SOURCING FROM VIETNAM: OPPORTUNITIES AND CHALLENGES

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01. **INTRODUCTION**

Vietnam has quietly become a preferred country of origin for manufactured goods of many types. The country’s location, workforce, resources and governance are favourable, but there are challenges, particularly in the area of logistics. Nonetheless, with careful planning and local knowledge and expertise, these are being overcome and Vietnam is becoming increasingly attractive as a source of relatively low cost but high quality manufacture. Damco has a significant presence in Vietnam, and offers these insights into the country and the opportunities available.

02. **LOCATION, LOCATION**

Vietnam is almost ideally situated relative to trade routes within and connecting to East Asia. The country borders China to the North, and in the South Cambodia, and through that country there are routes to Thailand. A long coast faces the South China Sea, one of the world’s major shipping lanes, and the country is roughly equidistant between the major hubs of Singapore and Hong Kong (Ho Chi Minh City, formerly Saigon, in the South is around 646 nautical miles from Singapore; Haiphong, the port for Hanoi in the North, is around 637 nm from Hong Kong). The country thus offers itself both as an originating producer, and as a conduit for exports from other adjacent areas.

This long but relatively thin (just 50 km in parts of the central region) country has a continuous coastal plain with natural transport routes running roughly North-South. However, the inland is more mountainous, with difficult communication except by a number of navigable rivers down to the coast. The most important of these are the Mekong in the South, which can bring goods down from Cambodia to the Ho Chi Minh City area; and the Red River in the North which is navigable from China down to Hanoi and the port of Haiphong.

Industrial development is largely centred around Hanoi and ‘Saigon’, reflecting the capitals of the two former states that comprise Vietnam. The central region, including the much older capital of Hue and the port of Da Nang, also sees some investment but as shown below, the current infrastructure does not favour these areas.

03. **TRADE DEVELOPMENT**

Vietnam, in most parts an immensely fertile country, has long been an exporter of agricultural and food products, from cashew nuts to fish. It has significant offshore oil reserves (although production seems to have peaked and some promising areas are the subject of multi-country territorial dispute as to the ownership of small and uninhabited islands).

Fisheries are worth a special mention - Vietnam has built an extensive export trade for its fish with, amongst others, the European Union countries. Their success in meeting stringent quality, food safety and other regulations suggests that the local management and workforce can hurdle similar barriers in other sectors.
Like many South East Asian countries, an export staple has long been the textile, garment, footwear and accessories (e.g. handbags, umbrellas) sector: low labour costs for relatively unskilled work. This continues: Nike, for example, manufactures more of its footwear in Vietnam than in China.

But the story of the past decade or so is of Vietnam’s transition into more skilled and high tech manufacture, especially of telephones, computers and other electronics but including an increasing range of other manufactured goods. Examples range from the Taiwanese contract electronics manufacturer Foxconn, who were an early FDI (foreign direct investor) in Vietnam, to the Italian Piaggio Group who use Vietnam as a hub for the manufacture of modern scooters for both Asian and European markets.

Vietnam’s global exports (2015 figures) in value terms are now dominated by telephone sets and components, followed by the textile and garment trade. Also important are computers and accessories, footwear, mechanical goods, fishery products and wooden furniture, with many other products of smaller but significant value. There is this an interesting and hopefully sustainable blend of traditional strengths and more high-technology ventures.

Export destinations are similarly diverse - in 2015, some 21% of exports were bound for the US and 19% for EU countries. China, Japan, South Korea and ASEAN countries each accounted for around 10% of exports.

![Fig 1: Vietnam: Top 5 Imports / Exports](image-url)
Besides local investment, necessarily limited in Vietnam’s current state of development, there has been increasing FDI from China, South Korea, Taiwan, Japan, the US and many European countries. This has been encouraged by the government’s attitude to international trade, and the various Free Trade Agreements which it has struck or is negotiating.

Although a one-party state, the Vietnamese government’s stance is increasingly liberal - almost all sectors of the economy are open to private investment, and this does not necessarily require a domestic partner or joint venture. Vietnam only joined the World Trade Organisation in 2007 but even prior to that bilateral free trade agreements were in place with a number of countries. Other multilateral agreements are now in place or under negotiation.

Bilateral agreements, directly or through ASEAN, cover trade with Japan, Chile, South Korea, China, India, Australia and New Zealand. Likely to be ratified (relatively) soon are the Trans Pacific Partnership Agreement (Australia, Brunei, Canada, Chile, Japan, New Zealand, Peru, Singapore, United States, Malaysia, and Mexico), which is signed but not yet ratified; the Eurasia Economic Union (Russia, Belarus, Armenia, Kyrgyzstan and Kazakhstan), which has also been signed but not yet ratified by all partners; a European Union FTA, which is going through legal processes and expected to come into operation in 2018, after which there will be a 7-10 year process of tariff reduction and abolition; and a similar FTA with the non-EU members of the European Free Trade Agreement (Switzerland, Lichtenstein, Iceland, Norway), which is still being negotiated. It will be noted that some of these FTAs overlap - expert guidance may be required to guide a buyer or investor through just what terms apply to a particular investment or trade.

Although not all these agreements are in place there has been a definite and continuing stimulus to FDI in Vietnam in anticipation. That is not the only factor: for well-developed coastal China, for example, Vietnam is seen as a stable but relatively low cost country in which to relocate manufacturing, as Chinese labour and other costs increase.

![Fig 2: Vietnam’s Manufacturing Capability Development (1990-2015)](image-url)
05. ADVANTAGES AND DRAWBACKS OF SOURCING FROM VIETNAM

On the positive side, Vietnam’s population of over 90 million is relatively well educated. Labour costs though rising are appreciably lower than in many Asian states. Government is stable, and largely supportive of business and of open markets. Internationally, Vietnam is well-placed on trade routes not only to the US and Europe but to growing middle-class markets elsewhere in Asia.

However, as with many countries in this phase of development, there can be impenetrable bureaucracy. This may lead in turn to corrupt practices, although government commitment, the conditions of the various FTA agreements, and the active involvement of external investors should address some of these problems.

Less easy to resolve, at least in the short term, are Vietnam’s deficiencies in logistics and infrastructure, which lead to import, export, and internal costs much higher than those of even its near neighbours. Research by Maersk in 2014 suggested that Vietnamese logistics costs amounted to around 25% of GDP, where the comparable figure for China is around 18% (and China is, relatively, a higher labour cost country - the comparison with some other SE Asian nation costs is even less favourable). A glance at Vietnam’s existing logistics infrastructure will reveal the underlying reasons for this discrepancy.

06. LOGISTICS, TRANSPORT AND INFRASTRUCTURE

Viewed on the map, Vietnam appears to have all the elements of a promising internal and external multi-modal logistics infrastructure. On closer inspection, however, the picture is rather less inviting.

Roads - the dominant mode of freight in Vietnam, around 70%. As of 2010, only around 20% of roads were paved, and ‘expressways’ were uncommon, even on links to the major ports of Cai Mep and Haiphong. Even though the government has made considerable investment, much remains to be done.

Railways - There is essentially one railway in Vietnam running along the coastal plain from the Ho Chi Minh City area via Da Nang in the centre to Hanoi and its port of Haiphong. From there the route divides into China, North-Westwards towards Kumming, and North East towards, ultimately, Beijing.

Unfortunately, the colonial power at the time (France) built the railway to metre gauge, which is not entirely suitable for the speedy transport of large containers (and US-style double-stacking is pretty well out of the question). Further, China’s railways are built to the 1435mm ‘standard gauge’ so although there is dual gauge railway from the Hanoi area on the North East line up into China, for most traffic a change of gauge and therefore of vehicle would be necessary. Unsurprisingly, then, rail only accounts for 10% or less of Vietnam’s internal freight traffic.

Proposals for redevelopment of the railway were shelved in 2010, partly because of the level of debt the Vietnamese government would have had to incur, but also because the plans
were almost entirely focused on passenger traffic. Rail expansion also has the challenge that the real need is probably not North-South (which for freight may well be more effective using coastwise shipping), but on the short links from inland areas to ports, distances over which rail is unlikely to be competitive.

There are also proposals for extension of a modern rail line from the Ho Chi Minh City area into Cambodia and possibly through to Thailand, but this would take major investment. On the positive side, recent law changes allow private investors to develop rail terminals, and in theory own rolling stock and run trains, over the nationally-owned rail network.

**Inland waterways** - Vietnam has long relied on its rivers for bulk transport, in particular the Mekong in the South and the Red River in the North, but also elsewhere. However, a combination of low fixed bridges, uncertain dredging, and often fairly primitive cargo handling facilities alongside rivers and canals restrict the utility of waterways, especially at night. (In terms of TEUs, the biggest barges on the lower Mekong are of around half the capacity of those that serve Rotterdam down the Rhine - a system which otherwise looks geographically somewhat similar). Additionally, the new deep water port of Cai Mep is finding that the need to tranship from barges seriously reduces the productive use of wharfage for deep sea operations.

**Air freight** - internal air freight in Vietnam is minimal: the distances involved hardly justify it. Externally, there has recently been major expansion at Hanoi, but freight capacity here, and at Ho Chi Minh City and other airports, is still seriously constrained.

**Ocean shipping** - despite its long coastline to the South China Sea, Vietnam is surprisingly deficient in sizeable ports. A recent development, and the country's first truly 'deep water' port, has been at Cai Mep, serving the South of the country. Cai Mep can now handle container ships of up to 14,000TEU, coincidentally around the maximum capacity of the 'new' Panama Canal. Haiphong in the North would benefit from significant investment. Elsewhere, Da Nang can cope with large, but shallow draft cruise ships but is limited for freighters and, like other smaller ports along the coast, essentially loads coastwise feeders for transhipment at Haiphong, Cai Mep or sometimes further afield.

The continuing development of Cai Mep has seen an increasing number of direct-to-destination lines, especially to the US, rather than via transhipment at Singapore and other hubs, and this trend is likely to accelerate as more capacity comes on stream.

The Vietnamese government is of course well aware of these logistics and infrastructure deficiencies, but their resolution would be hugely expensive. Ironically, too, Vietnam’s very success economically has removed it from any list of least developed countries, so international grants and loans are only available on much more onerous, and sometimes unacceptable, terms.

One result of all these developments, or lack of them, has been a considerable growth in the need for management of cross border trucking - particularly across the Chinese border for incoming materials and parts, and for finished goods back. This also applies in the South to and from Cambodia and even Thailand, from which countries the Cai Mep port development in particular can offer attractive shipping opportunities.

In addition, better logistics will not necessarily equate to cheaper. Investment has to be paid for. As an example, in order to recoup some of the government’s heavy investment in the Cai Mep terminals, the transport ministry has introduced ‘minimum guaranteed port tariffs’. The idea is understandable, but it is suggested that these relatively high tariffs are dissuading
some lines from using Vietnam’s terminals. As and when roads, railways and waterways are developed, there will doubtless be similar conflicts between the need to promote the economy and the need to pay off the investment.

07. LOGISTICS CHALLENGES

The above may sound daunting, but it should not dissuade investors in, or buyers from, Vietnam. Improvement in logistics, infrastructure and other areas, is evident and continuing, and the new FTA agreements and the investment they promote can only accelerate the process.

Nonetheless it is clear that to utilise Vietnam successfully as a source, some specialised combinations of skills are required by your logistics service providers.

In particular, your partner needs to be very acute in recognising the advantages of the various FTA agreements, how these overlap (or even conflict), the likely progress of those that are still in the negotiation or ratification process and what their timescales mean for your investment and sourcing decisions.

Second, a facility, based on local knowledge and expertise, of how to combine the multimodal opportunities of Vietnam’s internal logistics is vital. Despite what we have written above, road, rail, inland waterway and coastwise shipping can be combined to provide effective and reasonably economic solutions, but this requires an in-depth knowledge of each mode and its problems – for example transhipment between modes, or the ability to source warehousing facilities.

As in most countries, understanding of the regulations and bureaucracy is key to a successful outcome, and again as FTAs come into force this is a rapidly changing field of expertise.

Damco has long experience in the Vietnamese market, with locally based staff (both indigenous and from overseas) familiar with all the ramifications. We have strong relationships with local logistics partners, and our usual commitment to promoting and developing local skills and capabilities is evident. Likewise, we have built over the years sound and positive relationships with national regulatory, Customs and other authorities. We have a proven ability to manage both import and export flows, and our Vietnamese teams work seamlessly with our staff in other countries, whether they be sources of raw materials, points of transhipment, or destinations for finished goods.

To learn more about what Damco can offer you in considering Vietnam as the exciting sourcing country that it is, please contact here
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About Damco
Damco, one of the world’s leading third party logistics providers, specialises in delivering customised freight forwarding and supply chain solutions. The company has more than 300 offices in over 100 countries and employs 11,000+ people. Damco is part of the Maersk Group. More information about Damco can be found on www.damco.com