally, the investment amount from Japan to Vietnam (4.1 billion USD) exceeds that from South Korea (2.6 billion USD). However, Japan's investment in Vietnam is only 6.4% of its total investment in the United States. In contrast, South Korea's investment in Vietnam accounts for 9.5% of its investment in the United States. Since the US-China trade war in 2018, South Korea's investments in China have decreased, while its investments in Vietnam have significantly increased. As a result, South Korea's investment in Vietnam in 2023 reached 1.4 times that of its investment in China. Japan's investment, on the other hand, only reached 1.1 times that of its investment in China, clearly indicating a growing preference for investment in Vietnam from South Korea.<sup>1</sup>

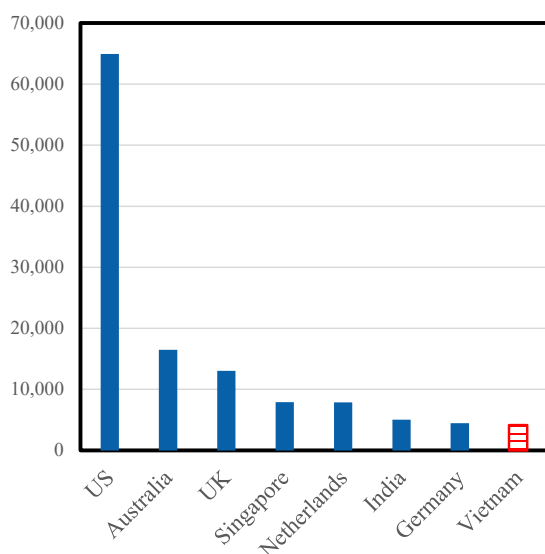
<sup>1</sup> South Korea Ministry of Economy and Finance, "2023 Foreign Direct Investment Trend" ("2023 년 연간 해외직접투자 동향") (March 15<sup>th</sup>, 2024)

Top 5 countries for Japan's FDI and top 5 countries/regions for South Korea's FDI

Chart 3

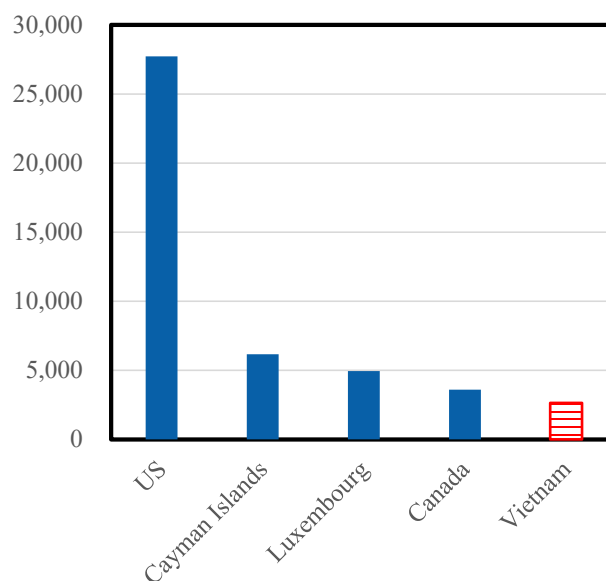
Top 8 countries for Japan's FDI in 2023

(Million USD)



Top 5 countries/regions for South Korea's FDI in 2023

(Million USD)



Source: Japan External Trade Organization (JETRO), Korea Ministry of Economy and Finance; Compiled by DIR.

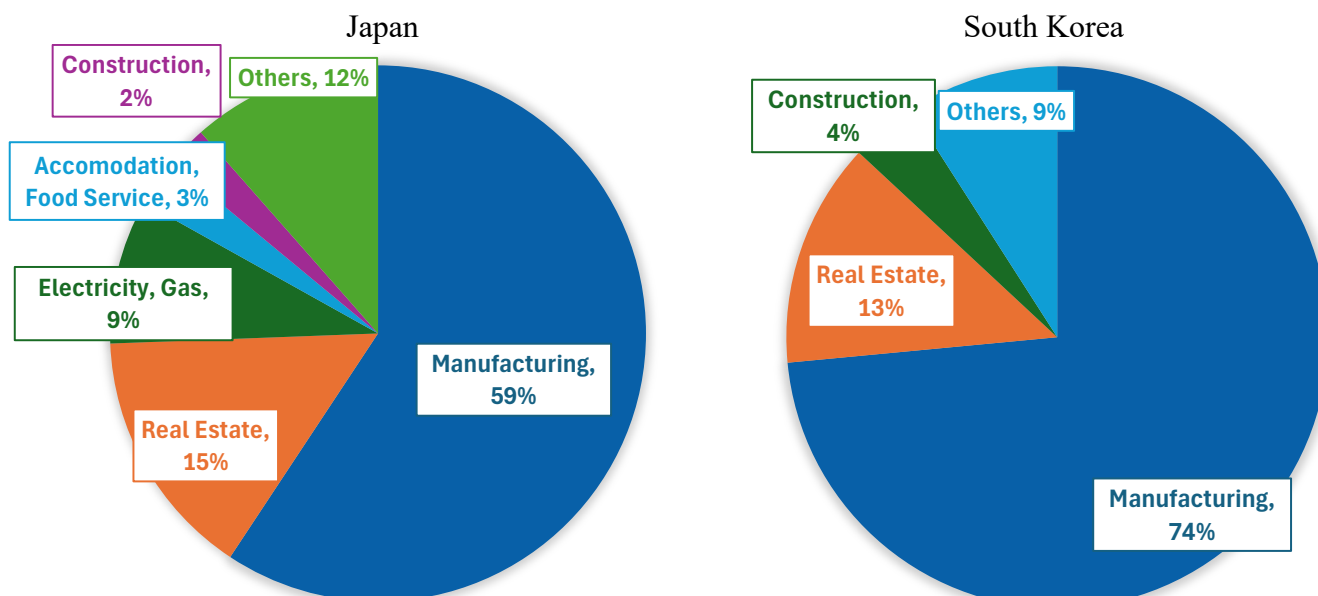
In the first half of 2024, notable South Korean investment projects in Vietnam include a biochemicals manufacturing project in Ba Ria-Vung Tau Province by the conglomerate Hyosung, amounting to 730 million USD. In contrast, Japan has projects such as a chemical plant project in Ba Ria-Vung Tau Province by the major chemical manufacturer Tosoh (176 million USD) and a biomass power plant construction project in Yen Bai Province by IREX, focusing on renewable energy (approximately 120 million USD)<sup>2</sup>, but these are smaller in scale compared to South Korea's investments.

Moreover, there are differences regarding the investment sectors of Japanese and South Korean businesses in Vietnam. Chart 4 shows the percentage of FDI from Japan and South Korea to Vietnam by industry up to 2022. Both countries' investments are primarily concentrated in manufacturing and real estate, but South Korea has a higher percentage in manufacturing compared to Japan. The high proportion of manufacturing in South Korea's investment in Vietnam is due to major manufacturing companies such as Samsung, LG, and Hyundai establishing operations in Vietnam, where they produce mobile phone and automotive parts as their core business. In contrast, Japanese companies that have entered Vietnam belong to more diverse industries, with relatively high percentages in the electrics and gas sector as well as the accommodation and food service sector.

<sup>2</sup> JETRO, "Direct Investment by Foreign Companies in the First Half of the Year, Large Investments in Manufacturing Steady (Vietnam) | Business News – JETRO" ("「上半期の外国企業の直接投資、製造業の大型投資堅調(ベトナム) | ビジネス短信 —ジェトロの海外ニュース-ジェトロ」") (July 18, 2024))

Percentage of FDI from Japan and South Korea to Vietnam by industry up to 2022

Chart 4



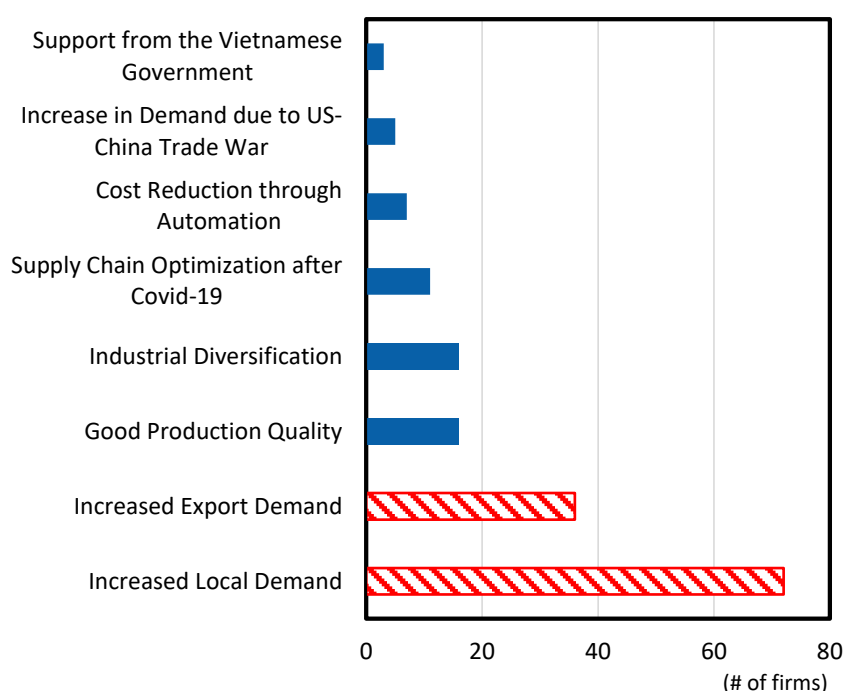
Source: Japan Bank for International Cooperation (JBIC), Vietnam Ministry of Planning and Investment; Compiled by DIR.

According to the “2023 Survey on the Status of Japanese Companies Expanding Overseas (Asia and Oceania Edition)” conducted by JETRO in August to September 2023, 86.3% of Japanese companies that have entered the Vietnamese market in the B2B sector are targeting local Japanese companies as their customer base. In contrast, the same ratio for Japanese companies operating in China is only 76.0%, highlighting the limited sales channels for Japanese companies in Vietnam.

Chart 5 shows the factors contributing to the increase in sales of South Korean companies in Vietnam, where the most valued factor was "increased local demand," followed by "increased export demand." It is thus important for Japanese companies to learn from the experiences of South Korean companies so that they can capture the robust domestic and export demand in Vietnam. According to the "Survey Report on the Overseas Business Development of Japanese Manufacturing Companies - 2023 Overseas Direct Investment Questionnaire Results (35th Edition)" conducted by the Japan Bank for International Cooperation (JBIC), the most frequently cited reason for Vietnam's attractiveness is "the future growth potential of the Vietnamese local market," and Japanese companies that have entered Vietnam are showing strong expectations for the Vietnamese market. Furthermore, the high regard that Vietnamese people have for Japanese products is also a tailwind that drives Japanese companies' expansion in Vietnam. According to a "Survey on Awareness of Korean Products and Korea" conducted by the Korea International Trade Association (KITA) in May 2022, 70% of Vietnamese respondents chose Japanese products as an alternative to Korean products, which is the highest percentage among the surveyed countries. The high favorability that Vietnamese people have for Japanese products indicates the significant potential demand in the local market, highlighting the importance of accurately understanding the demand in the Vietnamese market.

Main factors contributing to increase in sales of South Korean companies in Vietnam

Chart 5



Source: Korea International Trade Association "Report on the Actual Business Environment Survey of Companies Expanding into Vietnam (2023)"; Compiled by DIR.

Furthermore, many Japanese companies that have expanded into Vietnam at this point are merely using Vietnam as a production base, where raw materials and components are sourced from Japan. On the other hand, in order to successfully expand into Vietnam, it is crucial not only to import raw materials and components from Japan and produce in Vietnam but also to localize the sourcing of raw materials and components. According to the aforementioned survey by the JETRO, the local procurement rate for Japanese companies that have expanded into Vietnam is 41.9%, which is lower compared to Japanese companies in Thailand (59.6%) and Indonesia (53.3%). Looking at the breakdown of local procurement, we find that 41.0% is from local companies, 45.5% is from Japanese companies operating in Vietnam, and 13.5% is from other foreign companies.

Approximately 47% of Japanese companies that have expanded into Vietnam are in the manufacturing sector, producing machinery and equipment, apparel, which require raw materials and components such as electronic devices, rubber, metals, wood, resin parts, textiles, and semiconductors. Many companies may have thought that local procurement would be difficult because the supply chain of local Vietnamese companies has not been sufficiently developed. However, the fact is that while indeed some high-value-added components such as semiconductors must be sourced from Japan, a wide range of raw materials and components can now be procured domestically in Vietnam. For example, not only intermediate goods such as wood and textile products that are abundantly supplied in Vietnam, but in recent years, there has also been an increase in the number of local Vietnamese companies that can supply high-precision resin and high-precision press parts for automobiles. The "Vietnam North-Central Region Japanese Manufacturing and Related Trading Company Supplier Directory," published by the JETRO since 2014, shows that the number of high-quality suppliers in Vietnam has increased from around 50 in 2014 to around 100 in 2024, indicating a significant improvement in the supply chain within Vietnam. Additionally, according to the aforementioned survey by JBIC, Japanese companies view Vietnam's cheap labor as the second most significant factor in terms of Vietnam's attractiveness. Thus, by procuring raw materials and components and utilizing Vietnam's cheap labor to produce high-value-added products, Japanese companies in Vietnam can sell the product both domestically in Vietnam and abroad to advanced countries such as Europe and the US.

During the Covid-19 pandemic, many Japanese manufacturing companies were seriously affected due to disruptions in the supply chain. By establishing system frameworks and supply chains to procure raw materials and components locally, Japanese companies can better utilize Vietnam's low wages and favorable political and diplomatic conditions so that they can enhance the stability of their supply chain and reduce logistics costs, leading to the establishment of a more efficient production system. By deepening collaboration with excellent local suppliers, it will also be possible to manage risks without overly relying on international supply chains.

## What if the bamboo breaks? Vietnam's Risk

Even for Vietnam, which balances the seesaw of the US-China relationship with "bamboo diplomacy" (diplomacy that is flexible and resilient like bamboo), risks from both the US and China exist. At the same time, there are also risks such as domestic political instability and delays in economic reforms. Japanese companies need to carefully consider these risks when expanding into Vietnam.

Vietnam and China are in conflict over territorial issues in the South China Sea. During General Secretary Lam's visit to China, he met with President Xi of China, and both leaders expressed their intention to "control differences in positions" regarding the South China Sea issue. However, if issues such as fishing disputes arise, it may not be easy to "control" the situation. Vietnam has a history of being ruled by Chinese dynasties for nearly a thousand years, and conflicts, such as the Sino-Vietnamese War in 1979, have also occurred. Considering this historical background, it is not a problem that can be resolved overnight. If the relationship between Vietnam and China deteriorates sharply, there is a possibility that China may impose export and import bans. Therefore, Japanese companies that procure raw materials and components from China should prepare alternative measures in advance.

Regarding the US, with President Trump being re-elected as president, there is a possibility that the US will significantly raise tariffs on Chinese products that are reprocessed in Vietnam. In fact, in 2019, President Trump stated, "A lot of companies are moving to Vietnam, but Vietnam takes advantage of us even worse than China. So there's a very interesting situation going on there,"<sup>3</sup> highlighting the need to carefully consider the impact of potential future tariff increases by the US. As a result, expanding sales channels to markets outside the US has become increasingly important.

There are also risks related to domestic politics. As pointed out in the previous report<sup>4</sup>, General Secretary Lam has gained the trust of both the northern and southern factions, but his experience as a "four pillars"<sup>5</sup> leader is still limited. Therefore, there are some high-ranking officials within the party who feel resistance to his leadership, and some news has indicated that officials have been gathering around Prime Minister Chinh, who has more extensive experience in state affairs. Additionally, with the new president-elect Luong Quang entering office in October 2024, General Secretary Lam has stepped down as president, with Vietnam returning to a collective leadership system under the "four pillars." As a result, it can be said that General Secretary Lam's power has somewhat decreased. At this point, he has established power through the "burning furnace" anti-corruption campaign, and there is no one within the party who can oppose him. However, if dissatisfaction with him increases within the party, the possibility of political instability in Vietnam cannot be ruled out.

Finally, there are risks associated with economic reforms. With Vietnam's rapid economic growth in recent years, various interest groups have emerged. For example, when former President Nguyen Xuan Phuc was ousted during the anti-corruption campaign, Vice Prime Minister Pham Binh Minh, Vice Prime

<sup>3</sup> The Guardian, "Trump warns China is 'ripe' for new tariffs and suggests Vietnam could be next" (June 27<sup>th</sup>, 2019)

<sup>4</sup> Qianmao Ted Zhu, "Where is Vietnam heading under leadership of new General Secretary To Lam?" (October 29<sup>th</sup>, 2024)

<sup>5</sup> The four main leaders in Vietnam's political leadership (General Secretary, President, Prime Minister, Chairman of the National Assembly).

Minister Vu Duc Dam, and several ministers were also deemed to be part of the same interest group as Phuc and were asked to resign. These interest groups may strongly oppose General Secretary Lam's policies out of concern that reforms could undermine their interests. While a delay in economic reforms is unlikely to lead to an immediate change in government, it is important to be cautious about the potential decline in public trust.

Vietnam has overall advantages in economics, politics, and diplomacy, making it an attractive candidate for Japanese companies considering foreign expansion and the C+1 strategy. However, there are also several risks involved. In chart 6, we present a summary of the benefits and risks associated with entering the Vietnamese market, drawing insights from the previous report's analysis. It is vital to gain a thorough understanding of these benefits and risks before making the decision to enter / expand in the Vietnamese market.

**Benefits and risks regarding business expansion and growth in Vietnam**

**Chart 6**

	<b>Benefits</b>	<b>Risks</b>
<b>Political</b>	Rivalry between the northern and southern factions has eased. Political stability	General Secretary Lam has limited experience. Possibility of opposition emerging
<b>Diplomatic</b>	Balancing between the US and China through Bamboo Diplomacy	South China Sea territorial issues. Trump Tariff risks
<b>Economic</b>	Economic reforms progressing. Infrastructure and innovation development	Possibility of delays in reforms

Source: Compiled by DIR.