SME and FDI Policies in East Asia

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Topics
- QCD of Japanese enterprises
- Supporting industries
- Success factors in industrial parks
- Country evaluations by Japanese FDI
- Malaysia’s Manufacturing++ and cluster-based approach
- SME policies of Malaysia, Thailand
- Policy Proposals for Vietnam
Quality, Cost, Delivery (QCD)

- Japanese manufacturers pursue QCD for competitiveness.
- They also demand QCD from suppliers.
- Q means zero defects (all problems solved within factory, never shipped to customers).
- C means cutting cost (subject to Q).
- D means on-time delivery and no (excess) inventory. It was spearheaded by Toyota's just-in-time system. Logistics is also key for quick delivery.

The Pledge of Monozukuri (Manufacturing)

1. Keep Delivery Date
   --It is our responsibility
1. Guarantee Quality
   --It is our pride
1. Cut Cost
   --It is our duty

A panel inside a Japanese FDI factory in Hanoi, Vietnam
Supporting Industries (SI)

- “Supporting industries” refers to parts industries for mechanical assembly such as electronics, cars, motorbikes.
- Development of SI is key to competitiveness, since 80-90% of production cost is parts cost.
- The term “Supporting Industries” has been used by Japanese government since mid 80s.
- Similar terms: parts & components, suppliers, vendors, subcontractors, ancillary industries.

The core parts of SI:
Metal, plastic, rubber, electrical, screws, nuts & bolts, springs, etc.

The core processes of SI:
Mold & die, pressing, casting, forging, welding, plating, heat treatment, machining.

Source: Nguyen Thi Xuan Thuy (2007)
### Japanese Motorbike Assemblers in Vietnam (Honda, Yamaha, Suzuki)

#### Sources of Motorbike Engine Parts, March 2007

<table>
<thead>
<tr>
<th>Section</th>
<th>No.</th>
<th>Part</th>
<th>Local purchase</th>
<th>Imports</th>
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<td>Head cylinder</td>
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<tr>
<td></td>
<td>2</td>
<td>Cover cylinder head</td>
<td>○ ○ ○ ○</td>
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<td></td>
<td>3</td>
<td>Piston</td>
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<td></td>
<td>4</td>
<td>Crankshaft</td>
<td>○ ○ ○ ○</td>
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<td></td>
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<td>Connecting rod</td>
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<td>6</td>
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<td>Rocker arm</td>
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<td>11</td>
<td>Valves</td>
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<td>12</td>
<td>Valve spring</td>
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<td></td>
<td>14</td>
<td>Cam chain</td>
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<td>15</td>
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<td>台湾 台湾 台湾 台湾</td>
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<td></td>
<td>17</td>
<td>Joint carburetor</td>
<td>○ ○ ○ ○</td>
<td>台湾 台湾 台湾 台湾</td>
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<td></td>
<td>18</td>
<td>Air cleaner assy</td>
<td>○ ○ ○ ○</td>
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<tr>
<td></td>
<td>19</td>
<td>Carburetor</td>
<td>○ ○ ○ ○</td>
<td>台湾 台湾 台湾 台湾</td>
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<tr>
<td></td>
<td>21</td>
<td>Air cleaner assy</td>
<td>○ ○ ○ ○</td>
<td>台湾 台湾 台湾 台湾</td>
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#### Factors for Supporting Industry Development

Most crucial factor is **DEMAND SIZE**. Additionally, the following conditions are also needed.

- High-quality industrial human resources
- Proper tax and tariff policy
- Overcoming information and perception gaps
- Stable policy environment
Why is Demand Size So Important?

Generally, supporting industries are more capital-intensive than final assembly

- Large investment in equipment (indivisibility)
- Unit cost declines inversely with production volume

“Supporting industries will develop naturally, even without promotion policy, if demand size is sufficiently large.”
– an auto parts supplier.

Limited Demand Size in Vietnam

The larger the demand size, the higher the local procurement ratio.

Motobikes > E&E > Automobiles

<table>
<thead>
<tr>
<th>Localization ratio in Vietnam</th>
<th>Production-size comparison: Vietnam vs. Thailand</th>
</tr>
</thead>
<tbody>
<tr>
<td>Motorbike</td>
<td>Data for 2003 (Mishima)</td>
</tr>
<tr>
<td>TV</td>
<td>Data for 2002 (GSO, New Net Asia)</td>
</tr>
<tr>
<td>Automobile</td>
<td>Data for 2005 (VDF-MOI hearing)</td>
</tr>
</tbody>
</table>

How to Achieve Agglomeration and Competitiveness in Parts Industries (Policy Proposal for Vietnam)

Ingredients for Successful Industrial Estates

Mr. Hajime Yamaguchi (Sumitomo Corp.), creator of two successful industrial parks in Indonesia and Vietnam:

Success ingredients are:
1. **Good location** (access to urban center, port, airport)
2. **Good infrastructure service** (power, water, waste treatment, etc)
3. **Good management** of industrial estate (pre- and post-investment support)
FDI Policy: Centralized vs. Decentralized

- Thailand (BOI) and Malaysia (MIDA) have centralized FDI policy, marketing and approval systems (2-3 zones within country, but no local incentives)
- Vietnam has decentralized FDI approval and marketing (provincial level).
- China: built-in local incentive to attract FDI and over-invest; less attention to quality or environment.

JBIC Survey of Japanese FDI

Japan Bank for International Cooperation (JBIC) conducts annual survey on Japanese multinational firms. In 2005, 590 firms were surveyed.

| Where do you plan to expand business in the next three years? (Multiple answers) |
|---|---|---|---|
| 1 | China | 82% | 8 | Indonesia | 9% |
| 2 | India | 36% | 9 | Brazil | 7% |
| 3 | Thailand | 31% | 10 | Taiwan | 7% |
| 4 | Vietnam | 27% | 11 | Malaysia | 5% |
| 5 | United States | 20% | 12 | Mexico | 3% |
| 6 | Russia | 13% | 13 | Germany | 3% |
| 7 | Korea | 11% | 14 | Philippines | 3% |
### China (perception of Japanese FDI, 2005)

<table>
<thead>
<tr>
<th>MERITS</th>
<th>DEMERITS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large domestic demand</td>
<td>Unpredictable laws (60.7%)</td>
</tr>
<tr>
<td>Cheap labor</td>
<td>Violation of intellectual property (49.4%)</td>
</tr>
<tr>
<td>Large parts supply</td>
<td>Severe competition among rivals (44.9%)</td>
</tr>
<tr>
<td>Export base (to world)</td>
<td>Wage increase (42.7%)</td>
</tr>
<tr>
<td>Industrial agglomeration</td>
<td>Exchange control (41.6%)</td>
</tr>
<tr>
<td>Export base (to Japan)</td>
<td>Social unrest (39.3%)</td>
</tr>
<tr>
<td>Cheap materials</td>
<td>Unpredictable taxes (34.8%)</td>
</tr>
<tr>
<td></td>
<td>Unrecoverable payments (32.6%)</td>
</tr>
</tbody>
</table>

### Vietnam (perception of Japanese FDI, 2005)

<table>
<thead>
<tr>
<th>MERITS</th>
<th>DEMERITS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cheap labor</td>
<td>Poor infrastructure (55.9%)</td>
</tr>
<tr>
<td>Human resources</td>
<td>Undeveloped laws (38.2%)</td>
</tr>
<tr>
<td>“China plus 1” (*)</td>
<td>Unpredictable laws (38.2%)</td>
</tr>
<tr>
<td>Future potential of domestic market</td>
<td>Poor logistics and transport (35.3%)</td>
</tr>
<tr>
<td>Export base (to Japan)</td>
<td>Poor supporting industries (29.4%)</td>
</tr>
<tr>
<td>FDI incentives</td>
<td>Lack of information (26.5%)</td>
</tr>
<tr>
<td>Export base (to world)</td>
<td>Unpredictable taxes (17.6%)</td>
</tr>
<tr>
<td>Political stability</td>
<td>Lack of middle managers (17.6%)</td>
</tr>
</tbody>
</table>

(*) Diversification of investment risk by investing in countries other than China.
MAIN FOCUS OF IMP2
(1996-2005)

- Manufacturing Plus Plus Orientation
- Cluster-Based Industrial Development


Manufacturing ++ Strategy

R&D  Product Design  Assembly and Production  Distribution  Marketing

+ --- + --- + --- + --- +
Twin Strategic Thrust of Manufacturing Plus Plus

- Move Along The Value Chain Towards Higher Value Added Activities
  - R&D and Product Design Emphasis
  - Services, Distribution and Marketing Emphasis

- Shift The Whole Value Chain To a Higher Level Through Productivity-Driven Growth
  - Higher Technology Utilisation (Automation/Robotisation)
  - Increase Total Factor Productivity (TFP)

Cluster-Based Industrial Development

Key Elements

- Identification of Clusters
- Enhancing Value Added and Value Chain
- Identifying and Developing Key Suppliers
- Strengthening Economic Foundation

➢ IT IS IMPORTANT THE 4 ELEMENTS TO BE IMPLEMENTED SIMULTANEOUSLY
CLUSTER-BASED INDUSTRIAL DEVELOPMENT

Key Elements

- A Cluster is an agglomeration of key industries – suppliers, critical supporting sectors & services, infrastructure & institution
- Companies form partnerships with suppliers & competitors to increase value added activities i.e., common labour pool
- Companies form strong links with local R&D institution to strengthen product development & design capabilities
  • Outside the cluster, the companies are connected to a global network of subcontractors & vendors

Cluster-based industrial development need to be supported by the requisite economic foundation:

- Human Resource
- Technology
- Physical Infrastructure
- Business Environment
Industries To Be Developed On A Cluster-Based Approach

- Electrical and Electronics
- Textiles and Apparel
- Chemicals
- Resource-based Industries (Rubber and Wood)
- Agro-based and Food Products Industries
- Transportation
- Materials and Advanced Materials
- Machinery and Equipment

Major Indicators of Manufacturing Growth

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<tr>
<th></th>
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</tr>
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<tbody>
<tr>
<td>Value Added (RM mil) (^1)</td>
<td>140,109</td>
<td>93,740</td>
<td>199,479</td>
<td>156,900</td>
</tr>
<tr>
<td>Annual Growth Rate (%)</td>
<td>4.3</td>
<td>3.4</td>
<td>1.5</td>
<td>7.8</td>
</tr>
<tr>
<td>Share to GDP (%)</td>
<td>34.8</td>
<td>34.5</td>
<td>30.3</td>
<td>31.4</td>
</tr>
<tr>
<td>Share to Total Exports (%)</td>
<td>81.5</td>
<td>84.5</td>
<td>84.2</td>
<td>83.6</td>
</tr>
<tr>
<td>Share to Total Employment (%)</td>
<td>26.9</td>
<td>27.2</td>
<td>27.3</td>
<td>28.9</td>
</tr>
</tbody>
</table>
Two Purposes of SME Policy

SMEs for generating jobs & income
- Small shops, restaurants, family businesses

SMEs for international competitiveness
- Local suppliers with competitiveness (QCD)
- Foreign SME suppliers with global competitiveness

Malaysia’s SME policy targets only the middle group (competitive local SMEs). It supports only those firms that introduce new technology, management, IT, etc.
Common Policy Measures

- Local content regulations (no longer allowed under WTO)
- Attraction of FDI suppliers
- FDI-local linkage promotion
- Incentives (targeted, conditional on effort/action)
- Assist participation in global production networks

Vendor Development Program (Malaysia, 1988-97)

- Large FDI firms (“anchors”) were asked to nurture local vendors (first-tier suppliers & Bumiputra firms).
- Interest-free loans were provided to participating local firms.
  Not very successful due to low capability of local firms, unwillingness of FDI firms.
- Later, replaced by Industrial Linkage Program (ILP, 1997-). Candidates were expanded to second-tier suppliers and non-Bumiputra firms also.
Small and Medium Industries Development Corporation (SMIDEC) (Malaysia, 1996-)

- Eligibility—local capital >60%, annual sales <RM25m, employees <150; manufacturing, manuf. services, agro business
- **Grants** for business planning, product & process improvement, marketing, certification, improved packaging, design, labeling, etc.
- **Soft loans** for factory relocation, ICT, etc.
- Quick disbursement with monitoring; must return money if plans are not implemented.
- Match-making database of 18,000 firms
- FDI-local matching, 250 cases per year

BOI Unit for Industrial Linkage Development (BUILD) Program (Thailand, 1992-1997)

- Targets: electronics, cars, machinery
- Database for company matching
- Training local suppliers & seminars
- Trade fairs

Not successful due to lack of recognition, needs study, coordination among organizations

Subsequently, JICA was asked to draft master plan on development of supporting industries.

**M1**—Incentives for investment and training
Tax & tariff exemptions and training subsidies for pressing, casting, forging, welding and die-and-molds

**M2**—Mechanism for receiving foreign experts
Needs matching, assist life & work of foreign experts; invite retired engineers from Japan

**M3**—Strategic FDI marketing
Shift from general to targeted marketing; attractive industrial parks and rental factories

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Vietnam (cont.)

**M4**—Database
Start with small size and expand later; database and company matching must be integrated

**M5**—Technical education and training
Establish/support a few pilot schools and disseminate nationwide

**M6**—Testing centers for motorbike parts
Create new centers and strengthen existing ones; TA and equipment should be provided