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Growing Pains in Vietnam

by Dennis J. Meseroll and Kendall K. Turner

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remain about the proliferation and storage of nuclear waste, about the availability of uranium for nuclear fuel, and about the potential link between nuclear energy production and nuclear weapons production; but these issues, although significant, should not slow down the advance of this technology.

Nuclear energy is a dependable, around-the-clock power supply that does not produce any greenhouse gases — making it the most scalable current power generation technology that does not contribute to global warming. Today, there are plans to build more than 200 new nuclear plants worldwide, although rising costs and supply chain problems are inhibiting the industry's growth.

6. The Private-sector Solution Myth: Industry alone can accomplish the energy shift.

Reality: This myth is the result of the mistrust that has grown in some developed countries, including the U.S., about the ability of government to play a positive role in resolving long-term economic problems. But although it is true that private entrepreneurs and corporations accomplish most of the world's innovation and R&D and operate many of its energy businesses, it is also correct that historically, major shifts in energy markets — France's embrace of nuclear power, Brazil's creation of a sugar-based ethanol industry, the rise of wind power in Denmark — were rooted in government policy choices. Given the magnitude of the challenge that the energy shift presents, it is clear that government decisions, public–private initiatives, and tax incentives will be necessary components in achieving major technological breakthroughs and building new energy infrastructure.

In short, the realities of energy in the late 2000s are contradicting perceptions and expectations from all quarters. The world has discovered in the last few years what some energy experts have been warning of for decades: Civilization's reliance on fossil fuels is, in the long run, unsustainable. At the same time, scientific consensus on the dangers of global warming has been reached. It cannot be ignored or dismissed: Humans need to sharply slow the growth of greenhouse gases to avoid irreparable damage to the environment. This will limit the options that companies and nations have to meet future energy needs. And it will accelerate the shift away from fossil fuels to more sustainable forms of energy.

Amid all the uncertainty about the future of energy, however, two things are certain: The energy shift is already happening, and it will continue. As it proceeds, this shift will transform the commercial, industrial, and consumer landscapes of the world throughout the 21st century. For business leaders, the status quo is not an option. The corporate energy policies that have been adequate in the past will be inadequate in the future.

Eric Spiegel
(eric.spiegel@booz.com) is a senior partner based in McLean, Va., who leads Booz & Company's work for global energy and utilities clients. He has more than 22 years of related consulting industry experience in leading major energy client assignments in Asia, the Middle East, Europe, and the United States.

Neil McArthur
(neil.mcarthur@booz.com) is an Amsterdam-based senior partner with Booz & Company who leads the firm's European energy, chemicals, and utilities practice. He has more than 24 years of industry and consulting experience and serves on the firm's Executive Committee.

Also contributing to this article was Booz & Company Senior Executive Advisor Bert Shelton.

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by Dennis J. Meseroll and Kendall K. Turner

Consider the double-edged sword hanging over Vietnam. For the past five years, the tiny emerging nation has been a favorite of foreign investors. Real foreign direct investment (FDI) in productive assets rose an average of 45 percent in both 2006 and 2007, reaching approximately US$20 billion. That's roughly one-fourth of comparable FDI in China, a country with a nominal GDP 46 times that of Vietnam's.

Concerned about the commercial risks — and growing costs — of concentrating their entire Asian operations in China, many multinationals adopted a "China plus one" investment strategy, opening facilities in at least one non-Chinese Asian location to balance their manufacturing footprint. Vietnam has become the second-choice nation for more and more companies. For example, Canon and Nissan are expanding their existing operations in the country, and Hanesbrands is setting up two new apparel factories. One of the main reasons for these moves: Manufacturing workers in Vietnam are paid about $110 per month, including benefits; in popular Chinese regions like Dongguan and Shenzhen, wages range from $180 to $232.

But all this positive news has come at a significant cost to Vietnam. The surge in FDI overheated the economy, causing a boom in imports; the subsequent inflation was worsened by speculators. With so much investment powering the economy, Vietnamese authorities faced pressure in early 2008 to minimize inflation by strengthening the nation's currency, the dong, primarily through higher interest rates. Authorities were reluctant to take this step, however, because the depressed dong, kept low artificially, ensured the competitiveness of Vietnam's exports. Hence, instead of tackling the threat of rising prices, Vietnamese financial chiefs issued new dong to buy U.S. dollars in hopes of devaluing the nation's currency even more. This boosted overall liquidity and loosened the credit markets, which, in turn, fueled further speculative investment and consumption and brought a fresh round of inflation.

Multinationals with the foresight to remain in Vietnam during its current dark period will find their patience rewarded.

Consumer prices took off throughout 2008, hitting a new peak in July when they increased 27 percent year-over-year, with food registering the highest rise, at 45 percent. Wages rose as well, up as high as 20 percent in the first half of 2008, according to Citibank.

As if the situation weren't bad enough, Vietnam's young stock market also holds the dubious honor of being the worst performer worldwide in the first half of 2008. The index gained 23 percent in 2007, but fell 59 percent between January and June — largely because of the belated efforts of the central bank, the State Bank of Vietnam, to reduce liquidity by increasing bank-deposit and lending rates after having kept the rates unchanged for more than three years. Local investors pulled their money out to cover short-term borrowings or to protect themselves from the worsening correction in share prices, while domestic and foreign investors alike found their ability to participate in the market constrained by the State Bank's rules requiring local banks to provide funding for the purchase of equity shares. Vietnam's 2008 GDP will likely fall below the government's revised estimate of 7 percent, after having risen nearly 9 percent in 2007.

All of this has begun to interfere with the plans of some multinational companies that at one time looked to Vietnam as a refuge from higher costs in China. For example, Nippon Light Metal Company has canceled construction of an aluminum hydroxide plant in Vietnam that was originally slated to open in 2011 because of the escalating prices of construction and raw materials. And Samsung Electronics, although still committed to opening a new cell phone handset facility in Hanoi, has slowed its hiring efforts because fewer capable Vietnamese are willing to work for the inflation-battered dong.

Still, Vietnam's troubles represent an opportunity for multinational firms. As the nation's speculative investment bubble bursts, real estate and construction costs will decline along with inflation. The Vietnamese government will then be able to resume public outlays for the infrastructure projects necessary to support foreign participation in the economy and sustain real long-term growth. In the wake of these events, foreign investors will be able to capitalize on a market that is again hungry for jobs and products to purchase. Onetime costs for real estate and facilities will be significantly reduced from today's historic levels, and negotiation of investment incentives packages with the government or acquisition of local companies will be significantly easier and more cost-effective. In short, multinationals with the wherewithal and foresight to remain in Vietnam — or to go there for the first time — during its current dark period will find their patience generously rewarded.

Indeed, there is precedent for this in the region. Prior to 1997, Asia attracted almost half of the FDI flowing into developing nations. Thailand, Malaysia, Indonesia, the Philippines, Singapore, and South Korea all experienced annual GDP growth greater than 8 percent during the late 1980s and early 1990s. The growth was so spectacular that the phenomenon was dubbed "the Asian economic miracle."

These fast-growing countries, much like Vietnam today, were heavily dependent on exports, had large current account deficits, and produced few productivity gains. Then came the 1997 crash. Currencies across Asia collapsed; in Thailand, for instance, the baht lost more than half of its value. Banks were shuttered as borrowers defaulted on loans and most investors sought shelter elsewhere. Indonesia, Malaysia, the Philippines, Singapore, and Taiwan experienced an average inflation rate of approximately 15 percent that year — as compared to Vietnam's present rate of 27 percent. GDP across the Asia-Pacific region, which had grown 7.5 percent in 1996 and 6.1 percent in 1997, fell to approximately 4 percent in 1998.

Some of the countries tried to raise interest rates to cool down their economies, but even that failed to attract the capital needed to prevent additional economic hemorrhaging. Consequently, the International Monetary Fund offered the most deeply affected economies a series of bailout packages on the condition that they institute wide-ranging economic reforms, including changes designed to eliminate monopolies, trade barriers, nontransparent corporate practices, and other impediments to growth, as well as instituting new efforts to protect social spending and monitor the financial system.

Eleven years after the crisis, the region overall is far wealthier and has fewer people living in poverty than ever before. The rate of this recovery, however, varied widely. South Korea was the first country to exceed its pre-crisis peak level of per capita GDP, at the end of 1999. Malaysia and Thailand followed in 2000. Economic growth rates for developing countries in East Asia hit 10.2 percent in 2007; the current global slowdown will likely reduce this figure to approximately 8.5 percent in 2008, the region's lowest growth rate since 2002 — but still a very healthy number.

As the economies of Southeast Asia recovered, a formerly distressed Thai facility became Chemdal's most profitable plant.

Significantly, the multinational companies that moved into these markets immediately after the crash were able to capitalize on reduced costs of doing business in a market desperate for jobs, construction work, and investment. To cite one example: U.S. minerals producer AMCOL, through its subsidiary Chemdal (since acquired by the German firm BASF), invested in a superabsorbent polymer manufacturing plant in Thailand in late 1997. The company purchased industrial land for 30 percent less than the standard asking price from a domestic company that needed to quickly sell surplus property. In this atmosphere of economic uncertainty, experienced employees were easier to recruit and hire, and, because the Thai government was eager to court investors, the investment incentives application and approvals process was accelerated. As Southeast Asia's economies recovered, this formerly distressed facility became Chemdal's most productive and profitable plant. Chemdal also aggressively entered the post-crash Korean market, which had lifted many of its restrictions against foreign acquirers, by purchasing a domestic bentonite mineral processing company for 20 percent of its former value.

Vietnam's situation is likely to be less severe than the 1997 crisis. Unlike the other former Asian tigers, Vietnam has very little short-term foreign debt. This means Vietnam will have substantial resources to at least stave off the worst effects of currency flight, stock market collapses, corporate bankruptcy, and other random shocks. Also, much of its trade deficit follows naturally from the massive inflows of FDI in the past two years, which will strengthen the country's long-term economic health. Capital outflows are relatively restricted, because the dong is not convertible; also, the Vietnamese currency is not floating as Thailand's baht was before it plunged. Moreover, despite the decline in Vietnamese stocks this year, foreign investors have been net buyers of local shares.

Perhaps the greatest reason for optimism is the Vietnamese government's efforts to put the country on the fast track to asset price correction. Without an international bailout, but learning from the experience of countries that survived the 1997 debacle, Vietnamese authorities have raised interest rates three times this year to tame inflation; projects funded by government bonds, state-owned enterprise activities, and government overhead have all been reduced; and the State Bank has provided more U.S. dollars to local banks to stabilize illicit exchange rates, a move that has lowered black-market dong–dollar exchange rates from their June 2008 peak of 20,500 to 16,800 in September. With the rise in interest rates and the consequent decrease in liquidity, consumer spending and property prices have begun to fall significantly. Hence, it is believed that inflation has already begun to cool down.

Manufacturers producing for the local market and dependent on imported components will suffer the most now. As the dong weakens, these companies' profits will fall because of both the increasing costs of materials and the decreasing purchasing power of their revenues. In the short term, multinationals should instead focus on exporting higher-value-added products from Vietnam and developing a skilled labor pool that will eventually be able to manufacture products for local as well as foreign markets. Talent is a scarce resource in Vietnam, and without it a company will be unable to take advantage of the country's imminent future economic growth.

Service industries that are dependent on local market demand or that have relatively high exposure to the real estate sector will also pay a steep price during this downturn. Architecture and engineering firms, advertising agencies that specialize in financial services and real estate, and the real estate and financial-services industries themselves will be the hardest hit. By contrast, companies that can export their services or that begin to develop such operations, including the software development and design and engineering companies that are clustered around Ho Chi Minh City, are in the best position to weather this period and look forward to a lucrative future.

Dennis J. Meseroll
(dmeseroll@tractus-asia.com) is a director of Tractus Asia Limited, a firm that focuses on Asian startup investments, acquisitions, and market opportunities.

Kendall K. Turner
(kendall@tractus-asia.com) is a research analyst at Tractus.

The Eco IT Solution

by Hugo Trepant, Gavin Chow, and Edward H. Baker

Let's face it: Few large companies doing business in a highly competitive world are willing to invest in reducing environmental impact without short-term competitive benefits. But consumers are forcing them to pay more attention to the planet. People are more eco-conscious than ever, and are demanding that the products they buy be more environmentally friendly. Indeed, according to a 2008 survey conducted by market researchers Information Resources Inc., more than half of U.S. consumers take into account at least one sustainability factor, such as whether a product is organic or packaged in an environmentally friendly way, when shopping for their household. And it's not just less-wasteful packaging that people are looking for. They want to know whether a product is manufactured using sustainable or recycled materials, and are eager to learn the effect on the environment of the manufacturing process itself. In response, corporations have tried to cast themselves as being sensitive to the environment. Many are working to lower their energy use and to find sources of raw materials that follow sustainable resources practices. And at least a few companies are participating in global campaigns intended to mitigate adverse effects on the environment, such as carbon trading. Much of this response, however, has been limited to activities that can rapidly cut costs, a somewhat narrow way of viewing the problem.

Case in point: the corporate IT department. Over the past five years or so, environmental awareness on the part of IT executives has risen dramatically. Corporate buyers demand energy-efficient hardware, and manufacturers are responding with chips and servers that require far less power to operate. The level of toxic materials in equipment has been drastically reduced, and recycling of old computer equipment has increased significantly among cor-

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