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Schaumburg-Müller, Henrik

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**Copenhagen
Business School**
HANDELSHØJSKOLEN

Centre for Business and
Development Studies
Porcelænshaven 18
DK-2000 Frederiksberg
Denmark
Email: cbds@cbs.dk
www.cbs.dk/cbds

Vietnamese Garment Enterprises After the Termination of the Multi-Fiber Agreement

Henrik Schaumburg-Müller

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Vietnamese Garment Enterprises After the Termination of the Multi-Fiber Agreement¹

Henrik Schaumburg-Müller, Associate Professor
Centre for Business and Development Studies
Copenhagen Business School
hsm.ikl@cbs.dk

Abstract:

This paper looks at the export developments of Vietnamese garment producers after the Multi-Fibre Arrangement was removed by the beginning of 2005. It uses a Global Value Chain approach and analyses what happens when there is a major change in the institutional context, in this case shift in the basic institutional international trade arrangements. The focus is on Vietnam and the Vietnamese garment suppliers looking at how they have performed after the removal of the quota systems and what kind of strategies they have pursued. The results show that Vietnamese suppliers have been able to compete internationally after the quota removals although many of them appear to be locked in the low value end of the chain. The data show, however, that they are not only able to compete and grow but also to change between buyers and markets, which provides them with the flexibility of shifting between chains.

Keywords: *Garment, Global value chains, Vietnam, Quota policies*

¹ A first draft of the paper was presented at the 2nd Aalborg University Conference on Internationalisation of Companies and Intercultural Management, October 2006. The paper has its background in the cooperative Vietnamese-Denmark International Business research project (www.vdibresearch.org.vn) under which the author worked together with a team of researchers from Foreign Trade University in Hanoi. The research team included Mrs. Huong Pham Thu, Mr. Tien Dao Ngoc and Mrs. Hai Nguyen Thi Hong who are all acknowledged for their contribution and dedication. The research team collected and processed the data from the Vietnamese garment firms.

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Introduction

The opportunities for developing country firms to be integrated in cross border trade relations depend today to a large extent on international trade arrangements. When the analytical framework of global commodity chains (GCC) was introduced by Gerald Gereffi, he used four dimensions to explain the organisation of such chains: Input-output relations, location, governance and the institutional context (Gereffi 1994). By context he meant the national and international institutional setting that outside the direct control of the stakeholders influences the way the GCC is organised. In the recent work on global value chains (GVC) the context has faded away (Gereffi et al. 2005). At a similar note, the strategic options of the producing suppliers have not been the direct focus of the GCC and GVC analysis; the emphasis has been on the lead firm governing the chain and the governance of the relations to its suppliers. In this paper we will look at the supplying firm and see how it reacts to changes in the institutional context and form its strategy in the garment GVC. We will see how Vietnamese garment producers reacted when the quota system of the Multi-Fiber Agreement (MFA) was abolished and a new global competitive framework emerged for trade in garments.

The MFA trade regime in textile and garment was phased out with the WTO Agreement on Textile and Clothing (ATC) by the end of 2004. For garment producers in many developing countries it meant a new more competitive global environment. Where the MFA system had secured national producers export quotas, and thereby an opportunity to become integrated in global value chains, they were now faced with a more open competitive environment and a risk of lead firms shifting their orders to the globally most competitive suppliers. There was an expectation that garment export from China would explode because Chinese producers were more effective producing better qualities at cheaper prices. Other production locations would face falling market shares as buyers abandoned them.

As expected China's export increased to such an extent that both the US and EU by the middle of 2005 reintroduced restrictions on their garment import from China making room for other countries to benefit and fill the gap left by China in a global market with increased demand for garments. The upsurge in Chinese exports immediately after the end to the MFA and the swift intervention by the EU and the US, resulting in agreements to restrict export growth, are clear indications that the market cannot provide what is termed "a level playing field". Policy driven regulations efforts will continue using WTO provisions of "unfair" and "unjust" market developments.

In Vietnam the garment industry has been one of the main successes behind the country's export driven growth strategy over more than ten years. Vietnam only became a member of WTO early in 2007 and its trade in garments was therefore regulated by bilateral agreements when the MFA quota system terminated. A main shift for Vietnam's export took place when the US market opened after a virtual trade boycott with the bilateral trade agreement (BTA) signed in 2002.

Up to the end of 2004 Vietnam was faced with quota systems for its garment export to both EU and US. Only the quota system with the EU was abolished together with the MFA while the system imposed by the US continued. Nevertheless the relatively more

open global trade regime for garments could mean that producers in Vietnam were faced with stiffer competition on their main markets particularly from China. Would the steep export growth stop and the country see a decline in its export of garments?

This study raises the question: *What has been the strategy and how have Vietnamese garment producers performed after the end of the ATC?*

The second section of this paper looks at the effect of liberalisation of the garment market from a theoretical point of view that reflect the changes in the trade environment situation, and section three provides an overview of the structure of the Vietnamese garment industry, its performance and competitive strength. The fourth section discusses the strategic options for the firms in the GVCs while the following section shows the performance of the industry after the ATC by first analyzing trade figures at industry level and thereafter presenting and analyzing preliminary findings from a survey of 34 garment firms in Vietnam before the conclusions are made in the final section.

Theoretical reflections on the effects of garment market liberalisation

Moving from a quota regulated trade regime to a liberalised one should according to a simple neo-classical economic argument lead to a change in trade flows from the less to the more price competitive producers *ceteris paribus*. Since the quota systems for garment imports to US and EU in particular have been quite elaborate allocating quotas to a large number of developing countries with significant variations in price competitiveness, it was envisaged that the removal of quotas would lead to a major reorganisation of the trade flows and shifts in the garment exports composition among the exporting developing countries. The widespread expectation was that well established export countries with large capacities such as China and India would gain while many smaller developing countries that had mainly come into the global garment value chains because of the quota systems would loose (Tewari 2006). Furthermore, the theoretical prediction will be that freer trade will lead buyers to pressure prices downward. Such shifts will have large repercussions on production and employment of the concerned countries.

In anticipation of these impacts, a lot of interest and concern was raised about who are likely to win and who will loose?² The outcome from these discussions reveals a more varied picture than the above trade theory argument. From the buyers point of view not only price but also a whole range of other competitive factors are important such as quality, delivery-speed and -certainty, production flexibility, and transport time and costs (Palpaceur et al. 2005). Development of various capabilities like skills, management practices, networking, etc. which are important at the firm level appear not only to vary between regions but also among firms within the same country (Tewari 2006). These factors together with other risk elements may be accommodated in neo-classical theory but it certainly makes the international buyers sourcing strategies more complicated and trade streams will not necessarily be diverted to the most price competitive suppliers. In addition to the competitive factors a range of other strategic considerations are made by the buyers. First of all, location considerations will make

² See <http://www.tradeforum.org/> and <http://www.ethicaltrade.org>

large buyers in particular assess country risks and spread orders to different countries to avoid a situation where unexpected developments in one country can harm the entire supply. Secondly, there can be substantial exit and shifting costs abandoning suppliers in one country and shifting to new ones in other countries.

When it comes to the discussion of who stands to win and who stands to lose, the overall assessment and fear for most producing countries has been that China will take it all. China has already become global leader in garment export in most product categories because its producers on average are the most competitive both with respect to price and quality. However, if we take the other competitive parameters and strategic considerations into account, the picture may be less obvious. Buyers may not want to put all their orders in China. Infrastructure problems in China are rising, wages are rising and the garment sector is not politically a priority sector in China, and furthermore some suppliers may see a country risk in placing all their eggs in the China basket. Therefore the broader picture says that there are still substantial opportunities for effective producers outside China.

However, institutional trade arrangements will also continue to protect less effective producers in other countries. These arrangements include producers in importing countries including developed countries. Soon after the free trade regime was introduced January 1st, 2005, political attention was raised about on the huge import surge from China into the US and EU, resulting in the introduction of export restraints agreements with China for garment exports. Furthermore, preferential trade arrangements for specific developing countries are still allowed creating preferential access to the EU market and under the African Growth and Opportunity Act scheme for producers in African countries to the US market.

Profile and development of the garment industry in Vietnam

Textile-garment is a fast-growing industry in Vietnam, constituting around 11% of manufacturing production. The garment exports have over several years shown double-digit annual growth rates. In the last couple of years, export figures have exploded and reached USD 4.4 billion in 2005 up from USD 1.9 billion in 2001. The increase has mainly been a result of the opening of the US market after the bilateral trade agreement (BTA) entering into force in 2001, but because of the steep growth, the US reintroduced quotas for the import from Vietnam from early 2003. Main markets for Vietnam's garment exports had earlier been Japan without quotas and the EU with quotas.

Both the textile and the garment sub-sectors have expanded production significantly over the last 15 years. The textile sector was initially larger than the garment sector, in terms of both employment and output, but the garment sector has expanded most and is now dominant one (Hill, 2000; Thoburn et al., 2002). Today, Vietnam is a large net importer of textiles catering for the inputs to the export garment sector. The garment industry in Vietnam is concentrated around Ho Chi Minh City (HCMC) and Hanoi where special industrial zones for textile-garment companies have been established. While there are some cluster characteristics for the industry, the diverse ownership structure is important. In 2003, there were 1,206 registered firms in the garment industry (excluding household enterprises and textile firms): 120 were state-owned enterprises (SOEs); 800 were private domestic-owned and most of them recently

established enterprises; and 278 had 100% or joint venture foreign ownership. The SOEs include large corporations that consist of many different enterprises located all over the country. VINATEX, formed in 1995, is the largest state-owned textile-garment corporation, covering 45 member enterprises that are horizontally and vertically integrated, including specialised support and trade companies. The SOEs have generally better machinery and equipment than the private firms, and they have a divisional organisational structure with a relatively large number of technical middle managers, which makes the decision-making structure cumbersome and inefficient. The SOEs continue to expand, although some are going through not a privatisation but an equitisation process, where the company is transformed to a shareholding company but often the state will maintain a controlling part of the shares. While most of the SOEs are concentrated in the North, the private domestic-owned firms are concentrated around HCMC and dominated by garment firms that tend to be medium-sized. For the private companies state connections play an important role, and in HCMC one finds both companies with owners from North Vietnam and firms owned by Vietnamese of Chinese origin. Many of them are owner-managed firms with a concentrated top management structure that keeps direct track of all company functions and is able to take quick decisions. Companies with foreign ownership have the highest productivity, and in the garment sector they produce almost exclusively for export. While 100%-owned FDI today is allowed, a substantial part of the early foreign investments in the industry was established as joint ventures with SOEs, but in 2003 240 firms were 100% foreign owned. The foreign investors are primarily from East Asia.

Before 1991, SOEs exported garments to the Soviet and East European markets. Since then the garment enterprises in all three sectors have been integrated in global garment value chains in various ways. Buyers are a) regional producers, mainly from Taiwan, Hong Kong and South Korea, sourcing from their own plants or from independent suppliers in Vietnam constituting a triangular GVC with buyers in developed countries; b) traders, mainly from Hong Kong and elsewhere in the region, sourcing “commissioned garments” for overseas buyers; and c) foreign retailers with their own brands sourcing directly in Vietnam. The organisation of the export production is concentrated on two modes: one assembling (cut, make and trim, CMT) and the second, variations of the own equipment manufacturing (OEM) (known in Vietnam as Free-On-Board (FOB) 1 and 2), where the local producer to varying degree sources fabrics and accessories (MPDF, 2000; Thoburn et al., 2002; Nadvi & Thoburn, 2004). The vertically integrated SOEs source more materials of their own compared to the private enterprises, which are more dependent on their buyers either supplying inputs or specifying to them the foreign fabrics and accessories suppliers from which they have to source (Van, 2003). The domestic market, with 80 million people, is also expanding fast as a result of a growing real per capita income. A large household production sector has traditionally catered for low-end products, while SOEs in particular have made well-known brand products for the domestic market. The new private firms produce relatively little for the domestic market. Despite custom duties there is fierce competition from Chinese imported products, much of which are apparently smuggled across the border.

Strategic Options for Local Garment Producers

Although expanding fast, the Vietnamese garment producers are still locked into a rather static supplier position in the garment GVC with difficulties of upgrading in the value chain being dependent on the foreign buyers' design, specifications and standards at the same time as buyers maintain full control over marketing. Most domestic producers are able to supply several buyers in different markets at the same time and the dominant strategy is therefore growth through expanded production volumes. The SOEs usually have more buyers than private companies and an aspiration to produce up-market and brand products. But there is little knowledge about the success of these strategies. Domestic producers are being certified according to various international standards or fulfil private ones in order to attract more up-market production orders.

More seriously, in a long-term perspective, the industry is also found to have low productivity compared, for example, to China because of poor organisation of production and a lack of updated equipment (MPDF, 2000; Van, 2003). It is predicted that large investments in equipment and human resources are needed for the industry to compete in a liberal international environment. With respect to profits and earnings, it is said that assembling producers in particular are being squeezed by the international competition and that profits are falling (Thoburn et al., 2002; Knutsen, 2004), but the evidence is limited. On the other hand, employment, real wages and new investments are all increasing (Thoburn et al., 2002; Nadvi & Thoburn, 2004).

Seen in a GVC governance perspective domestic private firms are primarily locked in the assembly mode and SOEs more in OEM types of captive relations with their buyers. For the private suppliers, this can be seen as a cost-competitive strategy with the great risk of producers being locked in at the lowest end of the value chain where opportunities are few (Tewari 2006). However, trade figures alone do show some dynamics. The turn to serve the US market after 2001 was quick, and offered stable and high volume sales. The challenge for the domestic firms is the production from the foreign firms located in Vietnam where the productivity is much higher than in domestic private companies and SOEs. The foreign garment firms now have the largest export performance.

Vietnamese garment producers' export performance after ATC

Overall the Vietnamese garment industry showed a new export record of USD 4.8 billion in 2005 - a growth of 9.5% compared to the year before. Significantly lower than the years before but far from a decrease that some feared. To identify the reasons behind the continued export growth we will start analysing the overall industry export figures by looking at the performance at the main export markets as shown in Table 1.

Table 1 Vietnams garment exports to main markets 2000-2005 in millions USD

Market	2000	2001	2002	2003	2004	2005	Growth 2004-2005
US	50	45	951	1,973	2,474	2,640	6.7%
EU	609	599	570	580	763	875	14.7%
Japan	620	588	521	514	531	605	14.0%
Others	614	730	710	587	618	680	10.0%
Total	1,892	1,962	2,752	3,654	4,386	4,800	9.5%

Source: Vietnam Textile and Apparel Association (VITAS) www.vntextile.com

The growth rate of 9.5% in 2005 was significantly lower than the preceding three years. The overall increase in these years was, however, almost exclusively a result of the steep growth in the export to the US market in the years after the BTA was signed. An increase from almost nothing to USD 2.74 billion in 2004 or 56% of Vietnam's total garment export. The US quotas introduced in 2003 moderated the growth in 2005 to 6.7%. Competitors in China were faced with export quotas to the US market by the middle 2005. Only in the first part of the year, could Chinese products enjoy free entrance to the US market while most of its competitors had free access except the Vietnamese producers who were restricted the whole year limiting the growth to the agreed increases in the quotas decided under the BTA, because Vietnam had still not finalised its inclusion in the WTO. If we look at the overall garment import to the US market for 2004 and 2005 we have the results shown in Table 2.

Table 2 United States imports of apparel (in billions USD)

	2004	2005	Import share	
			2004	2005
Vietnam	2.562	2.725	4.0%	4.0%
China	8.928	15.143	13.8%	22.0%
Rest world	53.278	50.845	82.3%	74.0%
World	64.768	68.713	100%	100%

Source: Major Shippers Report: U.S. Imports by Category, September 8, 2006. Available at <http://www.otexa.ita.doc.gov/msr/catV1.htm>. Note import figures for Vietnam are a little different from the export figures shown in Table 1.

The increase in overall import of garment to the US market from 2004 to 2005 was close to 5.5%. The increase in imports from China was substantially higher in spite of the restrictions imposed during the year. Overall China increased its market share of garment imports to the US by more than 50% in 2005 taking away a substantial part of others exporters share taken together, meaning that many countries must have experienced an absolute decline in their garment export to the US market in 2005. Vietnamese producers together maintained their share with an overall increase of about 6.3% in the US import; a figure that shows the producers ability to compete within the overall allocated quota ceiling. Had they not been able to compete with China, the now unilateral ceilings posed on them would not have protected them.

The export in 2005 to the EU market where Vietnamese producers now had free access showed the highest increase that year of 14.7%; lower than the growth in 2004, but much higher than in the previous four years, when the export to EU was almost stagnant. The Chinese competitors were faced with restrictions which must have benefited Vietnam's producers. However, for Japan, a market with free imports from both Vietnam and China, Vietnam's export resurged with a 14% growth after a steep fall from 2000 to 2004.

The overall assessment of the trade data shows that 2005 did not see a stagnation of Vietnamese garment export but demonstrated a significant change in growth rates for the different main export markets. Vietnam appears to have been able to compete on freer market terms but first of all, the producers have been able to shift their production towards buyers on other markets than earlier where the US buyers were more

dominating. We will now look at the micro level of how garment firms have reacted and managed under the changed conditions in 2005.

Garment firms' performance and strategies

The survey of garment firms took place in spring 2006 where 270 garment export companies were randomly selected and sent a questionnaire about their export performance and strategy in 2005. As expected few companies returned the questionnaire on their own. The companies who had received the questionnaires were therefore directly approached and assisted in filling out the questionnaire. So far we have surveys results from 34 garment companies; 21 from the North region (Hanoi), 7 from Central and 6 from South (HCMC) and 74% of them have more than five years export experience. The respondents include 14 SOEs, 12 domestic private owned companies and eight companies with foreign ownership.³ In a strategic perspective it is important to note that the survey confirms that most firms supplied to several customers at different markets and also used different export modes. They sold for example both directly to overseas retailers predominant at the US market and to foreign buyers represented in Vietnam. Whether a result of strategic intention or not, the garment producers are included in global garment chains for various markets in different ways at the same time, and not locked in with a single buyer or at a single market. They obviously have a capacity to manage relations to different buyers and possess potentially a room for strategic maneuvering. On the other hand, the companies are still predominantly using foreign brands and their contracts assembly based (CMT) or in the low end of OEM activities. The use of active marketing efforts was not frequent and mostly limited to activities through trade promotion organisations.

When asked in what direction exports had moved in 2005 compared to 2004 within ten product groups to the four main markets (US, EU, Japan and other markets) the result was that on average export had grown in all categories at all markets except for two products for the Japanese market and one for other markets. Significant increases were most predominant for products exported to the US and EU markets. The increased level of exports in 2005 was accompanied by an expansion of the companies' capacity compared to 2004. A significant number of the firms has employed more permanent staff, increased their registered capital and their production capacity. On average the firms viewed their competitive position with respect to quality, delivery time and technology as better than comparable foreign companies but not with respect to price.

Trying to look into what changes had taken place from 2004 to 2005 with respect to production management and strategy of the firms, we asked about changes in their contract arrangements and materials sourcing. The preliminary assessment of the data shows predominantly constant arrangements with a tendency towards a little more advanced form of assembly and OEM contracts but when asked about their sourcing of

³ The survey was undertaken as part of a research cooperation project, the Vietnam-Denmark International Business research programme, where a team of researchers from Foreign Trade University (FTU) in Hanoi consisting of Mrs. Huong Pham Thu, Mr. Tien Dao Ngoc and Mrs. Hai Nguyen Thi Hong together with the author undertook the survey. The 270 garment export companies were randomly selected from the yellow pages website for businessmen-vietbig business directory www.vietbig.com.

materials and accessories they seemed equally dependent on their buyers as the year before. Asked about barriers for expansion of their business the answers from the firms showed that only the allocation of quotas (for the US market) and access to working capital were perceived significant.

Finally, the firms were asked directly about their strategies where the majority of firms pursued product upgrading, searched for new customers and markets and strengthened their design capabilities. They seem to be passive price takers with no intention of using price as a parameter, and there was no clear sign of a changing strategy with respect to sourcing of materials.

Conclusion

When we look at how Vietnamese garment firms have performed in 2005 after the MFA quota systems were abolished both the aggregated trade data and the firm level data confirm that their export has increased. What that precisely means with respect to their international competitiveness is not that clear because the international trade regime in garments continues to be characterised by interventions and restrictions. But in the present environment Vietnam has been able to continue its export expansion although at a lower rate and maintained its import share in its most important export market in the US. Although Vietnam has not been able to follow China's export increase and gain of market share, this nevertheless indicates that it has maintained its strong export development in 2005 while other countries must have lost.

With respect to the Vietnamese firms' position in the garment GVCs they are still clearly locked into low end CMT and OEM positions although they have strategic intents to use their design and product upgrading capabilities. Their strategic room for maneuvering is, however, most predominant with respect to their flexibility to shift their operation to serve new customers and new markets with new products. Their performance in 2005 clearly demonstrates that the garment firms are able to pursue these options successfully and expand their performance.

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