Investing in Vietnam's garment industry offers more than just Free Trade with 52 nations. Risks of not becoming a garment player in Vietnam, which can be translated in a company's competitive disadvantage, are often underestimated. BDG has gathered 10 reasons why you should consider establishing your garment manufacturing business in Vietnam NOW.

1. Vietnam - the new manufacturing hub

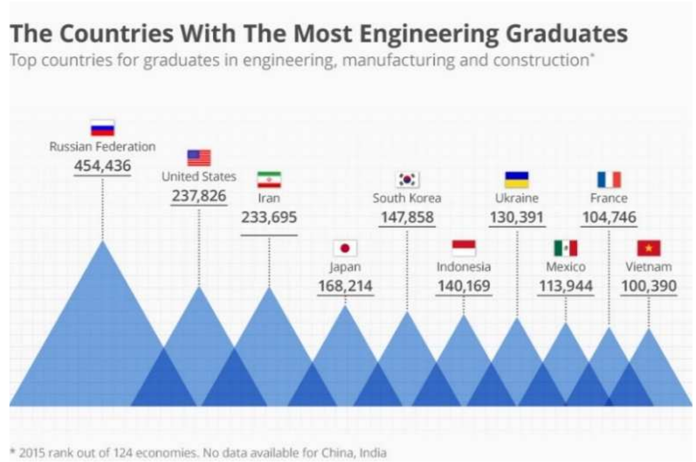
There have been a lot of discussions why Vietnam is about to become the world´s manufacturing hub. Let us draw some facts.

Based on the theory of comparative advantages, a country should allocate its production factors in a sector where it has its largest endowments. Once industrialized nations became expensive for in-country production, manufacturing companies moved their plants from Europe and the US to other countries – a natural process populist politicians use as their arguments in protectionist campaigns. While China nowadays attracts more manufacturing companies that require specific know-how (thus earning higher monetary values), Vietnam and Mexico are two examples of countries which are stepping in.

Why could Vietnam have comparative advantages in lower-level manufacturing goods?

It could be the combination of the enormous number of engineering graduates and the general education level of its people. Having a look at the number of engineering graduates per year in the world, Vietnam ranks 10th (Figure 1). On the other side, Vietnam still lacks a generally elevated education level as recent investments in the education system will only pay off slowly. According to the Hanoi Institute for Socioeconomic Development Studies, between 40 and 60% of Vietnam's workforce is unskilled. Thus, while Vietnam will slowly be able to send local engineers into the manufacturing sector, the manufactured products will yet lack high complexity.

Figure 1: Engineering graduates in numbers



Source: WEF 2015/UNESCO Institute for Statistics / Graphic by Forbes

Some people might see this as a problem for the sustainable development of the country. On the other hand, Vietnam could use this situation to position as the global manufacturing hub for less-complex production, while slowly increasing it in the years to come. Thus, the chances for the Vietnamese garment industry to grow in the long run could be high.

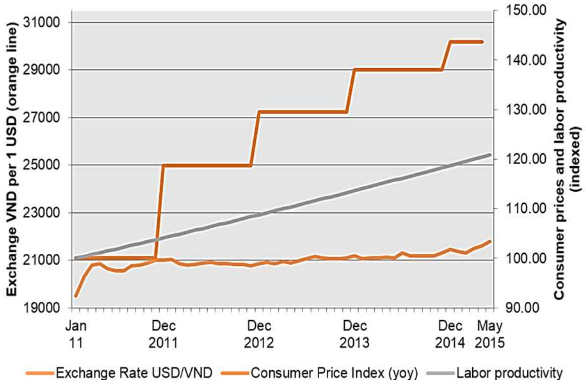
2. Labor productivity levels in garment manufacturing could reach the ones of China, but at more competitive wage costs

In an environment where labor costs rise faster than labor productivity, a country would become less competitive and will thus be vulnerable to a possibility of its manufacturing sector relocating elsewhere.

While we have seen a lot of relocation from the US and Europe to China, Mexico and finally Vietnam in the past decades, the question for the Southeast Asian country is: "could productivity gains keep abreast of the salary rises?"

Vietnam has seen some overall productivity gains in recent years, while labor costs rose at about twice the pace. BDG published a study in 2015 stating that the lack of productivity can only be re-established if either the Vietnamese Dong is devaluated or wages are cut. Since wage cuts are politically problematic, BDG expects the devaluation of the local currency Dong to accelerate in the coming years.

Figure 2: The competitiveness gap 2011-15



Source: The World Bank/GSO; Graphic via oanda.com

However, there are ways to lift productivity in Vietnam. Mr. JG Cheng, garment manufacturing consultant and specialist for the Vietnamese garment market says: "When you understand the Vietnamese market, achieve to set the right incentives for workers and manage the factory with cultural awareness, you will be able to achieve productivity levels comparable to China."

If garment manufacturers operating in Vietnam achieve China's productivity levels, the garment industry in Vietnam can be established as a successful industry for at least two upcoming decades.

3. The astonishing skills of the "unskilled"

If you have ever visited Vietnam as a tourist or travelled around the country on a business trip, you might have seen astonishing works along the local roads. You could see for example life-sized marble sculptures or wooden chairs with filigree-carving arm-rests.

Image via freshinterior.me

Sometimes, you will meet people who embroider several-meter large landscapes depicting every detail of Vietnam countryside's beauty. All of the creators would probably be classified in the section of the unskilled. Vietnamese people often show a remarkable persistence when doing detail-oriented work. What does this mean for the future of manufacturing in the country? Labor intense-manufacturing, including garment, can have a bright future in Vietnam. The challenge will be to instruct the workers using an approach which they will understand, while also putting a lot of attention to intercultural differences.

4. Vietnam's strategic geographic position

Being situated just next to China and its already developed supply chain is another very important reason why setting up a garment manufacturing business in Vietnam should be considered as we speak. Furthermore, Vietnam's position in the heart of Southeast Asian region is interesting in terms of both completing the supply chain and for future sales, since Vietnam still cannot produce all yarns and fabrics itself, despite remarkable improvements in the recent times.

While garment manufacturing is developing fast, Vietnam is still dependent on fabric and yarn imports from China and other countries. Thanks to its proximity, Vietnam can import the necessary products within a very short time, while enjoying beneficial tax rates. Shipping goods from China, including custom clearance, can nowadays be done in an average of around two weeks. However, when importing yarn and fabrics from China, 'Rules of Origin' for some Free Trade Agreements (FTAs) will not apply for the end product.

With its rapid development and focus on an ever more consumer oriented economy, China might become an interesting market for garment export in the near future. Even though China is still far away from becoming a net importer of garment products, this can change with further rising salary levels and development of the country's remote areas. Based on the data from China National Garment Association, despite slower economic growth in the recent years, garment sales are still rising at double digit levels. While China maintains a highly competitive position in the world garment market, it will probably take another decade or two for the country to become an attractive market for garment imports. Positioning early in Vietnam's market could be a big advantage for the future.

5. Curbed inflation and slower rising wage costs (real wages)

Since the garment manufacturing industry has traditionally been extremely globalized, salaries are usually mentioned first when it comes to measuring the competitiveness level of a territory. In Vietnam, the minimum wages have been increasing strongly in the past six years. While wages almost doubled, investors have become increasingly worried about the pace of the wage hikes since productivity gains in most industries could not keep pace.

However, there is a trend for slower wage rises as decision makers have become aware of the negative effects of overall competitiveness. This development will lower the pressure of international garment manufacturers in Vietnam when competing with manufacturers from other nations.

Table 1: Minimum wages rise and inflation

Year	Min. wage region IV in Mio. VND/ (USD)	%YoY +	Min. wage region I in Mio. VND/ (USD)	% YoY +	CPI
'12	1.4 (~USD 67)	27.3%	2 (~USD 96)	29%	9.1%
'13	1.65 (~USD 78)	17.9%	2.35 (~USD 112)	17.5%	6.6%
'14	1.9 (~USD 90)	15.2%	2.7 (~USD 127)	14.9%	4.1%
'15	2.15 (~USD 97)	13.2%	3.1 (~USD 140)	14.8%	0.6%
'16	2.4 (~USD 108)	11.7%	3.5 (~USD 158)	12.9%	1.3%
'17	2.6 (~USD 117)	8.3%	3.75 (~USD 169)	7.1%	4.8% (est.)

Source: GSO; Oanda.com; USD conversion at year-end exchange rates

Slower wage growth combined with a decent inflation rate are a good sign for new garment manufacturing owners who consider an investment in the country. In addition, given the fact that Vietnamese workers can achieve appealing productivity levels, factory owners should focus on training their workers to increase their competitiveness on a long run instead of worrying about rising cost levels too much.

6. Some market entry barriers likely to rise in the future

Theories about the ideal timing when entering a new market state that as a first mover, an organization can have low market entry barriers due to lower investment costs, little competition and availability of abundant workforce. The downside for having first-mover advantages is a higher risk of failure because first-movers often make mistakes in a new business environment.

With the development of a new market, market entry barriers become higher. This is already the case for Vietnam as the country is no longer a first-mover country for investors. Currently, foreign investors are in the position to learn from each other, while the market in general has become more transparent over the years. When considering a market entry, garment manufacturers ask themselves about the current maturity level of the Vietnamese market and whether the right time for an investment is now or in a couple of years. Also, they wonder whether Vietnam will soon become too expensive and manufacturing will again move to other countries.

We are convinced that Vietnam is going to be a manufacturing hub and that the business environment will remain investor-friendly for a long time. The trend of rising manufacturing costs will continue, but we doubt that investors will withdraw from the country very soon. Let us have a look at the reasons:

If costs would further be on the rise, there are not many other countries in the world where garment manufacturers would find the following market conditions: reasonable wages, political stability, established supply chains, well entrenched logistics solutions, direct market access to Asia, motivated workers and thus a promising basis for further productivity gains in the future. Despite some neighboring countries such as Myanmar or countries in East Africa which offer good business opportunities, we believe that the time of big relocation moves for keeping production cost at low levels is soon coming to an end.

New trends in garment manufacturing might be further advances in automation of production processes and increasing end-consumer prices combined with lower profit margins. If garment manufacturers want to be prepared for this development, they need to find a location for their production which is well integrated in the global supply chain and enjoys favorable conditions for global trade. While Vietnam is currently building its integration in the global supply chain, there is hardly any other country in Asia having as many FTAs as Vietnam. The advantages which go far beyond low labor costs are the reason why garment manufacturers should enter the Vietnamese market now before further market entry barriers will continue to rise.

7. Many regions with abundant workforce: moving from the cities to the countryside

Did you know that there are 5 million workers in the Mekong Delta (South Vietnam) working in agriculture?

The Mekong Delta is one of the regions in Vietnam where there is still abundant workforce. With nearly all regions being in zone IV (the most beneficial region in terms of labor costs) it becomes obvious that some remote areas can be attractive destinations for labor intense companies. Ho Chi Minh City and Hanoi labor costs have almost reached levels comparable to average wages in China.

Thus, it might be attractive for new investors to find a production site for their factory in the countryside. The following reasons depict why you should consider a factory setup in the countryside:

- Majority of laborers still work in agriculture, and earn low salaries. Working in the garment sector could improve their lives;
- Wage levels are roughly 30% lower compared to the urban areas of Vietnam;
- While it has become difficult to find enough qualified workers in some garment hubs (both urban and rural), labor competition in the countryside is in general weaker;
- Improving infrastructure conditions enable the set-up of an effective logistics chain;
- Many rural areas give tax incentives for new investments.

8. Factory disaster such as the Rana Plaza are unlikely to happen in Vietnam due to security standards and labor conditions

Rana Plaza (Bangladesh) stands for one of the biggest disasters in the 21st century, with more than 1100 dead and 2400 injured people. Although Rana Plaza was closed due to flaws in the building's structure on the day of the tragedy, some garment business owners forced their workers to come to work. In the months after the disaster, there were a lot of discussions about safety of low-cost workers and the fair value of a piece of garment in general. Today, it seems to be forgotten what moved the world 3 years ago. Conditions for workers have not substantially improved in Bangladesh, despite new rules, regulations and forced factory close-downs. Accidents such as the one at Rana Plaza could still happen and would thus further endanger the image of the garment industry.

Should there be more such incidents caused by negligence of workers' safety in the future, consumers might consequently become more aware of the origin of the clothes they wear. Garment producers put themselves at risk if they produce in a country which applies low security standards for their workers, does not fight consequently against child labor or which pays miserable salaries.

Vietnam has always applied strict rules when it comes to worker security, child labor and security of buildings is analyzed profoundly when applying for a construction permission. Thus, we believe that a second Rana Plaza in Vietnam is unlikely. For garment manufacturers who do not want to endanger their reputation due to negligence of their workers, disasters or child labor, Vietnam is a good place to produce.

9. The country's further integration in the world economy

Individually, or through the ASEAN, Vietnam signed FTAs with 52 nations across the globe. With the EU-Vietnam FTA and TPP awaiting to be ratified, this Southeast Asian country will become one of the most connected ones in the region when it comes to world trade. Knowing that the country only started opening its boarders in 1986, and that it became a member of the World Trade Organization just 9 years ago, the vast number of signed FTAs is even more impressive. For more information about Free Trade please refer to another BDG study.

10. Investments in supporting industries in process

In FTA such as EU-Vietnam FTA or TPP, we would like to pay attention to the requirement that a certain share of the work and basic products needs to be produced and manufactured within a single country, thus requiring strong supporting industries. While Vietnam has been lacking of supporting industries in the past, there is now some movement.

Yet today, 85% of fabrics and 85% of finished fabrics are still imported from other countries, mainly China, Taiwan and South Korea. The yarn production is now at a localization rate of around 50%.

Even with these inadequate numbers, it is likely that the situation for local sourcing will further improve, and that ever more garment manufacturers in Vietnam will be able to take advantage of preferential tariffs due to local sourcing. According to the decision of the government (36/2008/QD-TTg) dated in 2008 Vietnam is supposed to achieve a localization rate of 70% by 2020. Even though it might be difficult to achieve the goal by 2020, we are seeing continuous investments in the supporting industries. Vinatex, the biggest local producer of garment for example, announced after its 2015 IPO that it will invest close to USD 500 million in new production facilities, including fabric and yarn making. While Vinatex had a localization rate of over 50% in 2013, the company wants to further increase this figure and comply with all relevant international FTA requirements.

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