

# Vietnam's Supply Funnel

By George T. Haley, Ph.D.



## Despite its potential, Vietnam's future as a sourcing and manufacturing hub is clouded by weak infrastructure and a workforce that is still developing solid business skills.

**A**s labor costs in China continue to increase, some U.S. businesses are looking to Southeast Asian countries as competitive low-cost sourcing and manufacturing destinations. One of those countries, Vietnam, is gaining in popularity because of the work ethic of its people, relatively low labor and other costs, attractive government incentives, and an improving legal and business environment, according to Portland, Oregon-based Runckel & Associates. Like any emerging economy, Vietnam has its challenges, which means supply management professionals should do their homework to understand the pros and cons of sourcing or manufacturing in this developing country.

While China dominates the Asian business landscape, its changing economy also is influencing the fortunes of Vietnam and other countries in Southeast Asia. China has served as the world's factory floor for more than two decades. However, without its record-breaking trade surplus with the United States, China would have a trade deficit. Currently, China is the third costliest of Asia's developing economies, prompting even Chinese manufacturers to outsource to Vietnam and other low-cost Southeast Asian countries.

### **Impact of Overseas Chinese**

Rising labor costs constitute a major reason for outsourcing. The average annual labor cost in China has been rising rapidly in the past decade — up 8 percent annually from 2002 to 2005; 16.4 percent annually from 2005 to

2007; and 18 percent annually from 2007 to 2009. The box on page S7 compares China's total annual labor costs per employee with its Southeast Asian competitors. Wage rates vary across China; however, there are generally offsetting costs. For example, interior regions with lower wages require domestic shipping costs to transport goods to China's seaports, offsetting the lower labor costs.

Another economic force impacting many Southeast Asian countries is the Overseas Chinese business communities. Overseas Chinese are people of Chinese birth or descent who live outside the country. Overseas Chinese business communities in East and Southeast Asia play a leading role in the regional economies through cross-border investments and global trade networks. The Overseas Chinese historically have generated a greater than

proportional share of national GDP by orders of magnitude.

Due to the strength of the Overseas Chinese business communities, supply management professionals with a working knowledge of the communities' business practices can establish contacts with these communities to expand their supplier networks in any Southeast Asian country in which they choose to do business, including China. There is a good amount of consistency

possess relatively inexperienced business communities and bureaucracies. Steeped in tradition, and with less international exposure, the business community in Vietnam, for example, appears less forgiving of cultural failures than its more cosmopolitan counterparts in countries such as Thailand.

A major automobile manufacturer, for instance, inadvertently offended some Vietnamese government officials, stalling the company's major investment

stake in the Vietnamese project to two Singapore state entities.

When seeking to do business in Vietnam, supply management professionals should expect to find Vietnamese businesspeople and bureaucrats in the south more accustomed to dealing with foreign businesses than those in the north. I noticed this firsthand a few years ago when participating in a joint business-government conference on the Vietnamese tourism industry. The conference's goal was to make recommendations to the government about its development policies. Representatives from the southern part of Vietnam were far more knowledgeable of foreign business concerns and issues than their northern counterparts.

In the south, Ho Chi Minh City, formerly the southern city of Saigon, remains Vietnam's economic and business center. However, Vietnam's significant labor-cost advantage over China and other Southeast Asian countries shrinks considerably if companies invest in, or source from, the Ho Chi Minh City area, where labor costs can be double those in other parts of Vietnam.

### Language, Culture

English is the official business language of the Association of Southeast Asian Nations (ASEAN). However, less internationally experienced ASEAN countries still have an undersupply of people competent in managerial practices and foreign languages. Vietnam constitutes the most important of these economies from an international business perspective. Fluency in English translates into much higher salaries in Vietnam, reflecting demand. For instance, because of an undersupply of fluent Vietnamese English speakers, English speakers without business training command significantly higher salaries than those trained in business or operations management who are not fluent in English.

Shortages of other foreign-language speakers also permeate Vietnam. For example, Taiwanese, Chinese and South Korean investors and supply

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in Overseas Chinese business practices from country to country.

### Cultural Sensitivities

However, outside of the Overseas Chinese business communities, some Southeast Asian countries are more familiar and comfortable working with foreign business partners than others. Many newly emerging sourcing countries such as Vietnam and Cambodia

initiate in the country. The company's managers were only able to get the investment back on track with help from the government of Singapore. The company reached an agreement with Singapore whereby Senior Minister Lee Kwan Yew visited Vietnam to help resolve the company's issues with the Vietnamese bureaucracies. The price for that assistance was steep — selling 22 percent of the automotive company's

### Southeast Asia's Emerging Market Labor Costs vs. China's\*

Country Rank	Country	Total Labor Cost (per employee) (2010 U.S. Dollars)
1	Malaysia	5,824
2	Thailand	2,451
3	China	2,250
4	Philippines	2,246
5	Vietnam	1,152
6	Indonesia	1,089
7	Cambodia	672
8	Myanmar	401

\*From *China Briefing* newsletter, based on International Monetary Fund — World Economic Outlook Database.

management professionals in Vietnam also have had difficulties finding Vietnamese fluent in their languages. Foreign investors and buyers have routinely identified communicating with their Vietnamese suppliers as their greatest operational difficulty, and the potential loss of competent local personnel as their greatest problem.

Despite some similarities, Vietnam's ancient business culture also differs significantly from other Southeast Asian countries. Consequently, despite their common Confucian roots, Taiwanese, Chinese and South Korean business professionals have reported difficulty in managing their Vietnamese employees' and suppliers' sensibilities. Generally, other Southeast Asian business professionals have indicated that Vietnamese employees tend to be extremely sensitive. Many business practices and communications acceptable in other cultures are met with resistance from Vietnamese employees who view them as excessively harsh, especially when communicated in public.

One common mistake among foreign managers dealing with Vietnamese employees is to publically correct an employee's mistake. No matter how diplomatically it is handled, the employee's public loss of face will be considered excessively harsh, both by the employee and his or her fellow workers.

### Infrastructure Concerns

Unlike competing suppliers in China, Taiwan, South Korea or Japan, Vietnamese suppliers are less likely to invest in acquiring new capacity or technical capabilities unless they have the business orders to justify upgrading. That is why it is difficult for supply management professionals to determine a Vietnamese supplier's abilities to meet the needs or specifications prior to making a purchase. Supply managers should determine the capabilities required to meet their needs and decide if the potential supplier has the capabilities to meet those needs in their existing operation. They also should consider whether the potential

supplier's employees possess needed skills. Obviously, with every judgment call about a supplier's capabilities, the risk increases.

Despite Vietnam's economic growth (the second highest in Asia in recent years) and trade growth (with shipments up more than 400 percent since 1999), the country's ports have poor and outdated infrastructure. Shaped like a long, curved funnel, Vietnam has one of the greatest ratios of coastline to total area of any country in the world (see map at right). It has a wide northern area feeding into a long curved southern section that in places is no more than 70 miles wide. Compounding the country's infrastructure is the large number of ports (114) along Vietnam's coastline and the fragmentation of control over them among national and local governments as well as the private Vietnam Port Association.

Vietnam's government considers 14 ports — particularly Saigon Port, Da Nang Port and Haiphong Port — key to Vietnam's economic development. Government officials have allocated large investments to improve port facilities, but political infighting has hampered implementation. Until those investments come to fruition, Vietnam's ports will continue to appear small and antiquated compared to ports in other Asian countries.

Generally, shipments to the U.S. and Europe have to go through transshipment ports in China, Singapore, Malaysia or Thailand. Consequently, shipping goods from Vietnam to the U.S. or Europe typically takes longer and costs more than shipping equivalent goods from Hong Kong and other Chinese ports.

Vietnam has the potential to become an important source for supply management professionals, but it does have challenges. The country enjoys low labor costs, but its labor, while educated and trainable, tends to lack capabilities in international languages and business training. The country's poor infrastructure can add substantial cost to shipping from Vietnam. And while

actively pursuing foreign investment and accurately identifying the country's need to promote Vietnam as a business source, the Vietnamese government has shown insufficient effectiveness in implementing its solutions.

As the global economy continues to expand into developing economies, looking for new markets, suppliers, or manufacturing and service centers, it is clear the burden rests on supply management professionals to weigh all the factors before expanding business into new areas. **ISM**

**George T. Haley, Ph.D.** is professor of industrial marketing and international business at the University of New Haven in West Haven, Connecticut. He also is author of *New Asian Emperors: The Business Strategies of the Overseas Chinese*. For more information, send an email to [author@ism.ws](mailto:author@ism.ws).

## Map of Vietnam With Major Ports and Coastal Cities



This map shows how Vietnam is shaped like a long, curved funnel. The Southeast Asian nation has one of the greatest ratios of coastline to total area.