



Integration into Global Value Chains

A roadmap for Vietnamese Private Enterprises

March 2023

—

KPMG in Vietnam

Foreword

“The manufacturing sector in Vietnam, one of the three key industries of the government's strategy, contributed to nearly 86% of the total exports in 2022. A substantial percentage of manufacturing exports from Vietnam every year comes from Foreign-invested enterprises. For example – In 2021, Foreign-invested companies contributed 97.8% of the total export value of the electronics industry in Vietnam.

Inadequate industrial infrastructure and supporting industries, lack of skilled labor, and limited supply chain management capabilities have so far prevented Vietnamese Private Enterprises (PEs) from moving up the Global Value Chain (GVC). But Vietnamese PEs can improve their chances of GVC integration now if they can adapt to 'The Next Normal' by strengthening their capabilities across the supply chain.

This report will provide insights into Vietnam's position in the Global Value Chain in terms of 'Where we are' to 'Where to go next' and 'How to go'.”



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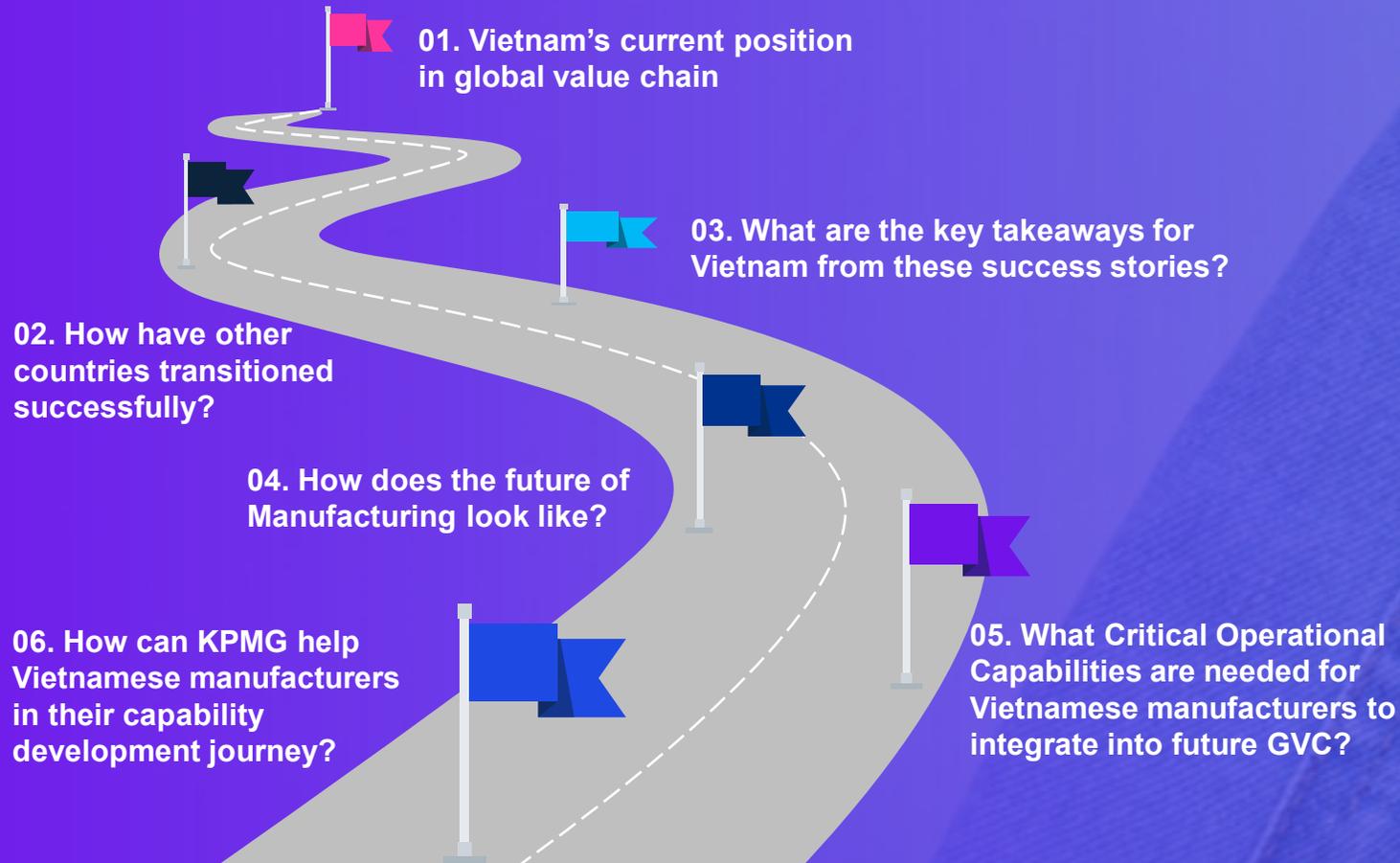
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Vietnam's current position in global value chain

Integration into Global Value Chain comprises of 4 stages

Commodities

- **Small percentage** of the entire domestic value added in exports comes from manufacturing (less than 60%)
- Exports of Commodities' countries travel along the value chain and serve as inputs in other countries' manufacturing industries.

*These criteria define countries according to the degree of dependence of their exports on manufacturing.

Limited Manufacturing

- Share of manufacturing in domestic value added in exports is **from 60% to 80%**, often alongside commodities exports
- **Medium** domestic value-added content of exports.
- Mainly engage in **low value-added linkages**, which lead to the **low profitability**
- The overall **industrial infrastructure** and the **suppliers' networks are being developing**
- Participants are mainly **labor-intensive manufacturers** whose outputs require **less technical complexity**

Advanced Manufacturing & Services

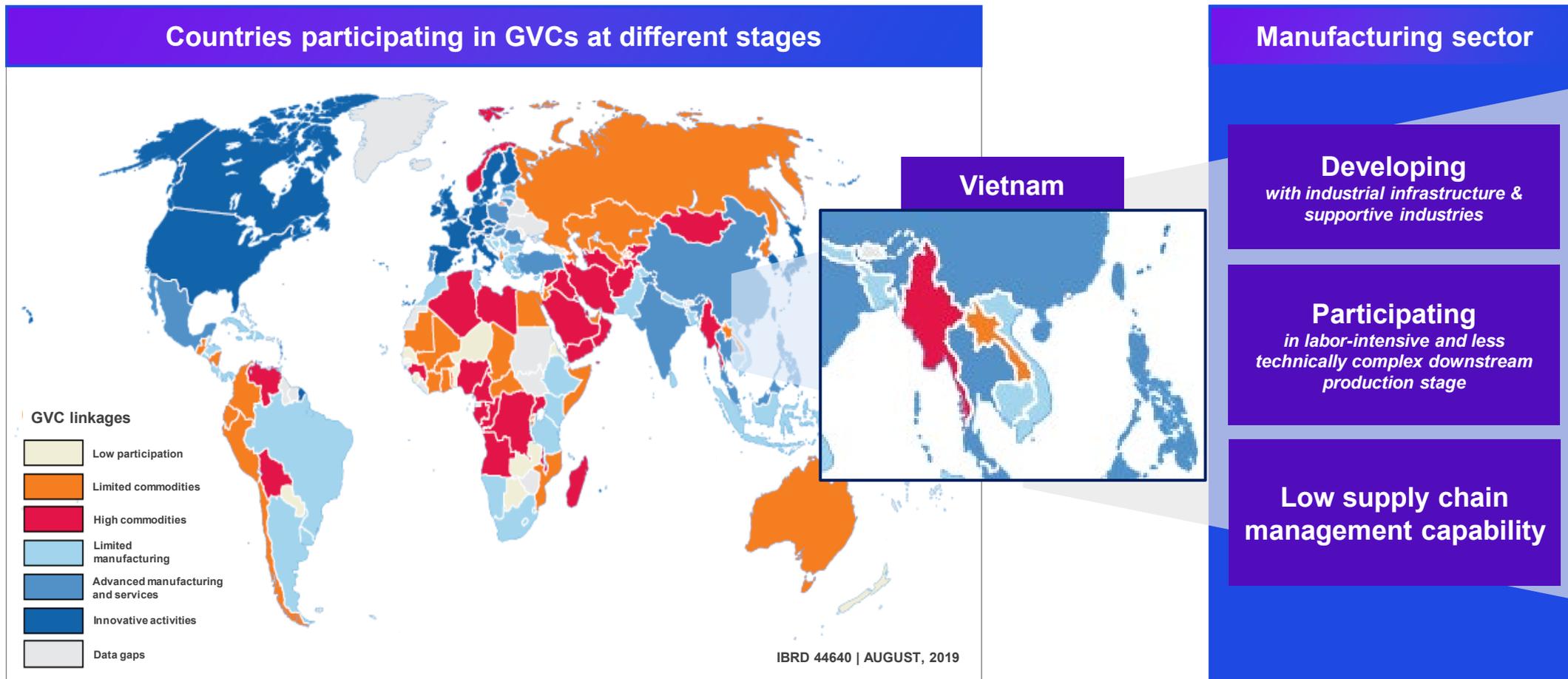
- High share of manufacturing and business services in domestic value added in exports, **equal to or greater than 80%**
- **High** domestic value-added content of exports
- Mainly engage and focus on the **high value-added linkages**, and generate **high profitability**
- The overall **industrial infrastructure** and the **suppliers' networks are well-established**
- Participants are **advanced manufacturers** which require **capabilities in complex production, sourcing network, design & innovation, technology application**

Innovative Activities

- Innovative GVC activities spend a **significant share of GDP on research and development, receive a substantial share of GDP from intellectual property**
- **Exhibit high** domestic value-added content of exports

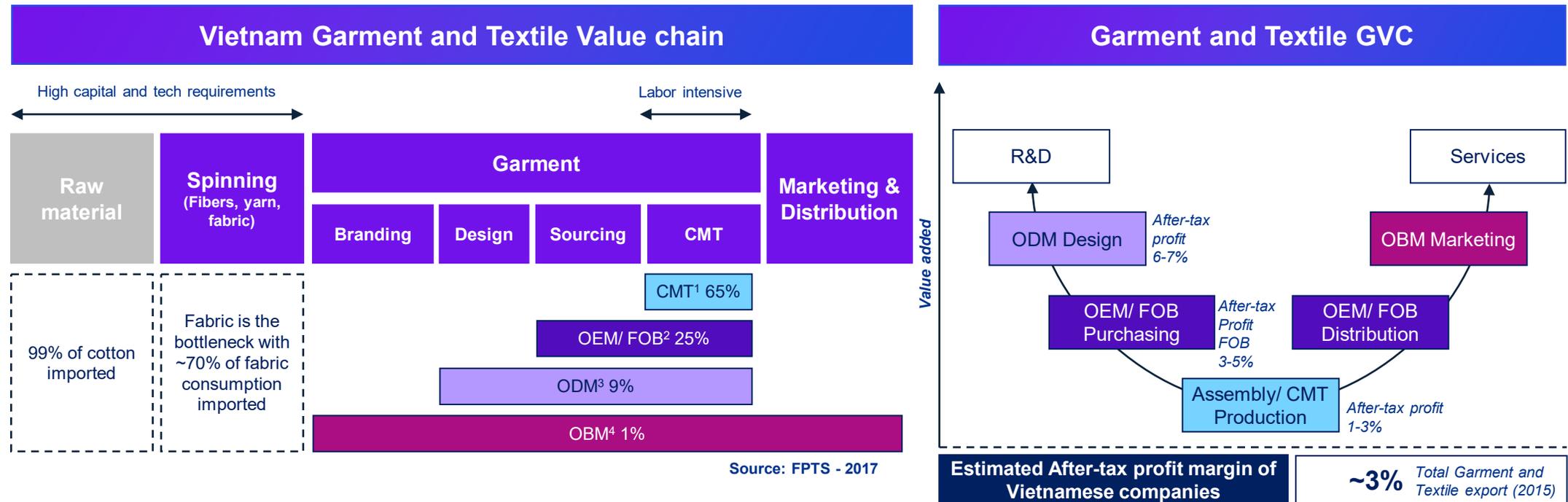
Source: World Bank Group, KPMG perspective

Vietnam is currently in the 'Limited Manufacturing' stage in the Global Value Chain (GVC)



Source: GSO, soyte.ninhbinh.gov, OECD, "Participation in the Global Value Chain...SME in Vietnam" report – Trung Nguyen & team, KPMG

Current position of Vietnam in the GVC can be explained through an example from garment and textile sector



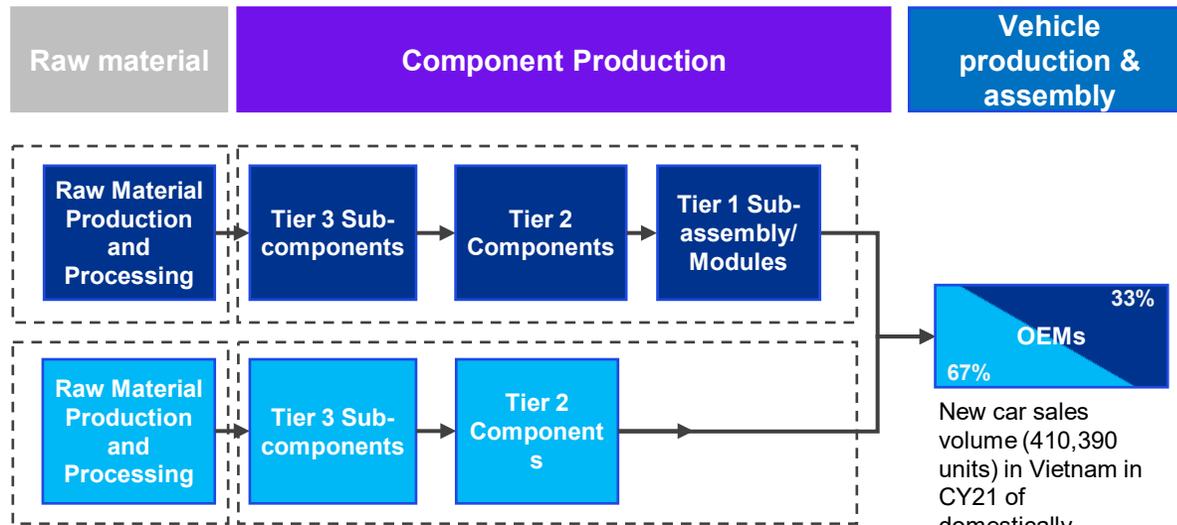
Vietnam in Global Value Chain of Garment and Textile industry contributes to the lowest value-added modality with the highest pollution emissions, where most companies are mainly manufacturing under CMT (65%). The characteristics of this stage is labor intensive and manual processes with after-tax profit earnings accounting for only 1-3% turnover.

¹ CMT: Cut-Make-Trim; ² OEM: Original Equipment Manufacturing/ FOB: "Free on board" or "Freight on board"; ³ ODM : Original Design Manufacturing; ⁴ OBM: Original Branding Manufacturing

Source: FPTs, Vietnam Industry and Trade Magazine

Vietnam's current position in the GVC can also be comprehended from the automotive sector in Vietnam

Vietnam Automotive Value Chain



Remarks:
In Vietnam, there are no Tier 1 suppliers that supply completed modules/ systems, but the OEMs mainly import or produce module/ system in-house at the assembly stage.

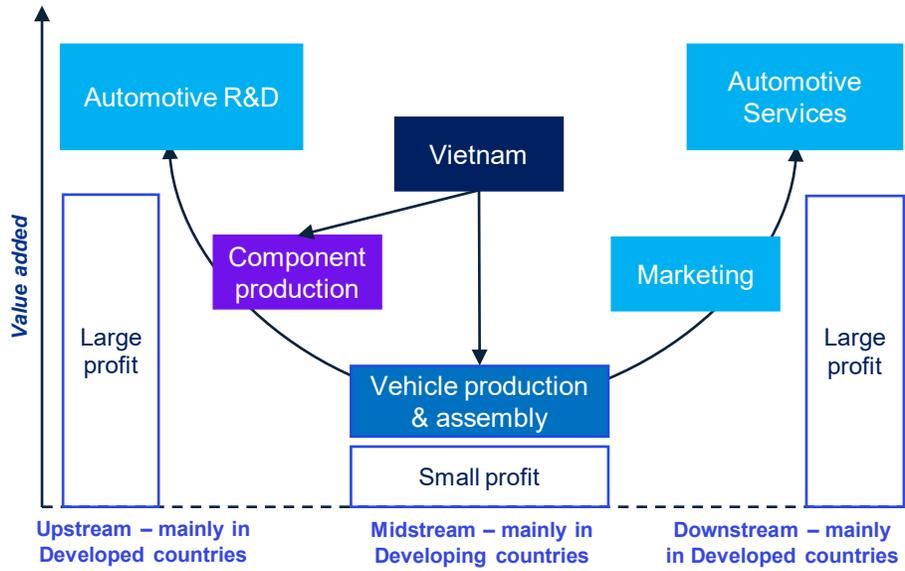
Legend: Foreign supply and Demand (grey box), Vietnam supply and demand (blue box)

OEMs 33%
67%
New car sales volume (410,390 units) in Vietnam in CY21 of domestically manufactured and assembled (CKD - Completely Knocked-Down) and foreign imported (CBU - Completely Built Unit) vehicles.

* CKD: Completely Knocked Down: Xe lắp ráp trong nước với 100% linh kiện được nhập khẩu

Source: IAFSM 2019, KPMG

The value and distribution map of the GVC of the automotive industry



Vietnam mainly participates in the last stage of the global value chain i.e., assembly. This stage contributes the lowest value-added contents in the value chain. However, local Vietnam automakers like THACO, and VinFast have been investing in R&D activities, especially in increasing supporting industry capability.



But what are the key benefits for Vietnam from transitioning to a higher stage in the Global Value Chain?

Key Benefits

The transformation to a higher level not only enhances the country's capabilities but also unlocks potential opportunities for further development.



Higher profit margins

Derived from more sophisticated products & production stages and application of advanced technologies & enhanced efficiency and capabilities



New business opportunities

Gaining growth and expanding market penetration through economic diversification into new o- adjacent industries



Attractive destinations for diversifying or relocating supply chains

Derived from a well-developed infrastructure, good policy (incl. trade policy, inward FDI openness) and GVC-related factors (incl. institutional policy, customs, etc.)



Improved employment conditions

Better employment with improved wage rates and working conditions due to reduction of participation in labor-intensive stages and focus on advanced labor development

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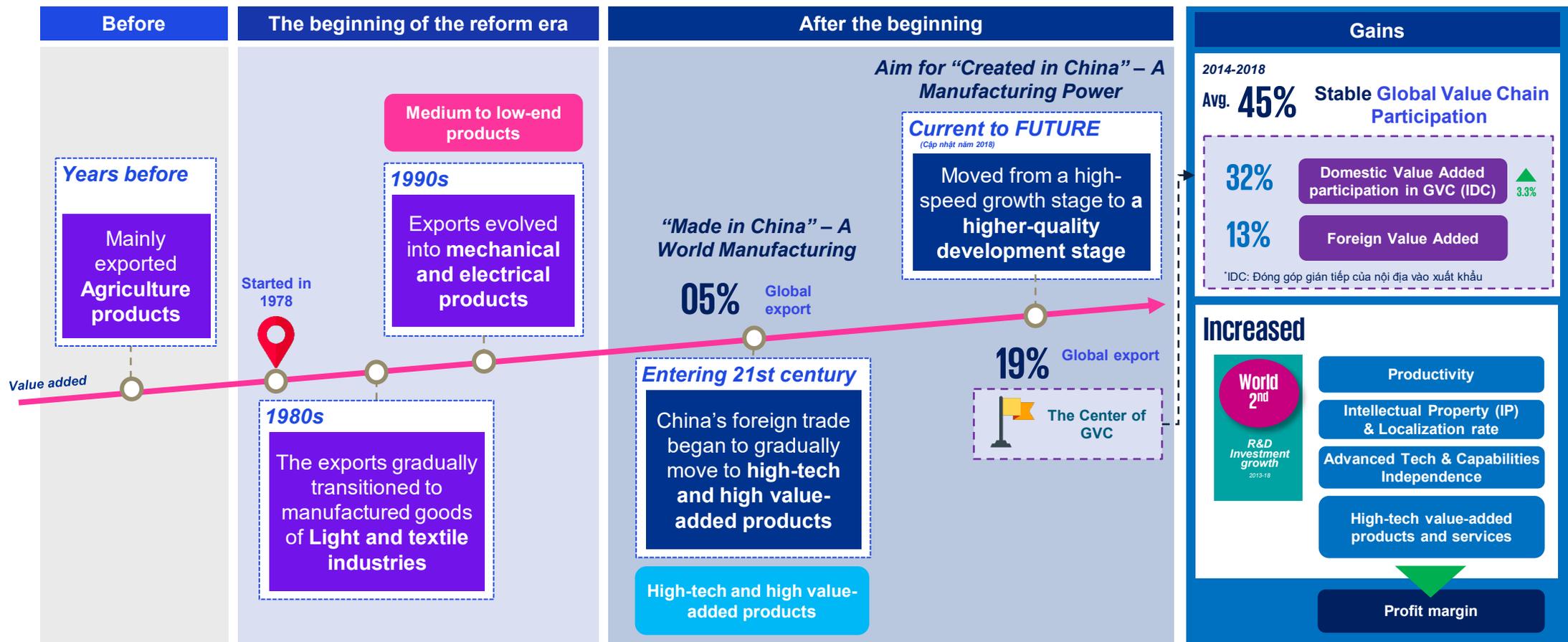
How have other countries transitioned successfully?

A few Successful case studies from the Region



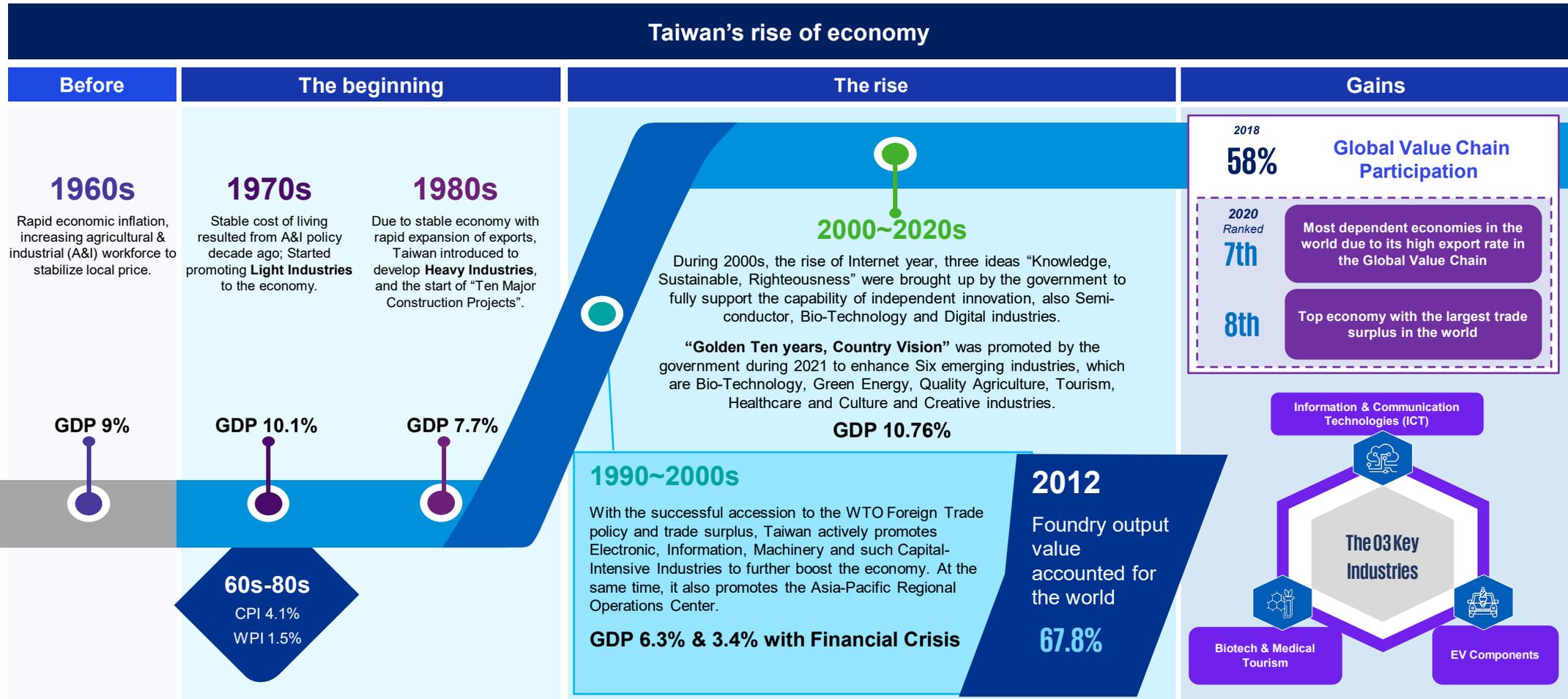
China's reform and opening-up journey towards the higher stage of the Global Value Chain: Transformation roadmap & gains

China's Reform and Opening-up Journey - A process of continuously deepening its integration into the global value chain





Taiwan's economic advancement and move up the Global Value Chain: Transformation roadmap & gains



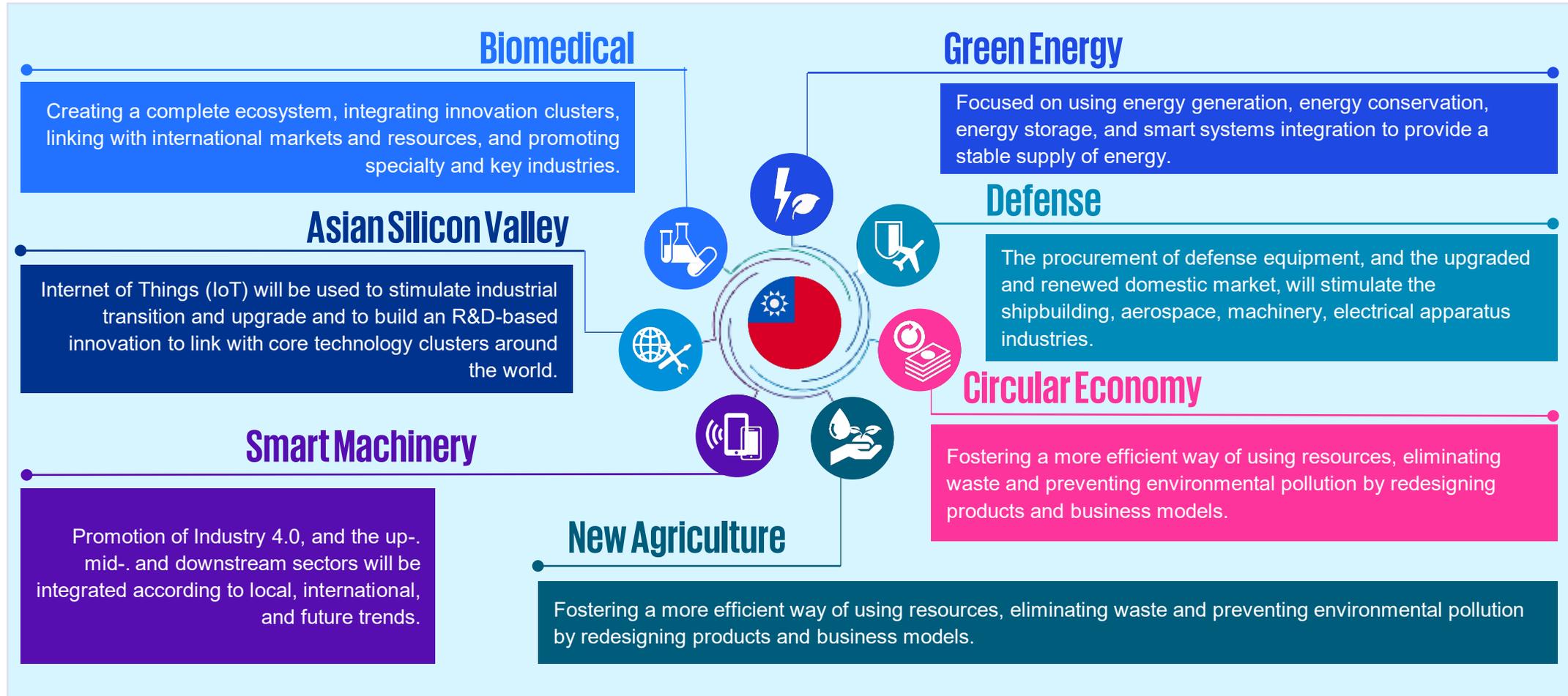
Source: Taiwan News, National Development Council(NDC), Statista, Wiley Online Library, CommonWealth Magazine, Information Technology & Innovation Foundation (ITIF), Taiwan Institute of Economic Research(TIER), Metal Industries Research & Development Centre(MIRDC)



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Taiwan's economic advancement and move up the Global Value Chain: Inner Motivation – Policy Spotlight - The 5+2 Innovative Industries Plan



Source: Taiwan News, National Development Council(NDC), Statista, Wiley Online Library, CommonWealth Magazine, Information Technology & Innovation Foundation (ITIF), Taiwan Institute of Economic Research(TIER), Metal Industries Research & Development Centre(MIRDC)

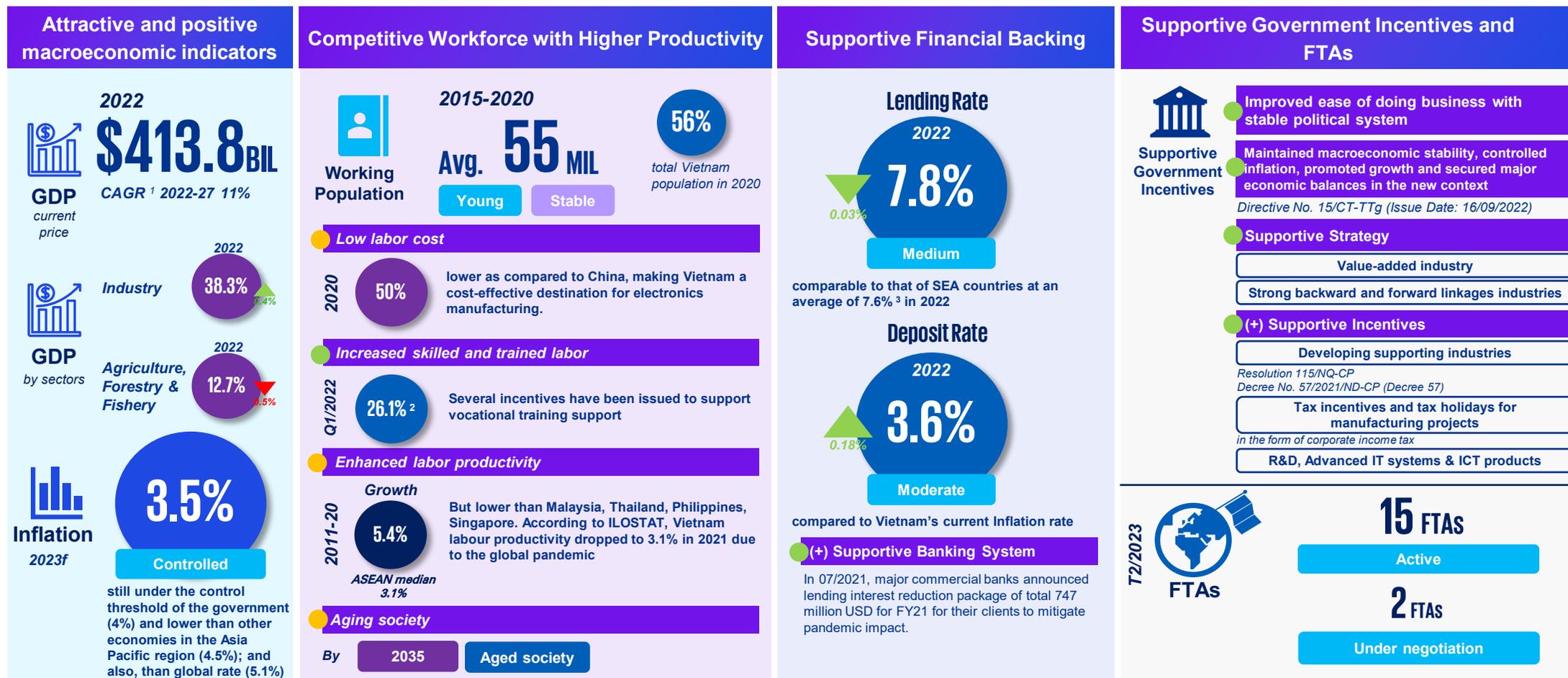


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03

**What are the key
takeaways for Vietnam
from these success
stories?**

Vietnam's macroeconomy remains attractive and positive, especially for manufacturing sector, with strong support from government and FTAs



Source: GSO, UNFPA, IMF, World Bank, VCCI, ILOSTAT, VEPR, VGP News

¹CAGR: Compound Annual Growth Rate

²Skilled and qualified labor

³This value is calculated by KPMG based on IMF statistics for 9 SEA countries including: Myanmar, Indonesia, Vietnam, Singapore, Thailand, Malaysia, Brunei, Cambodia, Timor-Leste. In this, the lending interest rates of the following countries are assumed based on the CAGR values of each country, including Myanmar (estimated for 2021, 2022); Singapore, Malaysia, Brunei, Cambodia, Timor-Leste (estimated for 2022).



But infrastructure, companies' capabilities, and skilled labor have remained challenges for Vietnam's global value chain integration

Vietnam's economy relies on foreign direct investment, but in contrast to other countries in the region, it hasn't been able to build a robust system or forge an organic connection with the domestic market. Vietnamese SMEs' integration rate into the global production network remains low – reflected in some of the challenges below.

Infrastructure, Logistics, and Supporting Industries

- Inadequate infrastructure development has led to low connectivity of various transportation modes
- With more than 3000 logistic enterprises, the logistics sector is severely fragmented. Numerous middlemen in logistics increase the cost of freight transport within Vietnam, all together driving up the transaction costs, a big hindrance in Vietnam's economic growth
- Compared to China and India, Vietnam has a lower localization rate (36%), which further affects the country's weak supporting sector and low rate of local component procurement.

Talent and Skilled Labour

- Skilled labor is needed by manufacturers for complex processes. It can also be a challenge to find adequate labor that can meet the local market demand.

Management Capabilities & Technology Enhancement

- **Supply chain planning and management are critically** striving to be cost competitive and establish a supply chain that is responsive and resilient
- **Corporate governance practices are still not well-implemented** in Vietnam with the rate of independent audits for private enterprises still low. The reform to a higher standard of business practices is needed, which is highly required for deeper integration into GVCs with new FTAs
- **Limited capacity for product and process innovation as well as R&D facilitation.**

Source: "Participation in the Global Value Chain...SME in Vietnam" report – Trung Nguyen & team, OECD, World Bank Group, KPMG

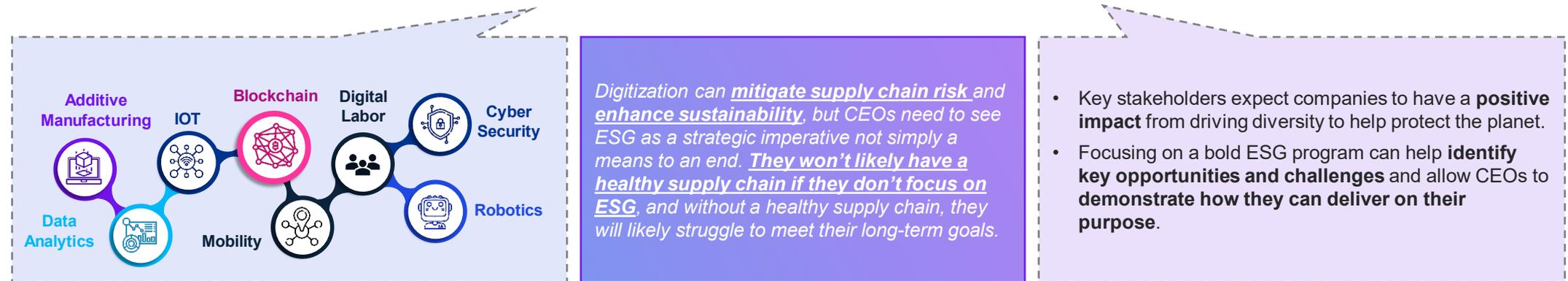
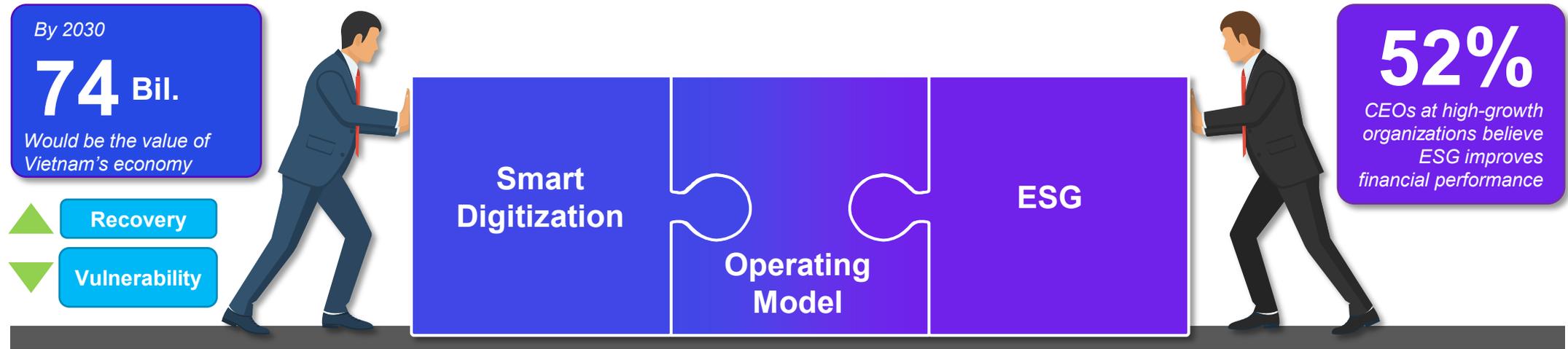
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How does the future of Manufacturing look like?



Perspectives of Global CEOs on Future of Manufacturing

Before COVID-19, the road to the Future of Manufacturing was believed to be through Digital Transformation. After the global pandemic, it became clear that driving focus on the twin transformation of Smart Digitization and Environmental, Social & Governance (ESG) is vital for resilience and sustained growth.



Source: Vietnamplus, KPMG

To be future-ready, private enterprises must realize the importance of The Next Normal and Knowledge Management to develop resilience and beyond

THE NEXT NORMAL

Three focus areas can help private enterprises navigate the transition to the “next normal”:

End-to-end forward-looking visibility

Having ‘control tower’ visibility on key real-time indicators; being able to maneuver your supply chain beyond your own business borders; and building real-time collaboration with your ecosystem of supply chain partners will likely be critical – all done using digital capabilities (eg - ERP). The ultimate goal is to enhance collaboration across the supply chain eco-system.

Agility

Making sure your supply chain is responsive and agile to manage the unexpected, and to deal with these threats and disruptions appropriately, efficiently and profitably.

Drive productivity and manage capability

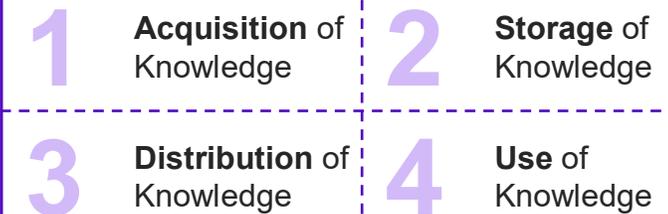
A mature supply chain capability, not just of the process but also of people, to always be a step ahead and ready to tackle supply chain risks and opportunities.

A skills matrix highlights potential skill gaps and upskilling opportunities

Skills Matrix						Skills-need Matrix					Output-availability Matrix				
Kỹ năng của nhân viên						Số lượng nhân viên cần có					Số lượng nhân viên hiện có				
Vị trí	1	2	3	4	5	Vị trí	3	4	5	Tổng	Vị trí	3	4	5	Tổng
Vị trí #1	4	4	5	5	4	Vị trí #1	7	3	1	11	Vị trí #1	5	5	3	13
Vị trí #2	4	3	3	4	5	Vị trí #2	1	1	1	3	Vị trí #2	1	1	0	2
Vị trí #3	3	3	4	2	4	Vị trí #3	11	6	3	20	Vị trí #3	13	15	13	41
Vị trí #4	1	2	2	1	1	Vị trí #4	7	4	2	12	Vị trí #4	4	3	2	9
Vị trí #5	1	1	1	1	3	Vị trí #5	9	7	3	19	Vị trí #5	4	7	7	18

KNOWLEDGE MANAGEMENT

The pace of change necessitates new techniques and mindsets. As a result, established methodologies for identifying critical knowledge and managing change are more vital than ever.



Knowledge Management (KM) Process

“96%” of respondents in the manufacturing sector are confident that **technology will play a role in helping KM respond to change and meet evolving needs.**”

Source: ‘The supply chain trends shaking up 2023’ thought leadership by KPMG; McKinsey; APQC

05

What Critical Operational Capabilities are needed for Vietnamese manufacturers to integrate into future GVC?

Manufacturing companies must demonstrate strong capabilities across the supply chain to facilitate their integration into future GVCs

TYPICAL END-TO-END CAPABILITIES OF A MANUFACTURING COMPANY

Financial Management	 <h3>Innovate & Engineer</h3>	 <h3>Plan</h3>	 <h3>Procure</h3>	 <h3>Make</h3>	 <h3>Deliver</h3>	 <h3>Marketing, Sales & Distribution</h3>
Tax	<p>Innovation & Engineer encompasses the full product development lifecycle and commercialization process, beginning with ideation and finishing with product end-of-life.</p>	<p>Plan covers supply chain planning processes, such as planning of demand, supply, balancing and execution of the IBP process. Plan also includes customer and supplier collaboration, as well as interfaces with financial planning processes in higher stages of maturity.</p>	<p>Procurement is the overarching function that describes the activities and processes to obtain or buy goods and services from an external source. It involves activities from establishing fundamental requirements, sourcing activities such as market research and supplier selection/ development and negotiation of contracts.</p>	<p>Make covers the entire spectrum of activities & processes pertaining to Manufacturing Operations. It includes key components such as Manufacturing capacity assessment, Planning & Scheduling production, deploying the Asset maintenance strategy and executing production with the required product quality.</p>	<p>The effective and efficient management of resources (products, items, SKUs etc.) - how they are obtained, stored and moved to the various locations whereby they are ultimately distributed to end users.</p>	<p>Marketing, Sales and Distribution involve in promoting and selling goods or services. The key aspects include marketing and sales strategy development, strong distribution systems, robust account management, effective sales operations and supportive customer service.</p>
People						

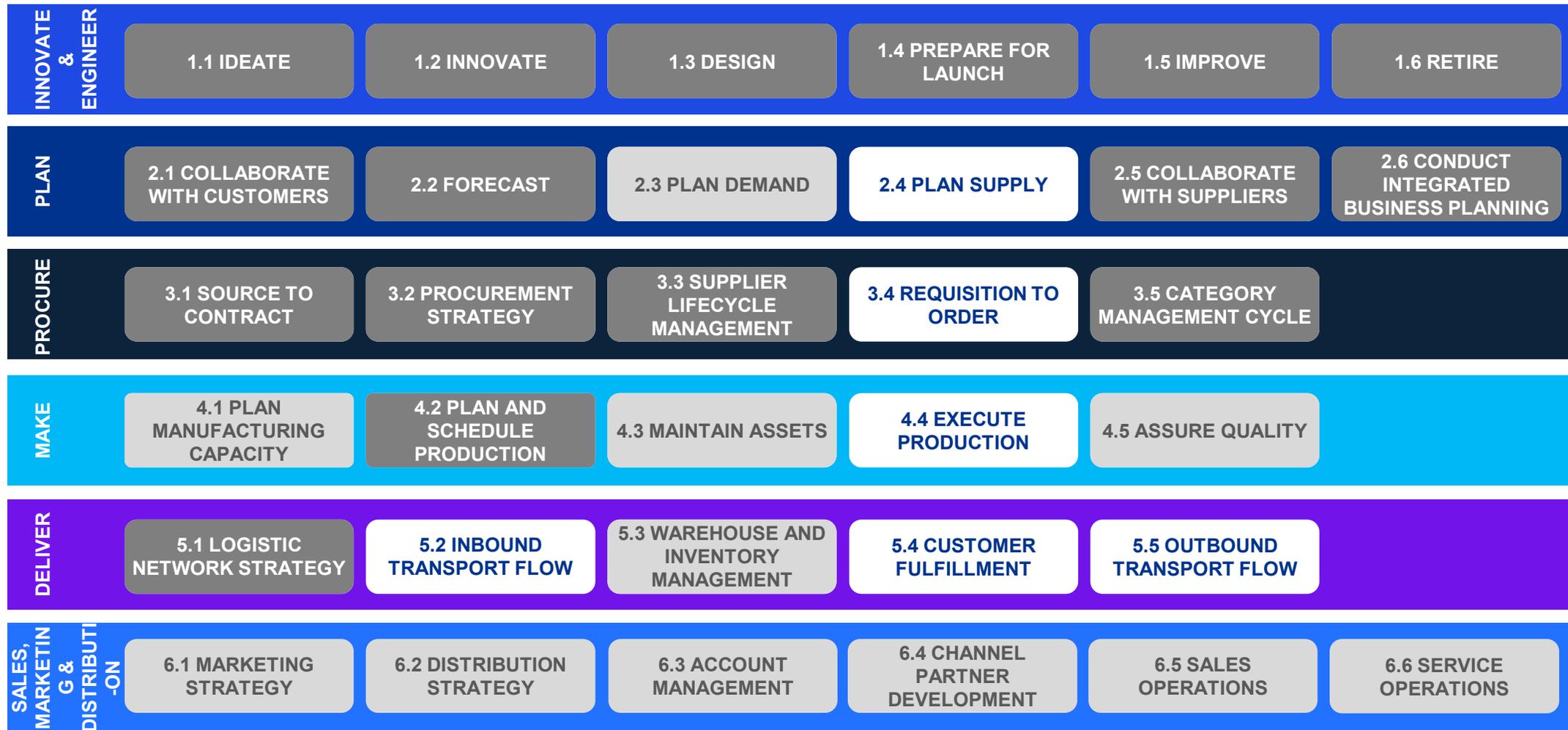
TECHNOLOGY ENABLERS

ESG (Environmental, Social, Governance)

Manufacturers can use below scale to assess their maturity levels of these key supply chain capabilities

	Level 1	Level 2	Level 3	Level 4	Level 5
1.0 Functional process	Reactive The capability of the function has a low level of operational competency, lacks formal processes.	Managed The capability of function has a low level of operational competency, its activities adhere to informal processes, behaviors and rely on employees' experience or intuition.	Established The capability of function has a steady medium level of operational competency, its activities comply with formal processes.	Integrated The capability of function has a high level of operational competency, which complies with the formal, documented processes and aligned to the needs and direction of the organization.	Collaborative The capability of function has a high level of operational competency, which complies with the formal, documented processes while focusing on the value realization with business relevant outcome metrics. The function constantly seeks out innovation and challenges for the business in order to add strategic value under a sustainable role in the organization.
2.0 People	The capability meets the required obligation, but its activities are reactive and without governance or control.	The capability meets the required obligation, but its activities are reactive and without governance or control.	The capability fulfills the required obligation through established governance, measurement and intentions, and control skills. Hence, this results in a consistent approach but lacks integration with other functions.	The capability fulfills the required obligation with established governance, measurement and intentions, and skills of control which are aligned to other functions or capabilities.	The capability fulfills the required obligation with established governance, measurement and intentions, and skills of control which collaborated with other functions or capabilities.
3.0 Service delivery model					
4.0 Technology			The individual in the function is to provide defined expertise.	Performance is measured and managed using established metrics focusing on operational excellence and predictable outcomes.	The capability fulfills the required obligation with established governance, measurement and intentions, and skills of control which collaborated with other functions or capabilities.
5.0 Performance insights & data				The individual in the function is continually looking to improve the effectiveness of the capability.	Performance is measured and managed using leading metrics with focus on operational excellence and predictable outcomes.
6.0 Governance					The individual in the function is continually looking to improve and develop new approach to enhance the effectiveness of the capability.

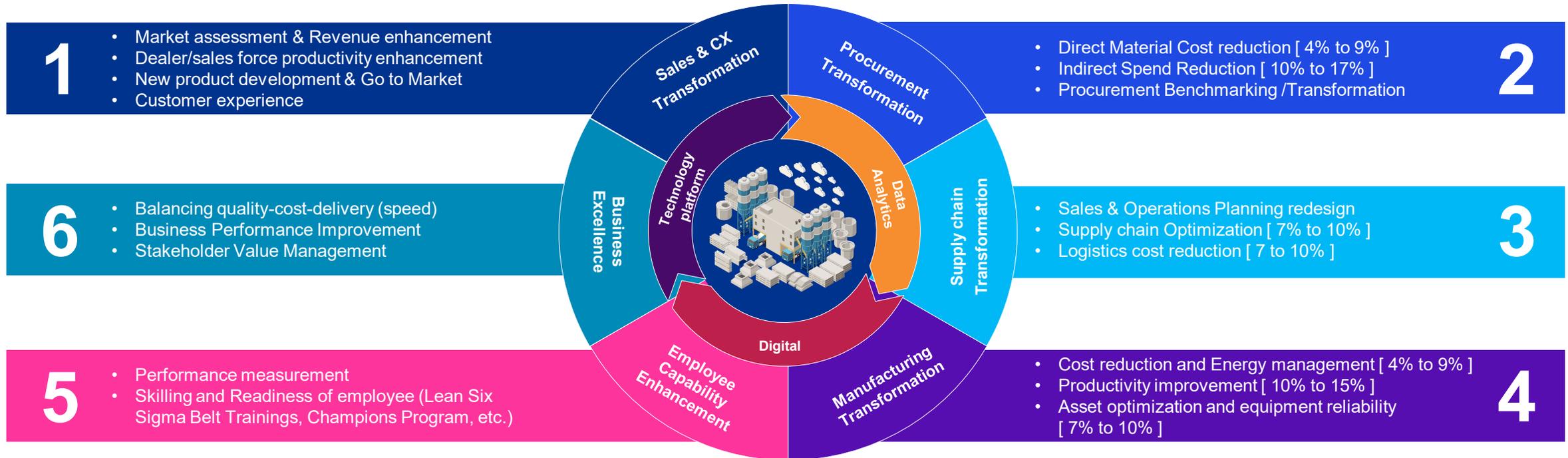
KPMG has the following view about the maturity exhibited by Vietnamese manufacturers across the critical supply chain capabilities



06

**How can KPMG help
Vietnamese manufacturers
in their capability
development journey?**

Our service offerings can help you transform your business by developing the critical capabilities needed for better Global Value Chain integration and gain advantages in this everchanging marketplace



We have helped clients across multiple sectors to achieve remarkable results in the following key areas:

A) Cost Reduction, B) Productivity Enhancement, C) Revenue Enhancement, D) Inventory Optimization and E) Customer Experience Enhancement

KPMG's proprietary Connected Enterprise framework will help businesses to accelerate the transformation with digital enablers



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