

AUTOMOTIVE WORKING GROUP'S POSITION PAPER

*Prepared by
Automotive Working Group
Vietnam Business Forum*

We would like to express our appreciation for the Government's Resolution No. 19/2016/NQ-CP dated 28 April 2016 and Gov't Resolution 35/2016/NQ-CP dated 16 May 2016 to improve business environment, national competitiveness and support enterprise development, especially for the Gov't's reviewing relevant policy to support the existing CKD vehicle assemblers to be sustainable after 2018 when the free import duty for ASEAN CBU vehicles occurs. We believe with the interest of government, the Vietnam automobile industry development will be enabling more healthy competition and promoting a level playing field for all players.

This policy document is intended to share the working group's opinion as to how to connect FDI with domestic enterprises more effectively and efficiently to achieve the auto industry's growth.

I. BACKGROUND

With the current global and regional integration trend, both foreign and local enterprises need to connect each other in certain ways to establish business cooperation forms and/or develop its existing business activities to leverage potential resources and get better opportunity to expand its markets. Vietnam's automobile industry cannot also be out of this trend.

Automotive market size reached over 300,000 units (including ~230K CKD vehicles and over 74K CBU vehicles) in 2016 (increased by over 22%) and it may increase by about 10% in 2017. However, both- the investors and the Government are not satisfied due to the overall production capacity utilization of a mere ~45%.

Moreover, locally assembled vehicles are dependent on import parts, mainly due to insufficient economies of scale from the small market while its supporting industry is too weak, only a few local parts available for auto assemblers. Among the existing part suppliers, over 90% are FDI enterprises and most of export parts are different from parts requirements for domestic market.

As previously mentioned, a single car is normally made up of some thousands parts including some large components such as the engine, which is assembled as a unit during the car making process but also contains hundreds of individual pieces itself. That is why, automakers have complex and multi-layered supply chains (Tier 1, Tier 2, Tier 3, and raw material suppliers) consisting of many suppliers in each tier.

Development of suppliers requires much effort, time and investment. Tier 2-3 suppliers are required to strictly adhere to production requirements such as Quality/Cost/Delivery (QCD), while for Tier 1 suppliers, R&D requirements such as parts development and proposal capabilities are necessary in addition.

Due to disadvantages of small production and economic scales, manufacturers of both vehicles and components need to import most of materials and parts, which includes logistics and packaging cost, and import duty. That is why, domestic production costs of vehicles and most of components are higher than those produced in Thailand or Indonesia. This production cost gap is approx. 10 - 20% that weakens CKD competitiveness vs. Asean CBU from 2018 when CEPT for CBU is eliminated to 0%.

In order to resolve the above issues, we need to have enough production volume for both parts and vehicles, which needs big enough market size for economic scale for both CKD vehicle and its component industry to improve cost effectiveness.

Regarding the linkage between FDI vehicle assemblers and local automotive part suppliers, there are main issues that make the connection not so much effective as below:

1) Demand issues: market size is not big enough

- Insufficient entry of global companies in the market: most global suppliers do not enter the market due to too small market demands; global suppliers cannot invest without guarantee that OEMs will maintain/increase production (major Tier 1 makers)
- Insufficient entry of export processing enterprises (EPEs): cannot invest unless there is sufficient domestic demand, as different products for export and domestic market (major EPE)
- Insufficient entry of non- automobile companies: cannot invest unless there is sufficient demand, as they need to invest different machines to manufacture 4- wheel parts (major material maker)

2) Supply issue: local supplier capability

- Not many local suppliers meet required standards for QCD to participate global supply chains
- Tier 1 suppliers need to be able to design and develop components themselves, otherwise for local suppliers, it requires copyright permit and/or technology transfer or licensing agreements from genuine part suppliers to localize in Vietnam
- Entering the market is not easy for companies with no experience in supplying 4-wheel parts, which have very high quality and safety standards (major assembly maker); Difficult to use same electronic part supplier, as electronics are consumer and module products, with different quality standards from vehicles as integrated products.

3) Other issues:

- Not all databases regarding local automotive part suppliers are regularly updated and/or available for convenient contact.
- Inadequate development of government reasonable measures and policies: Cannot be active due to complicated procedures and operations, as different licenses are required for export and domestic supply (major EPE)
- Insufficient use of local companies: it takes time and efforts to find a company that can supply products among many local companies with different level of capabilities (major assembly maker); local makers, though having technologies, are not capable of continuous on-time supply (major assembly maker); difficult to switch to local companies for high tech-products such as mechanical parts require advanced technology (major Tier 1 maker)

II. RECOMMENDATION

From VBF point of view, we think that the first priority is to increase the business size to ensure that automobile industry will be sustained in the future.

In terms of local vehicle production expansion, keeping in mind the limited time before ATIGA tariff elimination in 2018, last year VBF recommended the government to set up a task force including existing assemblers and suppliers to clarify policies for development of local production as soon as possible. As the result, the taskforce was established but currently main activities are to visiting some key assemblers' factories to understand current situations and listen to their proposal. We suggest the taskforce to invite some suppliers who might provide deep understanding of auto supporting industry. Also, we propose the taskforce is to hold monthly meetings among members with clear agenda and discussions for auto policy proposals, which can then reported to PM more frequently than it has been as the taskforce progress.

In order to support enterprises to overcome the post-2018 pressure, policy makers should work with business to design policy solutions to develop a stable growing market, narrow the production cost gap to avoid overheat competitive pressure on locally assembled vehicles from 2018, develop tailored programs to support businesses matching, supplier databases with regular update, and human resource development, and apply certain incentive policy for good performance for existing invested enterprises.

For resolving the demand-supply and other issues as above mentioned, government, foreign companies, and domestic companies are recommended to do the following:

1) For demand issues:

It's very crucial to develop a stable growing market through consistent and long-term automotive-related policies for 10-15 years; including but not limited to tax system; infrastructure policies. It should include communication efforts to achieve public supporting voice for those policies.

2) For supply issues:

Domestic part suppliers should not aim to "leapfrog" and become Tier 1 suppliers in the short term, and instead ensure that they can meet the production/service requirements (QCD) as Tier 2 and 3 suppliers, and cooperate with foreign suppliers as approach to develop its part business and/or get technology transfer. By doing so, local suppliers should step-by-step develop good understanding of the QCD requirements from FDI companies, and proactively use opportunities to enhance their competitiveness.

To participate in automobile global supply chains, they need to improve QCD issues by increase quality and productivity, cut costs, improve management capability, and comply with international practice and rules.

FDI companies should provide guidance to suppliers how it recruits suppliers, what is criteria, and help potential domestic suppliers to increase their QCD level (e.g.: by sending their experts to local suppliers), obtain technology transfer or technical know-how. Continue negotiating with existing part suppliers to expand localized parts.

FDI OEMs or suppliers are open to using suppliers which can meet the requirements mentioned, regardless of whether the company is local or foreign.

3) Other issues:

Suppliers should take part in auto part supplier databases and business matching programs, create attractive business profile. FDI enterprises should provide list of automotive parts that need localization with certain details like: name, specifications, quantities, and display those parts for potential suppliers' consideration;

Government should promote entry of foreign suppliers to Vietnam to enhance capability of local suppliers; encourage local enterprises to expand its investment in auto part manufacture.

In general, for increasing usage of local suppliers, it is necessary to resolve both demand-side issues such as small market and production volume, and supply-side issues such as insufficient capability of local suppliers for meeting the QCD requirements.

III. OVERALL CONCLUSION

Connection between FDI and domestic enterprises are very important for both enterprises and national economy. For auto industry, the first priority is to secure a stable growing automobile market while gradually enhancing supply capability of local suppliers; with FDI connection & support.

Thank you.