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Upgrading Vietnam Leather and Footwear Industry

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ABSTRACT

This paper focuses on the examine how the Vietnamese leather and footwear industry can develop in order to become a strong competitor on the global market. From the concepts we developed a conceptual model which will guide us through the research. The uncompetitive national environment of an export industry will have a bad influence on the performance of the firms and lead to export barriers. Firms can overcome these barriers by learning from global buyers. Knowledge transfer from the global buyer to the local firms will only occur if there is a good relationship between the two. When firms succeed to overcome their export barriers they have achieved upgrading.

KEYWORDS: *leather and footwear, global buyer, export barriers, competitiveness*

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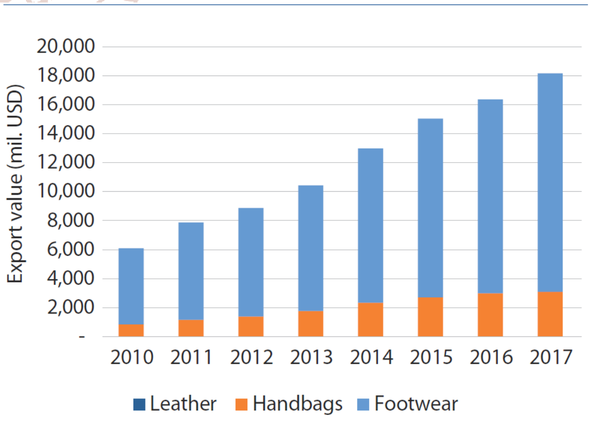
1. INRODUCTION

As developing countries liberalize trade and engage more openly in international production, the issue of upgrading becomes more central to debates on how traditional, labour-intensive sectors restructure themselves to maintain competitiveness in a more trade-liberalized environment (Dolan and Tewari, 2001). Upgrading means enhancing the competitive position of a firm and the micro level upgrading within value chains should contribute to the overall process of development of a country (Schmitz & Humprey, 2000). Due to their low labour costs, developing countries are supposed to specialise in the export of labour-intensive products, like garment, textile and footwear. Some developing countries have been able to achieve a substantial growth in quantitative terms in these sectors due to cheap labour. But cheap labour is available in many parts of the world and these countries need to upgrade otherwise they will be beaten when new countries with lower labour costs arise. One such case is Vietnam which, following the reforms in the late 1980s and early 1990s, achieved notable growth due to the cheap labour (Hill, 2000).

The leather and footwear industry in Vietnam has been developing very fast over the last decade. Prior to the opening of the Vietnamese economy in the early 1990s, the leather and footwear industry was involved mainly in sewing only the upper parts of products to be exported to the Soviet Union. At that time the quality and differentiation of products were not particularly high. The Vietnamese leather and footwear industry later suffered a severe crisis due to the disappearance of its established importers. As part of the Doi Moi reform policy the Government of Vietnam encouraged the formation of joint ventures with foreign partners. This initiative resulted in the relocation of many factories from countries like Taiwan to Vietnam. Therefore the sector started to recover and found new markets and the Vietnamese leather and footwear industry registered a sharp growth bringing the export value to unprecedented heights (EUECC, 2004). Figure 1 shows the remarkable growth of the Vietnamese leather and footwear industry.



Source: ITC Trademap, 2017.

Figure1: Vietnam leather and footwear export value 2010 - 2017 in million US Dollars

The data shows export of leather and footwear products grew 17 per cent between 2010 and 2017, from US$ 5.5 to 18 billion. Footwear is a major export, accounting for more than 80 per cent of the sector export value, followed by handbags with a share of 17 per cent, and leather products with just 0.1 per cent.

2. Literature review

2.1. Factor conditions

Porter (1990) defines factors of production as the inputs necessary to compete in an industry, such as labour, arable land, natural resources, capital, and infrastructure. According to the theory, nations are endowed with differing stocks of factors. A nation will export those goods that make intensive use of the factors with which it is relatively endowed. Factors of production can be grouped into a number of categories; these are human resources, physical resources, knowledge resources, capital resources and infrastructure.

Porter (1990) believes that basic and generalized factors are either inherited or easy to create and the advantage stemming from them is not that difficult to replicate, hence not sustainable. Advanced and specialised factors, on the other hand, are viewed as being more decisive and as a sustainable basis for competitive advantage. The mix of the available factors differs widely among industries. Competitive advantage from factors depends on how efficiently and effectively they are deployed. Not only how but also where the factors are deployed in an economy are crucial. Other determinants in the 'diamond' will be necessary to explain where factor advantage translates into international success because these shape the way factors are deployed.

2.2. Export barriers

Barriers to exporting refer to all those constraints that hinder the firm's ability to initiate, to develop, or to sustain business operations in overseas markets. (Leonidou, 2004: 281).

He classified the export barriers as internal and external. Internal barriers are associated with organizational resources/capabilities and company approach to export business. External barriers stem from the home and the host environment within which the firm operates. Lall (1991) however, restricted his definition only to marketing barriers. Export marketing barriers are those gaps which need to be filled before the competitive producer becomes a successful exporter (Lall, 1991: 139).

With 'gaps' he meant the inabilities of manufacturing firms to meet the requirements of their buyers (Lall, 1991). Although Lall's definition is specific to marketing barriers, it includes all export barriers that hinder the manufacturer from being competitive in the international market. He suggested that export barriers should not be analysed in isolation but studied in a broader perspective. Thus export barriers of manufacturing firms from developing countries are related to the requirements of their global buyers and their inabilities to operate successfully in export markets.

Studying the export barriers from this perspective helps us to have a comprehensive idea about the barriers themselves but also the factors that are contributing to their existence. Tesfom (2003) conducted a quite similar research of export barriers. He investigated the export barriers of footwear and textile manufactures from Eritrea, which is also a developing country like Vietnam. He developed a framework of export barriers that influence the marketing strategy from manufacturers from developing countries and he used this framework to classify the export barriers of the manufacturing firms in Eritrea. Since his research is in line with ours, this framework will also be suitable to classify the export barriers of the footwear-manufacturing firms in Vietnam. Export barriers are related to the company, product, industry, market and macro environment and they all influence the export strategy of a firm.

2.1.3. Related and supporting industries

The third determinant of the diamond is the presence of supporting (or supplier) industries and related industries that are internationally competitive.

The presence of supplier industries in a nation creates advantages in downstream industries in several ways (Porter, 1990: 101). The first is via efficient, early, rapid and sometimes preferential access to the most cost-effective inputs. More significant is the advantage that home based suppliers provide in terms of ongoing coordination (Porter, 1990: 103). But the most important benefit of home-based suppliers is in the process of innovation and upgrading (Porter, 1990: 103). Competitive advantage emerges from close working relationships between world-class suppliers and the industry. Suppliers can help firms to perceive new methods and opportunities to apply new technology. Having a competitive domestic supplier industry is far preferable to relying even on well-qualified foreign suppliers. The home market is highly visible to domestic suppliers. Proximity of managerial and technical personnel, along with cultural similarity, tends to facilitate an free and open information flow. And by this transaction costs can be reduced (Porter, 1990: 103).

The presence of related industries often leads to new competitive industries. Related industries are those in which firms can coordinate or share activities in the value chain when competing, or those that involve products that are complementary (Porter, 1990: 105). Firms from related industries can share activities such as technology development, manufacturing, distribution or service. And just as home-based suppliers, firms in related industries also provide opportunities for information flow and technical interchange. In addition, international success in one industry can pull through demand for complementary products or services from the other industry (Porter, 1990: 106).

2.1.4. Vertical acquisition

When a global buyer takes over a local manufacturer it is called a vertical acquisition. An acquisition is a strategy through which one firm buys a controlling, or 100% interest in the other firm with the intent of using a core competence more effectively by making the acquired firm a subsidiary business within its portfolio (Hitt, Ireland and Hoskisson, 2001: 277).

The primary reasons for acquisitions are retaining full control of the operation (Albaum, Strandskov and Duerr, 2002: 335) and to achieve greater market power (Hitt, Ireland and Hoskisson, 2001: 277). Market power usually is derived from the size of the firm and its resources and capabilities to compete in the marketplace, and in vertical acquisitions firms can gain competitive advantage and achieve greater market power by buying a supplier or distributor. When a foreign firm buys a supplier or distributor in another country then the acquisitions is also called a cross-border acquisition (Hitt, Ireland and Hoskisson, 2001: 282) or foreign acquisition (Witt and Meyer, 1998: 784). Foreign acquisitions can serve two purposes. One reason is to gain access to a foreign market or to selective skills, the other reason is to gain access to a highly favourable national diamond (Porter, 1990). Sometimes the only feasible way to tap into the advantages of another nation is to acquire a local company because an outsider is hard-pressed to penetrate such broad, systematic advantages.

2.1.4. The role of government

The government can influence each of the four determinants of the diamond either positively or negatively (Porter, 1990: 126). Factor conditions are affected through subsidies, policies toward the capital markets, policies toward education, and the like. Government bodies establish local product standards or regulations that mandate or influence buyer needs. Government is also often a major buyer of many products in a nation. Government can shape the circumstances of related and supporting industries in many ways, such as control of advertising media or regulation of supporting services. Government policies also influence firm strategy, structure and rivalry through such devices as capital market regulations, tax policy and antitrust laws.

3. Methodology

Both secondary and primary data were collected. Primary data were collected through interviews with managers from seven different footwear manufacturers in Vietnam. To create a proper foundation to this research the manufacturers were selected on three conditions.

First the manufacturer had to maintain export activities. Without any export activities or intentions to export, we cannot identify export barriers, which is the central subject in the second sub-question of this research.

Secondly the manufacturers were selected on their ownership. We can distinguish four different types of ownerships; these are state-owned, private owned, partly foreign-owned and fully foreign-owned. It is important for us to interview manufacturers with different ownerships to identify the differences between them in terms of export and upgrade performances.

Third, the manufactures had to be located in the South of Vietnam because the fieldwork was conducted in the south. More than 50 per cent of the footwear manufacturers are located in the south.

Although it was a hard process to find companies who were willing to cooperate we managed to interview managers of seven companies. The managers didn't want that the names of their companies would get reported in this thesis because of competition reasons.

To conduct this analysis a general analytic strategy was used (Yin, 2003). Theoretical propositions from the literature review were used to collect data; this has helped us to collect only relevant data.

4. Research results

The case studies have shown that some companies are doing better than others but they still face some common problems. We used the checklist to classify the export barriers. The identified barriers will be summarised in the table 1. This table only contains the export barriers that were identified in the case studies. An x stands for the presence of that export barrier at the company.

Table1: Export barriers of the leather and footwear case studies

EXPORT BARRIERS	Footwear manufacturers						
	S1	S2	P1	P2	P3	JV	FO
Internal export barriers							
Lack of knowledge to locate foreign marketing opportunities	x	x	x	x	x	x	**x**
Lack of specific information regarding foreign agents, distributors and prospective buyers	x	x	x	x	x	x	**x**
Lack of export marketing research	x	x	x	x	x	x	**x**
Language problems in communicating overseas customers	x	x					
Lack of personnel trained and qualified in export marketing	x	x	x	x	x	x	**x**
Inability of the firm to self finance exports	x	x			x		
High cost of capital to finance exports	x	x					
Strict credit requirements of the bank					x		
Product quality problems	x	x					
High sensitivity of products to fashion			x	x	x		
Lack of adequate skill to adapt products for foreign markets			x	x	x		
Difficulty in meeting importers product quality standards	x	x					
Lack of ability to supply required quantity on continuous basis	x	x	x	x	x	x	**x**
External export barriers							
Lack of adequate quality of raw materials	x	x	x	x	x	x	**x**
Strong competition from domestic producers in the foreign market	x	x	x	x	x	x	**x**
Strong competition from other foreign producers in potential markets	x	x					
Lack of government assistance in overcoming export barriers		x		x			
High interest rates	x	x					
Total export barriers	14	15	9	10	11	7	7

At the comparison of the different case studies we have identified five internal export barriers and two external export barriers that form constraints for all seven companies. The four internal export barriers are:

- Lack of knowledge to local foreign marketing opportunities
- Lack of specific information regarding foreign agents, distributors and prospective buyers
- Lack of market research
- Lack of personnel trained and qualified in export marketing
- Lack of ability to supply required quantity on continuous basis
- The two external export barriers are:
- Lack of adequate quality of raw materials
- Strong competition from domestic producers in the foreign markets

The first four internal export barriers of the leather and footwear manufacturers can be attributed to the low skills of the employees of the firm. Knowledge about the export market, how to get access to it and how to design products for it, are hard to learn for the footwear manufacturers. Also acquiring and adapting technology that is needed to the manufacture products for the export market is out of reach of the Vietnamese firms. Currently advanced technology cannot be acquired on the domestic market and the leather and footwear manufacturers need to learn this from their foreign partners.

The fifth internal barrier is often caused by the delay of imports of materials, which is related to the first external barrier. Due to the lack of domestic materials of adequate quality, firms need to import at least 80 percent.

The external barriers are caused by factors in the environment. The individual company cannot overcome that barrier by itself. High import of materials is caused by the fact that the quality of materials from domestic suppliers cannot meet the requirements of the global buyer, which is also discussed in the previous chapter. This barrier can only be leveraged when domestic suppliers upgrade their products and processes and produce better products that are suitable for the industry. Tough domestic competition and dependence on prices are actually two sides of the same sword. All the manufactures in the Vietnamese leather and footwear market compete on prices. The industry is part of a value chain where global buyers outsource their production activities to low-cost countries. For them price is the most important factor in the supply of their products. Of course quality, flexibility, delivery times and other requirements are also important but the global buyers want it all. They want the best products for the cheapest prices and due to their bargaining power they are able to influence the prices. The manufacturers have to accept the prices otherwise they will loose clients.

In the case studies we have seen that the SOEs face more export barriers than the private and foreign firms. This is due to the lack of finances and willingness to invest in the company. They complain about high interest rates that will raise their footwear prices, which is their only source of competitiveness. The private companies are doing better, besides the common export barriers, another important barrier to them, is the low design skills. They all managed to market their own branded footwear. However they face difficulties to design footwear that are suitable for their major export markets like EU and the US. The foreign companies are inferior to the mother companies in South Korea and Taiwan and therefore have no knowledge about the export markets.

5. Conclusions

In summary, the leather and footwear manufacturers in Vietnam need to overcome these barriers to survive in the industry. Tough competition will drive weak manufacturers from the market. Local firms cannot overcome external barriers by itself. Internal barriers however can be overcome by and investing and learning. By overcoming the export barriers, the local firms will upgrade become more competitive on the (global) market.

The global buyer is an important source of these factors. Global buyers can make investments and transfer knowledge to the manufacturers but this will only happen when there is a relationship between them. In the next chapter we will examine how this has happened in the past.

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