OECD Studies on SMEs and Entrepreneurship

# SME and Entrepreneurship Policy in Viet Nam

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# Table of contents

# Basic Statistics of Viet Nam

| | | | | | |
|---|---|---|---|---|---|
| **Population** | | | | | |
| Population (millions), 2019 | 96.5 | | Life expectancy (years), 2016 | 76.3 | (80.1) |
| Under 15 (%) | 23.1 | (17.9) | Male | 71.5 | (77.5) |
| Over 65 (%) | 7.1 | (16.8) | Female | 80.9 | (82.8) |
| Latest 5-year average population growth (%) | 1.1 | (0.6) | Largest cities (million people), 2019 | | |
| Income inequality (Gini coefficient), 2016 | 35.3 | (31.8) | Ho Chi Minh City | 9.0 | |
| Latest general election | 2016 | | Ha Noi | 8.1 | |
| **Economy** | | | | | |
| GDP (current billion USD), 2019 | 266.5 | | Value added shares of GDP, 2017 | | |
| GDP growth (%), 2019 | 7.0 | (1.7) | Agriculture, forestry and fishing (%) | 15.3 | (1.4) |
| GDP per capita, PPP (constant 2017 USD), 2019 | 8 041 | (44 688) | Industry (including construction) (%) | 33.4 | (22.5) |
| GDP per capita growth (%), 2019 | 6.0 | (1.1) | Services (%) | 41.3 | (69.7) |
| **General government** | | | | | |
| Revenue (% of GDP), 2015 | 23.8 | (40.1) | Gross debt (% of GDP), 2015 | 57.4 | (70.2) |
| Expenditure (% of GDP), 2015 | 29.2 | (41.7) | Tax revenue (% of GDP), 2015 | 18.2 | (34.0) |
| **External accounts** | | | | | |
| Exports of goods and services (% of GDP), 2019 | 106.8 | (29.2) | Net FDI inflows (% of GDP), 2017 | 6.3 | (2.3) |
| Imports of goods and services (% of GDP), 2019 | 103.6 | (28.9) | Exchange rate (VND per USD), 2019 | 23 223 | |
| Current account balance (% of GDP), 2018 | 2.4 | (1.9) | PPP for GDP (VND for USD), 2017 | 7 735 | |
| Main merchandise exports (%), 2018 | | | Main merchandise imports (%), 2018 | | |
| Electrical machinery and equipment | 41.7 | | Electrical machinery and equipment | 26.6 | |
| Footwear and gaiters | 8.5 | | Machinery and mechanical appliances | 9.5 | |
| Machinery and mechanical appliances | 5.9 | | Plastics and articles | 5.5 | |
| **Labour market, skills and innovation** | | | | | |
| Labour participation rate (aged 15-64, %), 2018 | 83.3 | (71.5) | Unemployment rate (age 15+, %), 2017 | 1.9 | (5.8) |
| Men (male population aged 15-64, %) | 87.2 | (79.6) | Youth (age 15-24, %) | 7.3 | (12.8) |
| Women (female population aged 15-64, %) | 79.4 | (63.3) | Firms with female top manager (%), 2015 | 22.4 | (16.2) |
| Vulnerable employment (% of total), 2018 | 54.6 | (11.8) | R&D expenditure (% of GDP), 2017 | 0.4 | (2.5) |

Note: OECD average value in parentheses. Sources: OECD database, World Bank, International Monetary Fund, International Labour Organisation, Observatory of Economic Complexity, Gallup World Poll, and national sources.

# Executive Summary

This report presents the findings of the OECD review of SME and entrepreneurship policy of Viet Nam, which was undertaken over the period 2019-2020. The report assesses the main strengths and weaknesses of Viet Nam's SME and entrepreneurship policies and offers policy suggestions to help address the main existing challenges. It includes chapters on SME and entrepreneurship characteristics and performance; the business environment for SMEs and entrepreneurship; the governance of SME and entrepreneurship policy; SME and entrepreneurship support programmes; business linkages; and business development services.

## Key findings

### *Viet Nam's (formal) SMEs contribute less to national employment and GDP than in the OECD area*

Viet Nam has been one of the world's fastest-growing economies in the last twenty years. The major economic reforms of the mid-1980s (*Đổi Mới* reforms) saw Viet Nam's growth model gravitate towards attracting foreign direct investment (FDI) and exports of manufactured goods. In 2019, trade flows (i.e. the sum of imports and exports) relative to GDP reached 210%, the highest value in the world for countries with a population of at least 50 million people. The content of exports has also changed over time, moving from basic agricultural produce in the 1980s, to textiles and footwear in the 1990s and 2000s, and to electronics in more recent years. As a result, industry accounts for 55% of total employment and for 62% of national value added (significantly higher than OECD averages, 23% and 33% respectively), with large manufacturing companies alone contributing 40.5% of GDP. By contrast, SMEs (1-249 employees) employ 47% of Viet Nam's labour force and generate 36% of national value added, much less than in the OECD area, although these figures are biased downward by the presence of a large domestic informal sector. Although SMEs account for a smaller share of the formal economy than in OECD countries, Viet Nam displays strong entrepreneurialism, as shown by high rates of business churning (business entry and exit rates combined), high-growth firms and gazelles.

### *Viet Nam's business environment has constantly improved, but there are still areas in need of policy reforms*

Overall, Viet Nam's business environment is conducive to business growth, although there are still areas for improvement. The national government has eased product market regulations through a series of simplification reforms, such as Project 30, and has lowered the statutory corporate income tax rate from 32% in the early 2000s to 20% today. The government is also envisaging the introduction of a preferential tax regime for SMEs which appears to be well designed, although it has not yet been voted into law by the National Assembly. On the downside, state-owned enterprises still account for a large share of the national economy (40% of GDP), hindering competition in many product markets, while compliance with tax regulations remains difficult, especially for SMEs.

Viet Nam's basic education is of good quality, as shown by OECD PISA (Programme for International Student Assessment) scores, which are in line with OECD averages. However, there are also clear signs of inequality in access to higher education and skills mismatches in the labour market. The technical and vocational education and training (TVET) system could help address these mismatches, but it currently falls short of this objective. Viet Nam's national innovation system is at an early stage of development, in line with the country's lower-middle income status. The government has introduced relevant laws to prop up the national innovation system, but some of them need to be better enforced or adjusted, such as the Intellectual Property Rights Law and the Science and Technology Enterprise Law.

### *Viet Nam's SME and entrepreneurship policies are relatively new*

Viet Nam's first SME and entrepreneurship policies date back to 2001, when a national law introduced a legal definition of an SME and established the SME Development Agency, which has since become the Agency for Enterprise Development (AED). More recently, the 2018 SME Support Law showed the commitment of the national government to supporting domestic SMEs. This law covers different policy areas such as taxation, access to finance, innovation and value chain development, although there are still areas that lack sufficient attention (e.g. SME digitalisation) and others where results have not been encouraging so far (e.g. the conversion of household businesses into formally registered enterprises). SME and entrepreneurship policy sees the involvement of different ministries and levels of government in Viet Nam, which calls for appropriate policy co-ordination arrangements. The SME Development Council was introduced in 2001 to this purpose, but it has not worked properly until now; it could, accordingly, be revamped to enhance co-ordination in SME and entrepreneurship policy.

### *Viet Nam has a relatively small number of targeted programmes for SMEs, some of which have experienced low take-up*

Viet Nam has a relatively small number of programmes that specifically target SMEs, some of which have also experienced low take-up; for example, the SME Development Fund (SMEDF) and the Credit Guarantee Fund (CGF) both have low usage by SMEs and partnering banks. For banks, this may be because capped interest rates are set too low, which is exacerbated by limited confidence that public guarantees will be honoured (in the case of the CGF and especially for guarantees backed by provincial governments), while, for SMEs, cost-sharing requirements may be too high, for example in the case of the SMEDF.

Innovation policy has mostly focused on the support of R&D and Intellectual Property Rights (IPR), *de facto* excluding most small companies in non-high-tech sectors. The introduction of simple policy instruments, such as innovation vouchers, could help redress this bias by strengthening innovation capability also in smaller enterprises. Policies to encourage business internationalisation have prioritised trade facilitation (e.g. through the launch of the Viet Nam Trade Information Portal), while trade promotion efforts for SMEs (e.g. market information, export advice, participation in e-commerce) are still at an incipient phase.

Training policies have mostly focused on labour market entrants and the unemployed, with less attention placed on training employees in SMEs. Finally, women's entrepreneurship support has recently gained some traction through a new project aimed at women's start-ups. Nevertheless, the government should also ensure that women are adequately represented in all SME and entrepreneurship programmes, including those under the framework of the SME Support Law.

### *Building stronger business linkages between MNEs and SMEs calls for an integrated policy approach*

While Viet Nam has been successful in attracting FDI and developing an export-led model of growth, buyer-supplier linkages between multinational enterprises (MNEs) and local SMEs are still limited, which reduces the scope for technology spillovers from FDI. A number of factors explain this situation, including difficulties for potential upstream SMEs to meet international technical standards and to achieve economies of scale. Viet Nam's main policy to encourage local SMEs to tap into GVCs is the "Supporting Industry" development programme, which targets six specific manufacturing sectors (i.e. textiles and apparel; footwear and leather; electronics; automobile; metal/machine tools; and high-tech industry). This programme is well-intended, but it should expand its focus to include potential SME upstream service suppliers as well as to second-tier suppliers. In addition, this programme could move beyond the mere provision of tax incentives and loan subsidies to embrace other important mechanisms that could boost upstream integration such as through supporting training, capacity building and business matchmaking. More generally, a more integrated approach is necessary to build supply chains that are more inclusive of domestic SMEs. This approach would hinge on four main pillars: improving firm-level capabilities and compliance with international technical standards; ease the search process for MNEs in finding "qualified" and "verified" domestic suppliers; upgrading the physical, digital and institutional infrastructure (e.g. upgrading the transport system, but also reinforcing IPR protection and supply chain finance); and encouraging relevant research from universities and the supply of support services from other stakeholders (e.g. testing by certification labs) in the national innovation system.

### *The government is promoting business development services (BDS) through direct provision and by enabling a private market*

Business development services (BDS) are non-financial services (e.g. training, advice and mentoring) that aim to improve the performance of enterprises in terms of access to and ability to compete in domestic or international markets. The main objective of BDS is, therefore, enhancing the competitiveness of SMEs by strengthening their managerial skills. The Agency for Enterprise Development (AED) is the main government entity in charge of BDS promotion in Viet Nam, notably through the three Assistance Centres for SMEs, commonly known as TAC (from the previous name of Technical Assistance Centres), which are located in Ha Noi (North), Da Nang (Centre) and Ho Chi Minh City (South). The TAC centres play an important role and should be strengthened, either by creating more in other locations or by enhancing the decentralised training offer of the existing centres, for example through the use of mobile BDS clinics to reach more peripheral locations. Going forward, it will also be important to further encourage the rise of a private market for BDS, in particular by helping SMEs defray the costs of private-sector BDS providers and ensuring the good quality of the subsidised business support services. In this respect, two recent pilot projects in Ha Noi and Ho Chi Minh City set a good example on which the government could build to create a national network of accredited BDS organisations.

## Selected recommendations

- Move forward with the current plan to enforce a preferential corporate tax regime for SMEs, in particular the legal provisions introducing lower tax rates for micro and small companies.
- Consider the introduction of another presumptive tax regime for household businesses and own-account workers to encourage their formalisation.
- Revamp the SME Development Promotion Council and expand its mandate to play a stronger inter-ministerial co-ordination role.
- Strengthen SME policy planning capacities in provinces that have not yet developed a local SME Development Plan by leveraging on the expertise of the Agency for Enterprise Development.

- Decrease the coverage rate of the CGF from 100% to closer to 80% to promote risk-sharing with partnering banks, and increase the annual premium fee for the credit guarantee from 0.5% to 1-2% (of the total guaranteed loan and interests) in order to promote the sustainability of the Fund.
- Complement supply-led programmes supporting R&D and technology-based enterprises with interventions, such as innovation vouchers, that aim to improve the innovation capacity of SMEs through skills upgrading and ICT adoption.
- Support more generously within-company training, with a view to enhancing the average labour productivity of SME workforces; for example, by implementing a demand-driven programme aimed at the upgrading of workforce skills in SMEs.
- Ensure that women-owned businesses are adequately represented in all government SME and entrepreneurship programmes, including those under the framework of the SME Support Law.
- Increase flexibility in the criteria for identifying “supporting industry” products to account for changes in industries and global value chains, expand the list to include key value chain services, and extend incentives beyond first-tier suppliers.
- Consider establishing new Assistance Centres for SMEs to ease access to government-supported BDS by SMEs located away from the current three centres. Alternatively, build up and expand the capacity of the existing centres to reach more peripheral locations, for example through mobile training units.
- Encourage the rise of a private market for BDS by covering part of the training or consulting costs faced by SMEs, while also controlling and ensuring the good quality of publicly-subsidised, private-sector BDS.

# 6 Business linkages in Viet Nam

This chapter provides an overview of business linkages between multinational enterprises (MNEs) and local small and medium enterprises (SMEs) in Viet Nam and national policies supporting these linkages. Viet Nam has attracted a large amount of foreign direct investment (FDI); nevertheless, business linkages between MNEs and domestic firms are still relatively undeveloped. Vietnamese suppliers are mainly relegated to lower-tiers of integration in the global value chains (GVCs), specialising in low value-added parts/components or assembly functions. To capture stronger gains from GVC integration, a multi-pronged approach should be taken to increase opportunities for local sourcing of inputs and intermediate products by foreign investors, focusing in particular on: strengthening firm-level capabilities through training and innovation support; developing supplier upgrading programmes boosting the capacity of local SMEs to comply with international technical standards and codes of conduct; setting up institutions offering specialised services to supporting industries, such as testing and certification agencies; providing supply chain finance; and involving universities in building up the technical and soft skills needed in GVCs.

## The state of business linkages

### *Viet Nam is increasingly integrated into global value chains (GVCs), but mostly in low value-added functions*

As noted in Chapter 3, Viet Nam has become an export powerhouse in the last 20 years, mostly thanks to its ability to attract foreign direct investment (FDI) in manufacturing. Multinational enterprises (MNEs) indicate that economic and political stability and low labour cost are the main pull factors to invest in Viet Nam (UNIDO, 2018[1]). In addition, independent surveys about possible alternative FDI destinations in the region point to Viet Nam as the most attractive location in Asia (AmCham, 2019[2]; EIU, 2019[3]).[1]

Since 2010, Viet Nam's inward FDI stock has grown at an average yearly rate of 12.8%, reaching USD 145 billion in 2018 (Figure 6.1, Panel A). This is 10 times the FDI stock in 2000 and 2.5 times that in 2010, corresponding to almost 20% of all investments going to developing Southeast Asian countries. From 2003 to 2017, the manufacturing sector, which attracted about one-third of total FDI in Viet Nam, was the recipient of 1 101 new investment projects.[2] The main industries of attraction were apparel and textiles, food and tobacco, electronic components, and metals (44% of the investment projects). The top countries of origin were Japan, Korea, and Taiwan (335, 133, and 109 investment projects, respectively).

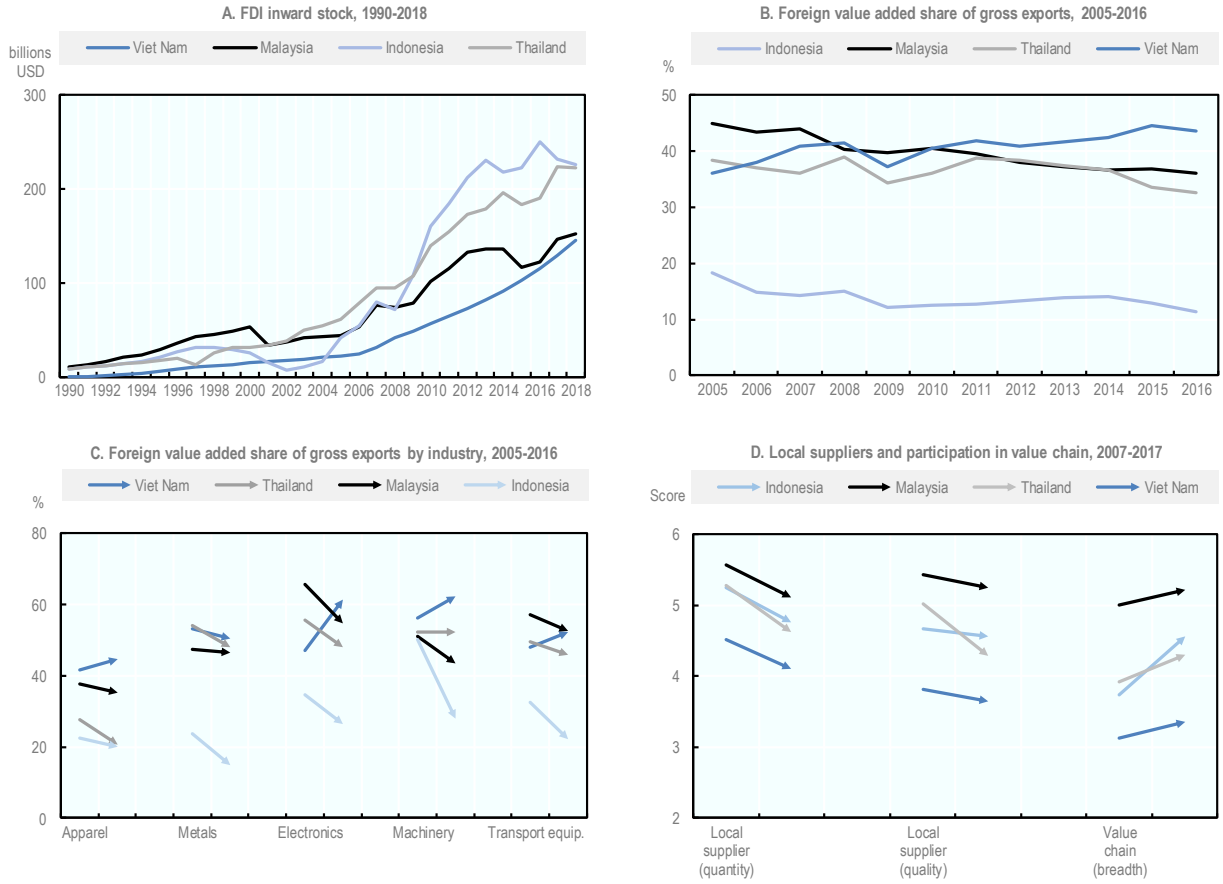
FDI has favoured export-oriented growth, transforming Viet Nam into a manufacturing-based and GVC-integrated economy. Nevertheless, FDI-driven exports include large import contents and low domestic value added with limited linkages between the MNEs based in the country and domestic companies (Hollweg, Smith and Taglioni, 2017[4]). A survey of Japanese-affiliated firms operating in Asia indicated that the local procurement of raw materials and parts in their local production activities in Viet Nam was only 36.3%, compared with 66.3% in China, 57.2% in Thailand, and 42% in Indonesia (JETRO, 2019, p. 45[5]). World Bank's enterprise surveys also find that the average share of local sourcing reported by foreign MNEs in Viet Nam is lower than the one reported in Thailand, Indonesia and Malaysia, albeit still significant at 45% (OECD/UNIDO, 2019[6]).

The experience of Viet Nam, similarly to other countries that have been major FDI recipients, shows that strong business linkages between MNEs and local SMEs are determined by the characteristics of foreign investors, such as the length of their presence in the country, the motivation underpinning their investments, and their global sourcing strategies; the characteristics of the domestic firms, such as their technological capacity, their human resource skills and their scale; and the characteristics of the institutional framework of the host country, such as the state of development of the domestic innovation system (Farole and Winkler, 2014[7]).

### *Backward participation in GVC is much more common than forward participation*

Viet Nam's GVC integration is predominantly via backward participation, measured by the foreign value added share of gross exports (FVA)[3]. This means that Viet Nam specialises within GVCs through the import of intermediate parts and components that are domestically assembled and then exported as final products. Indeed, Viet Nam's FVA showed a general increase from 36% in 2005 to 44% in 2016, compared with declining FVA shares in Indonesia, Malaysia and Thailand (Figure 6.1, Panel B). This increase was consistent across the main manufacturing industries attracting a large share of FDI, except for metal products (Figure 6.1, Panel C). This also implies that the domestic value-added share of total exports (DVA) has decreased over time in Viet Nam, and it is much lower than in Indonesia, Malaysia and Thailand.[4] This is especially true in the apparel industry, where Viet Nam's DVA is 55% compared with 80% in Indonesia and 75% in Malaysia and Thailand.

## Figure 6.1. Features of FDI and supplier relationships in Viet Nam




Note: Panel D. Scores from World Economic Forum (WEF) Executive Opinion Surveys on questions "in your country, how numerous are local suppliers" and "how do you assess the quality of local suppliers" [scale of 1 (low rating) to 7 (high rating)]. Scores for value chain breadth in response to question "how broad is companies' presence in the value chain" [scale of 1 (narrow – primarily involved in individual steps of the value chain, e.g. resource extraction, production) to 7 (broad – present across the entire value chain, e.g. production, distribution, design, marketing, etc.)] (WEF, 2017[52]).
Sources: Panel A. UNCTADSTAT database; Panels B and C. OECD-WTO's Trade in Value Added (TIVA) database; Panel D. World Economic Forum (WEF) Global Competitiveness Index Dataset.

StatLink https://doi.org/10.1787/888934224771

Vietnamese local suppliers are generally engaged in low value-added activities, either producing non-core intermediate components or involved in assembling components. Most domestic suppliers are indirectly linked to the GVCs, often as third-tier suppliers, with no direct connections with the lead foreign firms and few connections with first-tier suppliers, which have the largest potential impact on domestic productivity and technology (World Bank, 2017[9]). This is reflected in the relatively weaker perceptions of the capacity and quality of local suppliers in Viet Nam compared to other ASEAN countries (WEF, 2017[8])[5]. On "local supplier quality", based on an executive opinion survey of the World Economic Forum (WEF), Viet Nam ranked 116th out of 137 countries, trailing far behind Malaysia (23rd), Indonesia (54th), the Philippines (73rd), and Thailand (74th) (WEF, 2017[8]). In addition, the value chain breadth (degree of involvement of local companies in the value chain) is narrower in Viet Nam (score of 3.3 out of 7) than in Malaysia (5.2), Indonesia (4.5) and Thailand (4.3) (Figure 6.1, Panel D).

Domestic firms more intensely involved in GVCs are very different from other firms in Viet Nam. They tend to be larger and more diversified in terms of products than companies with no connections with foreign investors (UNIDO, 2018[1]); are engaged in more product and process innovation activities, often

developed in co-operation with other firms or institutions, and spend more on R&D; use more information and communication technologies (ICTs) to communicate with their clients; and are more likely to hold international certifications and invest in formal training of their workers than non-suppliers (World Bank, 2017[9]). In addition, they are also more likely to be a member of business associations, which increases the probability of becoming a supplier of foreign-owned firms, especially in the food, apparel, and wood industries (Chuc and Thai, 2017[10]). The challenge for Viet Nam is the short supply of domestic enterprises sharing these characteristics.

### *The nature of GVC participation varies by industry*

The nature of GVC participation in Viet Nam (e.g. backward or forward linkages and regional or global value chains) varies a lot across industries (UNIDO, 2018[1]). This is illustrated through the examples of GVC integration in three key industries attracting a large amount of FDI in Viet Nam: textiles and apparel, electronics, and motor vehicles.

**Apparel and textiles industry:** The apparel industry in Viet Nam consists of domestic producers catering mostly to the local market and foreign-owned enterprises that export. In 2018, Viet Nam was the 8th largest world exporter of textiles (USD 8.3 billion) and the 4th of apparel (USD 31.5 billion, after China, the EU and Bangladesh) (WTO, 2019[11]). This sector, dominated by foreign investors, is the second largest exporting industry after electronics. The foreign-owned firms import inputs from their global networks, as evidenced by the very low domestic value added in the sector (see Figure 6.1, Panel C) and the large share of textile imports, which corresponds to 2.6% of the world total (the 4th largest after the EU, the United States and China). Foreign investors mostly originate from China, Hong Kong, Korea and Taiwan and are mainly motivated by low labour cost and preferential access to high-income markets. FDI in apparel has generated huge opportunities for low skilled local employment and labour intensive “cut-make-trim” (CMT) processes (particularly for females), but it has also produced weak spill-overs and very limited knowledge transfer to local producers due to few backward linkages (Hollweg, 2017[12]).

Domestic firms, mainly concentrated in Ho Chi Minh City and Ha Noi, are vertically integrated and largely oriented to produce and sell apparel in the local market. Most of this production is not of export quality and satisfies around 15% of domestic demand (UNIDO, 2018). The few domestic export-oriented firms are partly owned by the Viet Nam National Textile and Garment Group (Vinatex) or other state-owned enterprises, with very few new private ventures emerging in the industry since 2005 (Frederick, 2017[13]).

**Electronics industry:** The electronics industry in Viet Nam started to develop after WTO accession in 2007 as foreign investors looked for new competitive production locations[6]. Leading electronics firms in the country include Samsung and LG, contract manufacturers such as Foxconn, and platform leaders such as Intel and Microsoft.

With an investment of more than USD 17 billion, eight factories and one R&D centre, Samsung is the largest foreign investor in Viet Nam, employing 160 000 workers (largely semi-skilled high school graduates and women, who represent three-quarters of its workforce) (UNIDO, 2018[1]). Around one-third of Samsung’s worldwide phone production is assembled in Viet Nam, in particular in Thai Nguyen, North Viet Nam, where Samsung has located the largest smartphone factory in the world employing 60 000 workers.[7] Korea’s LG and Japan’s Canon have placed the largest laser printer and inkjet printer factories in the world in the Ha Noi area. Microsoft has also moved production to Viet Nam because of rising labour costs in China, making Viet Nam its second largest employment base after the United States (Sturgeon and Zylberberg, 2017[14]). In 2019, phone system devices, including smartphones, represented 20.7% of Viet Nam exports, followed by integrated circuits (8.6%), almost entirely manufactured by foreign-owned enterprises. Besides competitive wages (which have however more than doubled between 2008 and 2014), Viet Nam has the geographic advantage of being on the border with China where the existing supply chain is based, has a large population and a growing middle class (UNIDO, 2018[1]). Furthermore, foreign firms have also been attracted by tax incentives and preferential land access.

FDI has fostered local employment in the industry, generating low- and mid-skilled jobs mostly in hardware manufacturing and in the assembly of smartphones, even though workers in knowledge-intensive business services, such as software services, are slowly increasing (Sturgeon and Zylberberg, 2017[14]). In general, export-oriented foreign investors have a low localisation ratio (i.e. share of local content and value added retained locally) because domestic companies do not have the appropriate capabilities in terms of the required scale, cost, delivery and quality. As a result, local suppliers are mainly in low value-added services, such as packaging and printing, and serve predominantly as second or third-tier suppliers. Instead, the main suppliers in the electronics industry are also foreign-owned companies that have followed the lead buyer in Viet Nam to reduce logistics costs (Binh and Linh, 2013[15]).[8]

In order to help improve the technical capabilities of local producers, in 2012, Samsung set up a large R&D centre in Ha Noi (the largest in Asia) and supported the Ha Noi University of Science and Technology with grants and scholarships to address the talent bottleneck of skilled workers. Similarly, Intel took actions to deal with the lack of technical and managerial human resources in Viet Nam by launching the Intel Study Abroad Programme, which since 2010 has sent Vietnamese students to the United States to be trained as engineers and managers.

**Motor vehicle industry:** Viet Nam's motor vehicle industry is composed of three main segments: 1) two-wheelers, a well-developed segment with a strong local supplier base and about 90% of domestic value added, 2) passenger cars, mainly consisting of assembly plants and targeting the domestic market, but with a low rate of localisation, and 3) buses and trucks with a higher local content (Arenas, 2017[16]).

The two-wheeler industry focuses on the production of motorcycles and motorcycle parts. The domestic industry started in the mid-1990s under market protection. At the beginning of the 2000s, Chinese companies began to export low-cost kit components of slightly modified versions of Japanese models, which were assembled by Vietnamese firms. In doing so, Chinese companies rapidly took a large part of the market. In reaction to this, the Vietnamese government introduced quality and environmental standards and enforced stricter local content rules and import tariffs with the aim to develop a stronger local supplier base. However, when Viet Nam joined the WTO, tariff barriers had to be dismantled, which led Japanese producers to invest in this industry to satisfy the booming domestic market. Driven by Japanese manufacturers, domestic suppliers in the two-wheeler industry were able to meet higher quality standards, although they specialised only in a limited number of activities (Fujita, 2013[17]).

In the passenger car subsector, several Original Equipment Manufacturer (OEM) brands, such as Honda, Hyundai, Toyota, and Mercedes Benz, invested in Viet Nam to perform assembly operations nearly two decades ago, mainly to avoid high import tariffs. The small size of the domestic market (about 300 000 cars per year) makes it difficult for Viet Nam to compete in this sector, given that most plants do not reach minimum economies of scale and have higher production costs than in neighbouring countries (Arenas, 2017[18]). The OEMs source locally only low value-added components, such as seats, tires and batteries, and the simplest phases of production, such as assembly, painting and welding. The local manufacturers of auto parts number about 200-300 firms, most of which are SMEs with low production capacity and poor technological endowment (Arenas, 2017[16]). More sophisticated parts, such as gear boxes and engines, are imported from branches of the parent companies or from foreign suppliers. The result is low local content in the passenger cars sector (under 20%), much less than in other neighbouring countries, such as Thailand (45%), which is the motor industry powerhouse of the ASEAN region (Arenas, 2017[16]).

Local content in the bus and truck subsector is higher than in the production of passenger cars. Seventy percent of electrical components and all frames and trunks are domestically produced. The production of commercial vehicles is much less susceptible to economies of scale than the passenger car subsector, so Viet Nam has been able to develop domestic capabilities in the local manufacturing of relevant parts and components (Arenas, 2017[18]).

## Current constraints to the development of business linkages

### *There are both firm-level and macro-level constraints to deeper GVC integration of Vietnamese SMEs*

Growing FDI has brought many benefits to Viet Nam: jobs for a young and growing population, opportunities for women to join the formal labour force, and a decrease in agricultural employment (from 65% in 2000 to 39% in 2018). However, linkages between MNEs and local companies are not automatic. The low propensity of MNEs in Viet Nam to source local inputs is a long-standing phenomenon. Recent statistics show that MNEs in Viet Nam still import large amounts of parts and components and when they buy locally tend to develop linkages with foreign rather than with domestic suppliers (OECD/UNIDO, 2019[6]). If domestic enterprises lack the prerequisites to meet international standards on product quality, cost, reliability and time delivery, MNEs will often ask their established international suppliers to relocate.

A critical barrier to deeper GVC integration is Viet Nam's large number of small and informal companies which feature average low productivity (World Bank/MPI, 2016[19]). Lack of economies of scale also explains why the cost of manufacturing intermediate inputs in Viet Nam is often higher than the cost of imported inputs, especially in the automotive industry (APEC, 2017[20]). Many firms also face language barriers in communicating with MNEs, a problem particularly stringent with Japanese companies which prefer establishing supplier relationships with Japanese-speaking firms to minimise miscommunication (APEC, 2017[20]). Finally, only a limited number of domestic firms are qualified for higher international standard certifications, such as ISO 14 000, occupational safety, health management, and corporate social responsibility (World Bank, 2017[9]).[9]

In addition to these firm-level constraints, there are also barriers in the business environment that prevent a more qualified involvement of domestic companies in GVCs. Foreign-owned firms express concerns especially about the inadequate level of education of the workforce and the complex regulatory environment (World Bank, 2017[9]; UNIDO, 2018[1]). The weak enforcement of the Intellectual Property Rights (IPR) Law is also an issue for MNEs, particularly in high-technology sectors (World Bank, 2017[9]). Another problem consists in finding reliable information about domestic suppliers and their capacity, which results in high search costs for MNEs and weakens linkage opportunities.

Logistics is also an issue, notably the poor efficiency in customs clearance, weak infrastructure quality and limited availability of competent service providers (Shepherd, 2017[21]).The service sector in Viet Nam is still in its infancy, with a contribution to GDP of 41.6%, slightly lower than in Indonesia (44.2%) but much lower than in Malaysia (54.2%) and Thailand (58.6%).[10] Domestic services contribute very little as inputs into other sectors' exports, pointing to the lack of a modern domestic service sector that could tap into GVC downstream activities (Hollweg, 2017[12]).

### *Productivity spill-overs from GVC participation have been limited*

Due to these constraints, Viet Nam has not fully benefited from the potential technology and productivity spill-overs from existing FDI. Most imported inputs are sourced at short distances from other emerging or developing countries, with the exception of Japan and Korea (UNIDO, 2018[1]). Technological and knowledge spill-overs are also weakened by the low absorptive capacity of domestic companies. Furthermore, when positive spill-overs happen, they are geographically concentrated in the regions where the FDI is located (Anwar and Nguyen, 2014[22]).

## The current policy framework to support business linkages

### *The Programme on the Development of Supporting Industries (SI) is the main policy to build FDI-SME linkages*

The Vietnamese Government has adopted the term "supporting industry" (SI) to define all industries manufacturing materials, accessories, components and spare parts used for assembling finished goods.[11] The term was employed first by the Ministry of International Trade and Industry in Japan in 1985 and has been widely used in Asia ever since. The concept was initially introduced in Viet Nam in 2003 by the Viet Nam-Japan Initiative, which aimed to strengthen Viet Nam's economic competitiveness through the promotion of Japanese FDI into the country and the development of domestic "supporting industries" (Thuy, 2007[23]). Since then, Viet Nam has introduced a number of decrees and laws aimed at regulating and promoting SI.

A progressive series of regulations from 2007 started to identify the supporting industry sectors – textiles and apparel, leather and footwear, electronics, automotive, metal products and high-tech industries (manufacture of special-use materials and supporting equipment, software and services for hi-tech industries) – and to clarify the various SI incentives. The Ministry of Industry and Trade (MOIT) was designated as the main co-ordinator for SI development across ministries.

Decree No. 111/2015/ND-CP confirmed the six target supporting industries, provided a list of prioritised SI products for each industry eligible for assistance policies and incentives (which can be updated periodically), detailed the different policy instruments, and confirmed the key co-ordinating role of the MOIT, as well as the responsibilities of other ministries.

As of 2020, the Programme on the Development of Supporting Industry for 2016-2025 (Decision 68/2017) was the main SI policy. The objectives of the programme are to address the lack of competitive local suppliers by supporting and connecting domestic enterprises to foreign customers in the selected SI sectors and to further attract foreign investment in these sectors.

The total budget for the first phase of implementation (2016-2020) was around USD 43 million, 86% from the state budget and the remaining from other sources; in the second phase (2021-2025), the estimated budget is an additional USD 38 million.[12] Among the instruments included in the Programme are supply-side measures aimed at enhancing the capacity of firms to become more competitive and demand-side measures designed to widen the customer base of the supporting industry firms. Box 6.1 highlights the main measures included in the Programme.

### Box 6.1. Viet Nam's Programme on Development of Supporting Industry during 2016-2025 - Highlights

**Support for R&D and technology transfer**

This is the main area of intervention, funded with 55% of the total budget, and includes two main activities:

- Introduction and dissemination of manufacturing technologies: firms that engage in R&D related to SI products are eligible for funding up to 50% of investment costs and can receive land, given or leased out by the State, to build R&D facilities.
- Development and adoption of standards on raw materials, components and spare parts in conformity with international requirements: projects benefiting SIs and using over 85% of raw materials from domestic sources to manufacture SI industrial products are eligible for partial funding up to 75% of the total project costs.

**Human resource development**

- SI firms can obtain funding for training activities to meet the international standard requirements of SI products.
- Training institutions, including universities and research institutes, are encouraged to develop training programmes to raise knowledge and skills of managers and technicians in SIs.

**Fiscal and financial incentives**

- Tax incentives and import duty exemptions are offered to SI firms.
- Short-term loans to finance SI production projects are offered at an interest rate not exceeding the maximum rate set by the State Bank of Viet Nam. SMEs manufacturing SI products may receive loans for up to 70% of their investments, providing they are able to contribute 30% of equity to the project.

**Demand side measures**

- Partial funding for participation in trade fairs and exhibitions, organisation of forums between Vietnamese SI enterprises and domestic and foreign firms, as well as other business matching activities.
- Provision of consultancy support for enterprises investing in SIs.
- Build-up of a databases on the market for SI products and the SI enterprises with the capacity to deliver products to international buyers.
- Establishment of Supporting Industry Enterprises Development Centres (SIDECs) to assist SI enterprises in R&D and technology transfer, including through testing facilities, and to deploy training and trade promotion activities as outlined above.

**Programme targets**

Clear targets for each area of intervention are identified in the SI support programme, indicating the number of expected beneficiaries. For instance, 1 000 Vietnamese companies were projected to participate in Phase I of the programme, of which 130 would become direct suppliers of enterprises manufacturing or assembling complete products, 2 000 enterprises would receive consultancy and training in meeting international requirements, and 500 enterprises would be supported in other training activities. The second phase of the Programme in 2021-2025 will take place pending a review of the

results of the first phase.

Sources: Decree No. 111/2015/ND-CP on Developing Supporting Industry, 3 November 2015; https://thuvienphapluat.vn/van-ban/Doanh-nghiep/Decree-of-Government-No-111-2015-ND-CP-development-of-ancillary-industry-300647.aspx; Prime Minister Decision No. 68/QD-TTg approving the Programme on development of supporting industries during 2016-2025, 18 January 2017, https://vanbanphapluat.co/decision-68-qd-ttg-2017-program-on-development-of-supporting-industries-during-2016-2025

### *A number of improvements could be made to the SI development programme*

While the very existence of a programme on SI indicates a high level of commitment by the government to attract FDI and build supplier capacity in the selected sectors and products, a number of improvements could be made to the existing policy framework. An initial and important observation is the limited availability of resources to implement a vast and ambitious array of measures. The definition of eligible SI enterprises and products is also problematic. In general, the simplification of procedures for being certified as a SI firm has been successful, but there are still rigidities in the definition of a "new investment" or identification of the sector of specialisation (APEC, 2017[20]).

Furthermore, although a list of eligible SI products is clearly defined in the Programme, a detailed list of parts and components could place first movers in new products or materials at a disadvantage in meeting the requirements for programme support. In other words, gaining approval for the inclusion of "unlisted components" for programme support could be a constraint for more innovative companies and suppliers operating in industries subject to rapid changes, given that the updating of the directory of eligible products would require time.[13]

A further concern is the absence of services in the list of eligible SI products. This reflects the general perception about services in Viet Nam, which are not yet considered a potential key area of value addition in GVC domestic participation (APEC, 2017[20]; Hollweg, Smith and Taglioni, 2017[4]). Services, such as telecommunications, information technology (IT), logistics and transport services could be included in the list of supporting industries. In manufacturing industries, in particular electronics and automotive, post-production services are increasingly generating high value added within GVCs, based on the increasing availability of data from the embedding of sensors and semiconductors in manufactured products. If Viet Nam were to develop stronger ICT skills, this could open up GVC opportunities in IT-related services, such as design services, software development, programming and business and professional services (see Box 6.2).

### Box 6.2. ICT services in Viet Nam

According to the Viet Nam Software and IT Services Association (VINASA), the Vietnamese IT industry has seen a steady growth in the past few years. The industry reached revenues of more than USD 70 billion in 2017, creating over 780 000 jobs. The hardware industry contributed more than USD 60 billion, accounting for about 86% of total revenues, while about USD 10 billion stemmed from the software industry, a steep rise from the USD 2.7 billion reported for 2013 (Sturgeon and Zylberberg, 2017[14]). The growth has been driven by cost-competitive wages relative to China and India. Contrary to the hardware manufacturing industry, which is dominated by MNEs, the IT services sector is characterised by both foreign and domestic companies of different sizes.

According to Sturgeon and Zylberberg (2017[14]) there are four types of IT services firms in Viet Nam: 1) a few medium-to-large locally-owned firms selling customised solutions to MNEs; 2) many locally-owned software development SMEs producing for the export market; 3) a number of IT services and system integration MNEs focused on the local market whose main clients are other MNEs operating in the country; and 4) a few MNEs providing software development and ICT-enabled services for export, often to parent companies or external clients.

The main challenges facing the ICT services industry in Viet Nam are the lack of a high-skilled workforce, funding, lack of scale, and slow regulatory reforms. The Vietnamese Government has established a number of funds at national and provincial/city levels to encourage entrepreneurship in the ICT services industry. In addition, there are programmes to provide loans, technical training and business mentoring. Going forward, a priority for the government would be to increase investments in training and education to build a more skilled labour force.

Source: Sturgeon and Zylberberg (2017[14]), "Viet Nam's evolving role in ICT global value chains", in Hollweg et al. (eds), *Viet Nam at a Crossroads: Engaging in the Next Generation of Global Value Chains,* World Bank: 133-157

In some cases, the exact nature of the activities covered by the Programme and the mechanisms for access also need further clarification. For example, the kind of training supported as well as the type of expenditures covered in the area of human resource development are not well defined. In this area, support measures should be more selective and tailored to the particular capacity-building needs of individual enterprises. For example, Malaysia uses the SME Competitiveness Rating for Enhancement (SCORE) system, a diagnostic tool to assess SME capabilities and performance, whose rating eventually informs the provision of tailored assistance for domestic SMEs (see 6.3). In adopting such a diagnostic tool in Viet Nam, vouchers could be used to send employees to training courses and tax rebates could be offered to SMEs going through the process of acquiring international standard certifications.

### Box 6.3. SME Competitiveness Rating for Enhancement (SCORE) system, Malaysia

**Description of the approach**

In 2007, Malaysia introduced the SME Competitiveness Rating for Enhancement (SCORE), a diagnostic tool used to rate and enhance the competitiveness of SMEs based on their performance and capabilities. SCORE is used as a tool for: 1) acquiring baseline data on SMEs; 2) evaluating and tracking SMEs' capabilities and performance; 3) facilitating linkages between SMEs and foreign and domestic buyers; 4) linking export-ready SMEs to the National Trade Promotion Agency (MATRADE), and 5) ensuring better funding access.

SMEs assess themselves on seven parameters: business performance, financial capability, management capability, production capacity (including level of automation), technical and human resource capability, quality systems and certifications, and innovation. Results of the self-assessment are rated on a scale of 0 to 5 stars and SMEs are offered tailored assistance depending on their score.

#### Table 6.1. The rating system of SCORE Malaysia

| Rating | Assessment | Assistance given |
|---|---|---|
| 0-2 stars | Very basic, manual or semi-automated processes | Integrated hand-holding assistance |
| 3 stars | Able to implement a quality system, undertakes product and process improvements, ready for export compliance certification, registered IP | Recommend measures for improvement |
| 4 stars | High level of automation, invests in product/process improvements, most likely exporting, with certification for export | Link with large enterprises/MNEs/MATRADE |
| 5 stars | Good branding/packaging, currently exporting with compliance to export requirements | |

Source: SME Corporation Malaysia (2018[24]), "Compendium on Methodologies for SME Internationalisation - Malaysia's contribution".

The companies can request a verified assessment by an auditor of SME Corp. Malaysia, which is in charge of the SCORE programme. The auditor provides recommendations for improvement and indications about the type of assistance needed. SME Corp. collaborates with various public and private bodies that have the potential to assist and support SMEs in building their capacity and capabilities.

**Factors of success**

The SCORE tool allows the identification of support services that are better matched to the needs of individual businesses. For instance, SMEs with a 3-star rating or below can receive support for improving their capacities, while 4- and 5-star companies are supported in getting involved in supply chains.

**Obstacles and responses**

A challenge has been to train auditors able to support SMEs in completing the online SCORE assessment tool and to undertake the direct assessment of those companies asking for it. The solution was to organise a specific training programme in the SCORE methodology, including both online assistance and site visits for direct assessment.

**Relevance to Viet Nam**

An SME diagnostic tool could allow the Supporting Industry Enterprise Development Centres (SIDECs) to assess the strengths and weaknesses of SME clients in the Programme for Supporting Industries and tailor the interventions according to the specific needs and potentialities.

Sources: SME Corp. Malaysia, SME Competitiveness Rating for Enhancement (SCORE), http://www.score.gov.my/index.php/about-us-score/; SME Corporation Malaysia (2018[24]), "Compendium on Methodologies for SME Internationalisation - Malaysia's contribution", https://apecmsmemarketplace.com/sites/default/files/doc/18_smewg47_010.pdf/

Finally, the Viet Nam Association for Supporting Industries (VASI) publishes an annual directory (hard copy) with detailed information on well-established Vietnamese manufacturing enterprises that have successfully become contractors of MNEs in Viet Nam, but focuses only on three sectors: mechanical, electronics and plastics and rubbers. Thus, the directory falls short of being a comprehensive database of all SI enterprises searchable online by MNEs seeking qualified local suppliers. The database of SI enterprises could be strengthened by providing online access to up-to-date information about local suppliers across all SI industries. Moreover, the database could incorporate information on the "reputation" of supplier companies, based on data collected with the involvement of lead firms, which could allow suppliers to earn the status of "verified" or "trustworthy", based on their quality and reliability over time (World Bank, 2017[9]). Approaches to improving a supplier database are highlighted in Box 6.4.

### Box 6.4. Improving a database on potential suppliers: public and private examples

**The case of Invest North Macedonia**

Invest North Macedonia, a national investment promotion agency, has created a database of suppliers in the automotive sector, including data about the listed companies, that enables the search for potential suppliers by several criteria, such as region, products, industry and tier (World Bank, 2017[25]). The database is user-friendly, accessible online to potential investors and available in Macedonian and English. The database contains basic information about companies, such as name, address, main products and webpage link. Non-mandatory information includes the number of employees, turnover, national and international certifications, and the supply chain position (1st, 2nd or 3rd tier). The database is developed in such a way that companies can update their own data and keep it current. Moreover, the database can interface with other existing databases, can be extended to other industries, and can integrate any future information required by MNEs.

**Implementing a rating system for verification as a competent and reliable supplier - the case of Alibaba**

An interesting additional information feature in a supplier database could come from the introduction of a rating system for "quality and reliability". For example, Alibaba's business-to-business web portal uses a rating system (from 0 to 10) based on how suppliers fulfil online orders; attaining a high rating helps suppliers gain the attention of more buyers (World Bank, 2017[25]). Furthermore, suppliers can opt for a fee-based "Gold Supplier" membership, based on a verification of their supplier capabilities, e.g. human resources, certifications, export capacity, production process management, and R&D abilities. "Gold suppliers" passing the assessment receive the label of "Assessed Supplier". Alibaba also has an exclusive channel for selecting export-oriented providers on which only suppliers with actual and regularly verified export capabilities are admitted

## *There could be better co-ordination between the Programme for the Development of Supporting Industries and other business linkages programmes*

An important area for improvement is to strengthen the co-ordination of the public and private institutions involved in policies and programmes supporting business linkages. In addition to the Programme for the Development of Supporting Industries implemented by the MOIT, there are in fact other initiatives targeting business linkages. The Ministry of Planning and Investment (MPI) is the focal Ministry to implement the national programme on value chains.[14] The Centres for Assisting SMEs (TACs), which operate under the MPI, also offer services to promote business linkages in collaboration with Korean and Japanese advisors.[15] The Ministry of Agriculture implements GVC policies in agriculture, and provincial authorities implement support projects on potential value chains in their locality, although most have difficulty in identifying the appropriate value chains and qualifying SMEs at the local level. Furthermore, the recent

SME Support Law (Law No. 04/2017) prioritises "SMEs participating in value chains" as one of the strategic segments to be supported through targeted training, consultancy, and preferential access to credit (interest rate subsidies) and premises. International donors are also active in this field, for example, the USAID-MPI Linkages for SMEs (LinkSME) Project 2018-2023 is an additional (USD 22.1 million) initiative to support linkages between SMEs and MNEs.[16]

If a large number of agencies are involved in implementing support programmes, and co-ordination across institutions is weak, the result is likely to be the fragmentation of policy initiatives, overlapping functions, and lack of cohesion in policy implementation. Given the limited resources available, better co-ordination and specialisation of the different institutions promoting business linkages and GVC participation could lead to more efficient and effective services. This could imply the need for a national co-ordination body or at least a mechanism with responsibility for an integrated approach to targeting SMEs with supplier development support. The experience of Costa Rica in establishing a national supplier development office is offered as a useful example for Viet Nam (Box 6.5).

### Box 6.5. The PROVEE Programme in Costa Rica

**Description of the approach**

Costa Rica's experience with programmes to promote business linkages provides an example of trial and error policy development. During the 1990s, several attempts to support business linkages failed due to competition among programmes and lack of co-ordination. In 2002, the Government set up Costa Rica (CR) PROVEE, a national supplier development office, to increase linkages between Costa Rican SMEs and multinational companies operating in the country. The activities co-ordinated by PROVEE include:

- Fiscal incentives for SMEs that supply to exporting firms;
- Access to finance to facilitate investments in technology;
- Awareness of the exporting firms about the benefits of domestic investment linkages;
- Programmes to connect qualified SMEs with exporting firms;
- Improvements in the organisational capacities of local suppliers;

**Success factors**

Costa Rica has a coherent institutional framework to promote business linkages. An empirical analysis has shown that PROVEE had a positive significant impact on real wages and the exporting probability of firms supported by some of the initiatives promoted under the umbrella of PROVEE (Monge-González and Rodríguez-Álvarez, 2013[26]).

**Obstacles**

The magnitude of the Programme remains limited relative to the size of the country. According to data provided by the Ministry of Finance, from 2001 to 2011, a total of 9 654 local companies supplied different types of goods to MNEs operating in special economic zones, while only 403 firms were involved at some point with PROVEE (4% of all local suppliers of MNEs).

**Relevance to Viet Nam**

PROVEE represents a good example for Viet Nam of how the co-ordination of different GVC activities can positively impact business linkages and the performance of domestic suppliers. However, it also points to the need of providing adequate funding in order to produce a significant impact at the national level.

**Sources of additional information**

Monge-González and Rodríguez-Álvarez (2013[26]), *Impact evaluation of innovation and linkage development programs in Costa Rica: The cases of Propyme and CR Provee*, Inter-American Development Bank.

OECD (2013[2]) *OECD Investment Policy Reviews: Costa Rica 2013*, OECD Investment Policy Reviews, OECD Publishing, Paris, https://doi.org/10.1787/9789264203952-en.

It is also important to co-ordinate with the private sector in the design and implementation of the supporting industry programmes. In Viet Nam, the involvement of stakeholders during the drafting of regulations is an obligation by law, and public consultations are frequently held with various business associations. However, the private sector could also be more involved in the process of capability building of domestic suppliers and in creating a transparent system for sharing information about suppliers' skills. This could also take into consideration linkages between first-tier and lower-tier suppliers, which could create significant space for knowledge and technology transfer. Based on an experience in Thailand, the main channels for this could be: 1) technical training visits, 2) organisation of seminars at first-tier plants, and 3) provision of manuals for lower-tier suppliers (Punyasavatsut, 2008[28]).

### *Monitoring and evaluation of the SI development programme should be introduced*

Monitoring and evaluation of business linkages programmes is another area for attention. In particular, while the Programme for Supporting Industries states clear outcomes in terms of expected recipients and improvements in their performance, it does not have a monitoring and evaluation plan. Monitoring and evaluation plans are ideally established at the onset of the programme, indicating clear objectives and indicators. The evaluation exercise can take place immediately after the end of the programme or later to focus on longer-term effects and should ideally compare the treatment group of assisted enterprises with a control group of non-assisted enterprises.

A limited number of indicators, easy to measure and to collect, should be defined. Some possible indicators would include (World Bank, 2017[25]):

- *Inputs and outputs*: public and private expenditures, number of companies involved, number of projects, number of hours in consultancy time, number of training hours;
- *Suppliers' outcomes*: increased sales, increased productivity, increased quality, new products, new jobs, number of companies having acquired the approved supplier status, national and international standards certifications, employee qualifications obtained;
- *Foreign investors' outcomes*: lower costs, increased local content.

It is useful to complement quantitative information with regular qualitative feedback from the MNEs and suppliers involved in the programmes. Another issue to consider is the frequency of data collection and whether to indicate mandatory reporting for companies receiving assistance.

## The role of the business environment for business linkages

### *Business linkages will benefit from the improvement of certain business environment conditions*

Business linkages between domestic companies and foreign investors would also benefit from the strengthening of certain aspects of the business environment (see also chapter 3). These relate primarily

to institutional and physical connectivity, fiscal and financial incentives, the innovation system, and social responsibility and environmental codes of conduct.

### *Better institutional and physical connectivity will support business linkages*

Soft and hard connectivity are key drivers of international competitiveness (Hollweg, 2017[12]; Shepherd, 2017[21]). In terms of institutional connectivity, there is a need to further streamline the regulatory environment, notably contract enforcement, which is positively associated with the local provision of inputs (UNIDO, 2018[1]), and to make border procedures more transparent and predictable. Viet Nam has started to implement e-customs procedures and a National Single Window to facilitate trade (see Chapter 5), which are important trade facilitation efforts. In this context, Viet Nam should continue with full integration of electronic procedures in the trade facilitation processes. Logistical support services, such as storage, warehousing and cargo handling, are also an important area in need of improvement.

In terms of physical connectivity, investments are necessary to upgrade the transport system, including ports, airports, roads and rail links. This includes establishing corridors among the major poles and trade gateways and developing a mobility strategy within the main economic centres (Hollweg, Smith and Taglioni, 2017[4]). Investment in physical connectivity is a key element for the development of a mobility value chain as described in Box 6.6, which could lead to increased opportunities for Viet Nam to move beyond a narrow focus on traditional motor vehicle GVCs.

#### Box 6.6. Developing a mobility value chain in Viet Nam

Due to rising income per capita, Viet Nam has seen rapid motorisation with registered motorcycles increasing from 1.2 million in 1990 to over 50 million, and is now on the verge of reaching the threshold after which countries see a rapid increase in car ownership. The dramatic diffusion of motorcycles has generated negative externalities in terms of pollution and traffic congestion in the main urban centres.

Viet Nam has the opportunity to switch from a narrow focus on the traditional motor vehicle GVCs to a broader mobility value chain, which should be multimodal and networked (Arenas, 2017[18]). This implies investing in public transport and shared-use mobility systems.

The role of domestic manufacturers in this mobility chain can build on existing local capabilities in producing parts and components for motorcycles and commercial vehicles to specialise in the production of buses, and specifically on minibuses. This is a market segment still open in the region and in which Viet Nam has the potentiality to upgrade its GVC capacity beyond the pure assembly phase. Moreover, there is an opening space in services related to the design, management and maintenance of the mobility systems, such as software design for transport intelligent systems (i.e. bus scheduling and integrated ticketing systems).

The leading actors in the mobility value chain will be private manufacturing firms and service providers, with a key role played by the public sector in implementing regulatory changes and setting appropriate incentives to foster the adoption of the new model (e.g. congestion charges to enter designated zones in urban areas). Collaboration between the private and public actors will also be key for developing new services and opening up business opportunities for new software solutions and platforms, so will the creation of a favourable environment for start-ups in the area of mobility solutions.

Source: Arenas (2017[18]), Developing Networked Mobility in Viet Nam, in Hollweg et al. (eds), *Viet Nam at a Crossroads: Engaging in the Next Generation of Global Value Chains*, World Bank; Arenas (2017[16]), "Viet Nam in the ASEAN Motor Vehicle Industry", in Hollweg et al. (eds), *Viet Nam at a Crossroads: Engaging in the Next Generation of Global Value Chains,* World Bank.

Physical connectivity also includes ICT infrastructure. Well-developed ICT infrastructure and reliable telecom services are key for increasing economic competitiveness and for upgrading SMEs within GVCs. Viet Nam's ranking on the ICT Development Index, based on indicators of ICT access, use and skills, has been declining relative to other countries (see Chapter 3), and although slightly better than Indonesia, lags considerably behind Malaysia and Thailand.[17] This warrants further action on the part of Viet Nam to improve its performance on ICT development.

Energy and water supply are also important. The lack of chemical and waste water treatment facilities has, for example, been indicated as one of the reasons holding back investments in textile production, notably in the most polluting phases such as dyeing (Hollweg, 2017[12]). The provision of adequate infrastructure and establishment of environmental standards are therefore needed to further encourage the development and upgrading of certain value chains.

### *Domestic suppliers are often at a fiscal and financial disadvantage compared to foreign suppliers*

In many aspects, domestic suppliers are in a less favourable position relative to foreign suppliers. For instance, domestic suppliers have to borrow in local currency, while foreign suppliers and MNEs are free to borrow in other currencies at lower interest rates. Taxation also creates an uneven playing field between foreign and local suppliers. Foreign suppliers, when established in export processing zones, are exempted from value-added tax (VAT), whereas domestic suppliers can only be reimbursed VAT after proving their products are bound to export, which in the best scenario generates delays. This tax incentive could be extended to domestic SMEs that sell more than a certain percentage of their production to firms operating in export processing zones. An additional important issue to address is the extension of measures, such as tax exemptions on import duties, beyond first-tier suppliers.

Access to working capital to finance the supply of goods to MNEs is also a constraint for Vietnamese SMEs. The availability of supply chain finance (SCF) is in short supply, with few financial institutions in Viet Nam offering modern SCF services in significant scale. SCF services not only enable suppliers to increase their working capital and scale up production, but also allow them to conduct more open-account transactions. In turn, this increases the productivity of suppliers and make them more attractive to global buyers. To help address the issue, the International Finance Corporation (IFC) is working with the government of Viet Nam to facilitate SCF in the country by improving the regulatory framework, sector infrastructure, capacities of SCF providers, and awareness of SME suppliers of the options available. [18] In the financial sector, the adoption of fintech and blockchain technology (Box 6.7) and the appropriate regulatory framework for this, is also expected to produce a significant impact on SME participation in GVCs.

#### Box 6.7. The role of blockchain technologies in enhancing the transparency of supply chains

Blockchain technologies are digitally distributed ledgers of records, transactions, or executed events that are shared across participating parties, such as those along a supply chain. Blockchain solutions can, therefore, allow the communication and exchange of authenticated data between each player in a supply chain without the intermediation of a trusted central organisation. Blockchain can improve supply chain transparency by allowing participants to record and verify price, date, location, quality, certification, and other relevant information in real time. Resulting benefits include:

- Increased traceability of material supply chains to meet "Responsible Business Conduct" (RBC) standards, increasingly required by MNEs;
- Lowered risk of fraud and counterfeiting;

- Improved visibility and compliance over outsourced contracts;
- Reduced paperwork and administrative costs; and
- Enhanced position as a leader in responsible manufacturing.

Administrative costs associated with quality control and compliance with RBC standards can be prohibitively high for SMEs. By reducing these costs, both for the contracting and the contracted parties, blockchain technologies have the potential to enhance linkages between MNEs and local SMEs.

Source: OECD/UNIDO (2019[6]), *Integrating Southeast Asian SMEs in Global Value Chains: Enabling Linkages with Foreign Investors*, OECD Publishing, Paris.

### *A stronger innovation system is instrumental to upgrading local suppliers*

The sustainable integration and upgrading of domestic enterprises in GVCs requires a well-functioning national innovation system (Lema, Rabellotti and Gehl-Sampath, 2018[29]), whose development should include the following dimensions:

- The integration of foreign companies into the national innovation system, notably by involving them in R&D and skills development projects aimed at the upgrading of local suppliers. Box 6.8 provides a programme example from Chile, which aimed to strengthen business linkages between domestic suppliers and foreign investors through the offer of incentives to innovation on both sides.
- The establishment of specialised institutions and service providers (e.g. testing and certification agencies) offering support to domestic firms in acquiring and adapting new technologies, complying with international standards, and accessing technical and managerial training. Malaysia's measurement and testing centres are an example (Box 6.9).
- The engagement of universities and vocational training institutes to deliver education programmes in line with the skills and competencies required by foreign investors. Language skills should also be improved, especially in the languages of the main foreign investors and key providers of technology (e.g. English, German, Japanese and Korean).
- A financial system geared towards the provision of investment credit, notably for investments in the machinery and technologically-oriented projects needed to establish long-term linkages with MNEs. This should include funding for intangible assets and access to entrepreneurial development services. Moreover, special credit facilities and advance and prompt payment mechanisms could be introduced to support domestic SMEs involved in business linkages that face cash-flow problems.
- The strengthening of intellectual property rights (IPRs) is key both for attracting R&D foreign investments and for protecting domestic innovators, an area where there is still large room for improvement in Viet Nam (see chapter 3 for more details).

### Box 6.8. The World Class Suppliers Programme in Chile

**Description of the approach**

The World Class Suppliers Programme is an important policy initiative started in 2009 in the mining industry in Chile. It is an example of a public-private partnership between BHP Billiton, a multinational enterprise with copper mining operations in Northern Chile, and *Corporación Nacional del Cobre de Chile* (CODELCO), the largest (state-owned) mining company in the country. The programme aimed to facilitate the development of innovative solutions to the operational and environmental challenges faced by BHP in its Chilean operations, and to help local suppliers develop into world-class businesses with the ability to export services and technology abroad. The objectives of the programme were to develop 250 Chilean-based resource industry suppliers into "world class" global suppliers by 2020 (later extended to 2035) through the upgrading of the technical and managerial capabilities of providers to the mining industry.

Two main participants are involved in the Programme: the multinational mining companies and the Chilean suppliers. The mining companies are involved in: 1) identification of the technical challenges; 2) selection of the suppliers; and 3) development of the operational project providing training, advice and infrastructures for testing the solutions. The incentive for the MNE is to find a solution for an operational problem not previously addressed and to improve the supplier's capabilities. The Chilean suppliers are involved in: 1) elaborating a solution to an operational challenge; 2) developing a technical project; and 3) developing a world-class path agenda, including how to scale up from local to international markets. The incentive for the suppliers is to invest in an innovative solution with a known demand and a guaranteed market, with a reduction in the level of uncertainty associated with the R&D investment.

A third player is *Fundación Chile*, a public-private foundation which acts as a broker between the mining firms and the suppliers. *Fundación Chile* designed the methodology for the development of the suppliers and, through the mobilisation of a team of external advisers, provided training and technical assistance to the new suppliers.

Project investments are in the range of USD 100 000-20 million, with consulting costs in the range of USD 10 000-40 000. As of 2017, the programme had facilitated the development of over 100 projects.

**Factors of success**

The Programme has been successful in achieving incremental innovation and some positive, albeit small, impact on exports. One of the highlights was the institutional strengthening that stemmed from the new linkages between local industry suppliers and the mining companies and new perspectives on corporate social responsibility activities. The new solutions implemented by the mining companies had positive effects on their operations, the local suppliers gained access to a regular market for their upgraded services, and the government benefited from more sustainable production in the mining industry. An additional factor of success was also the access of supplier firms to public funds and R&D tax incentives.

**Obstacles and responses**

The number of suppliers participating in the programme is still very small: 100 of the more than 6 000 estimated suppliers in the Chilean mining industry. It is not clear if the low number of recipient firms is due to low average skills among suppliers or to the cost undertaken by mining firms to detect technical challenges. Likely, both supply and demand factors have restrained the size of the programme.

Moreover, while the programme has been successful in addressing the technological problems identified by the mining companies, it has been less successful in helping supplier firms to replicate and scale up the technological solutions to the international market. This may be due to an incentive problem: while there are incentives for joint collaboration during the first phase, there is not a strong rationale for MNEs to provide their facilities for testing during the scale-up phase of the project. In addition, the scale-up of the innovation and its internationalisation require investments that are beyond the existing public funding possibilities.

**Relevance to Viet Nam**

The programme is innovative and has the potential to help suppliers and MNEs to build up a mutually beneficial long-term relationship around the themes of training, technological improvements and innovation. In addition, although the programme was originally launched in the mining sector, its principles are easily transferable to other sectors and value-chains.

Sources: Atienza and Valdés (2016[30]), "World Class Suppliers Program: The case of the mining cluster policy in Chile", Economics Department, Universidad Católica del Norte, Antofagasta, Chile
Bravo-Ortega and Muñoz (2015[31]), "Knowledge Intensive Mining Services in Chile", Discussion Paper No. IDB-DP-418, Inter-American Development Bank;
Navarro (2018[32]), "The World Class Supplier Program for mining in Chile: Assessment and perspectives", *Resources Policy*, 58: 49-61

### Box 6.9. Malaysia's measurement and testing centres

Compliance with international standards is an important requirement for suppliers in GVCs. The Malaysian government has built a number of labs, testing centres and other technical facilities to ensure that local suppliers have access to the measurement and testing services needed to comply with international quality certifications and standards. A key institution is the National Applied R&D Centre, which houses labs offering advanced testing services at subsidised rates. In addition, the Penang Skills Development Centre (PSDC), a public-private initiative involving the government, universities and industry, hosts one of the largest electromagnetic compatibility labs in Southeast Asia, as well as other shared testing facilities. With access to modern testing services, Malaysian companies can meet GVC quality requirements at a more affordable cost than if they had to invest in their own equipment or rely on overseas labs.

Sources: OECD/UNIDO (2019[6]), Integrating Southeast Asian SMEs in Global Value Chains: Enabling Linkages with Foreign Investors, http://www.oecd.org/investment/Integrating-Southeast-Asian-SMEs-in-global-value-chains.pdf; National Applied R&D Centre, http://www.mimos.my/technology/national-facilities/; Penang Skills Development Centre (PSDC), https://www.psdc.org.my/services/electromagnetic-compatibility-lab

### *Compliance with social responsibility and environmental codes of conduct are increasingly required in GVCs*

In a country like Viet Nam whose engagement in value chains has so far been mainly in labour-intensive manufacturing, upgrading the participation of local suppliers in GVCs will also involve better compliance with international social and environmental codes of conduct. Compliance with these standards has, in fact, become a common prerequisite for accessing global buyers. Awareness raising among domestic companies of international codes of conduct could be promoted with the assistance of lead firms, while

universities could include issues related to business social responsibility and environmental standards in their educational and training programmes. Lead firms could also be involved in supporting through cost-sharing the participation of domestic companies in "responsible supply chain management" initiatives. An example is the Viet Nam Business Links Initiative, a collaboration of international footwear brands to help local SMEs in the footwear sector to improve compliance with supplier codes of conduct (OECD/UNIDO, 2019[6]).

## Conclusions and policy recommendations

Viet Nam, emerging quickly as a manufacturing hub and home to some of the largest MNEs in South East Asia, has grown mostly as an export platform. However, there have been limited opportunities for FDI spillovers deriving from the local sourcing of inputs and intermediate products by foreign investors. Enhancing business linkages has clear advantages for all parties involved in the process. Suppliers can generate jobs and improve their competitiveness, potentially moving up the value chain. Foreign investors can reduce costs by sourcing more complex parts and components from local companies. The domestic economy in general can improve its competitiveness from spillover effects, leading to an increase in productivity, innovation capacity, skills and wages.

Policies meant to attract FDI are very different from policies aiming to capture possible gains from GVC integration (Pietrobelli and Staritz, 2018[33]). To capture these gains, it is necessary to undertake programmes to strengthen firm-level capabilities, encourage supportive research from universities, foster a wide offer of advanced services, especially in the field of testing and certifications, build an efficient credit system geared towards the provision of supply chain finance and long-term credit, nurture a well-educated labour force, and build good-quality soft and hard infrastructure.

The following policy recommendations are offered to strengthen business linkages between MNEs and SMEs in Viet Nam.

### Policy recommendations on business linkages in Viet Nam

- Increase flexibility in the criteria for identifying "supporting industry" products to account for changes in industries and global value chains, expand the list to include key value chain services, and extend incentives beyond first-tier suppliers.
- Introduce, in close collaboration with Viet Nam-based multinational enterprises (MNEs), supplier development programmes aiming to build up the capacity of SMEs to meet the international standards requirements of MNEs.
- Enhance the existing supplier database to facilitate linkages between MNEs and local suppliers, including by posting it online and introducing quality assessments of local suppliers.
- Enhance the integration of foreign and domestic firms in the national innovation system and promote institutions offering specialised services to supporting industries, such as testing and certification agencies.
- Involve national universities and vocational education institutions in building up the technical and soft skills needed in GVCs.

- Implement supply chain finance mechanisms to smoothen commercial transactions between local domestic suppliers and MNE clients.
- Improve the GVC-related regulatory environment, notably contract enforcement and border procedures, making them more transparent and predictable.
- Upgrade the transport system including ports, airports, roads and rail links, establishing corridors among the major poles and trade gateways, and developing a mobility strategy within the main economic centres.
- Enhance compliance of domestic suppliers with international codes of conduct addressing labour and environmental standards.
- Introduce monitoring and evaluation of business linkages programmes, including the Supporting Industry Development Programme, identifying key indicators and regularly collecting data and feedback from participating MNEs and SMEs.

## Notes

[1] The AmCham (2019[2]) survey was conducted by the American Chamber of Commerce in Singapore with senior executives in US companies based in Viet Nam. The Economist Intelligence Unit (EIU) survey included responses from senior executives active in the main Asian countries, Australia and New Zealand.

[2] Data from fDi Markets, https://www.fdimarkets.com/.

[3] Gross exports can be decomposed into two main components: Foreign value added (FVA), i.e. the value of intermediate imports embodied in gross exports, and Domestic value added (DVA), i.e. the value of domestically produced intermediates in gross exports (OECD, 2019[35]). FVA is considered a measure of "backward linkages", that is, when an economy imports intermediates to produce its exports. DVA is considered a measure of "forward linkages", as it captures the domestic value-added contained in inputs exported to a partner country.

[4] DVA also depends on the export specialisation of each country. For instance, Indonesian exports are driven by oil, palm oil, gas and rubber, which explains the much higher DVA compared to Viet Nam where exports are mainly manufactured goods (Amendolagine et al., 2019[34]).

[5] Based on responses to the WEF executive opinion survey questions as input to the Global Competitiveness Index 2017-2018, "In your economy, how numerous are local suppliers?" and "In your economy, how do you assess the quality of local suppliers?".

[6] With the exception of Panasonic and LG, which have older facilities in Viet Nam producing consumer appliances for the domestic market.

[7] "Why Samsung of South Korea is the biggest firm in Viet Nam", *The Economist*, 12 April 2018, https://www.economist.com/asia/2018/04/12/why-samsung-of-south-korea-is-the-biggest-firm-in-vietnam.

[8] For instance, most inputs for Samsung products are imported and those sourced domestically are provided by Viet Nam-based foreign suppliers from Korea, Japan, Malaysia, Singapore and UK (Sturgeon and Zylberberg, 2017[14]).

[9] For example, among the members of the Viet Nam Association for Supporting Industries (VASI), only 14% of the 132 firms specialised in metal processing and 25% of the 16 firms in electronics and electrical components had ISO 14 000 certifications. This increased to 47% among the 36 suppliers specialised in plastics and rubber.

[10] Information from the World Bank database (Services, value added (% of GDP), 2019 data,https://data.worldbank.org/indicator/NV.SRV.TOTL.ZS).

[11] The definition of supporting industry is set out in Decree No. 111/2015/ND-CP on the development of supporting industries, 3 November 2015.

[12] Prime Minister Decision No. 68/QD-TTg approving the Programme on the development of supporting industries during 2016-2025, 18 January 2017, https://vanbanphapluat.co/decision-68-qd-ttg-2017-program-on-development-of-supporting-industries-during-2016-2025/.

[13] For instance, a pre-determined list of parts and components eligible for government support can represent a limitation for potential suppliers of new inputs, such as new textile materials, or suppliers trying to undertake inter-chain upgrading, for example when producers of metal components try to shift from the motorcycle industry to commercial vehicles and buses.

[14] The MPI, for example, has signed a Memorandum of Understanding with SME support agencies (e.g. VIETRADE) and business associations, such as the Viet Nam Association of SMEs (VASME), the Viet Nam Association for Supporting Industries (VASI), the VCCI, and the Viet Nam Textile and Apparel Association (VITAS), to deliver training and consultancy services to build the capacity of Vietnamese SMEs to participate in manufacturing supply chains. In addition, it organises events and platforms to facilitate linkages between SMEs and lead firms.

[15] In particular, TACs co-operate with the Japanese International Cooperation Agency (JICA) to send senior experts from Japan to SMEs in supporting industries with the objective of offering advice on technical innovation, production and quality management and facilitating connections with Japanese companies.

[16] The USAID LinkSME project provides technical support to local SMEs to help them participate in GVCs and assists foreign companies in finding qualified local suppliers.

[17] Based on information from the International Telecommunications Union, https://www.itu.int/net4/itu-d/idi/2017/index.html#idi2017economycard-tab&VNM.

[18] “IFC Promotes Supply Chain Finance in Viet Nam, Improving Competitiveness of Local MSME Suppliers”, International Finance Corporation Press release, 11 November 2019, https://ifcextapps.ifc.org/IFCExt/Pressroom/IFCPressRoom.nsf/0/0611FB41CE54EBA3852584AF001DCF6C.

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