

“Preservation”

Data Center Service Expansion Strategy in Vietnam

Hideki Takagi
Yoshiyuki Oba

OVERVIEW: Noting an increase in enquiries about offshore support, Hitachi Information Systems, Ltd. established a Global Strategy Promotion Office in its Corporate Strategy Division in April 2008 with the objective of extending its business globally by actively expanding its overseas operations through an international strategy that uses the international procurement it has conducted to date as a base. Vietnam is second only to China in the attention it has gained as a base for manufacturing. Although its IT market is expanding, albeit from a low base, the current focus is mainly on local demand for hardware and exports of software. The domestic market for IT services is still underdeveloped. In response, Hitachi Information Systems, Ltd. has looked to Vietnam as a model case for the global expansion of its business with the aim of encouraging the broader adoption of IT services through its core business.

INTRODUCTION

NOI BAI airport is the gateway to the northern part of the Socialist Republic of Viet Nam. Traveling from the airport into central Hanoi, after first passing through rural countryside that reminds the traveler of the Tohoku region in Japan, one comes upon a large complex of Japanese industrial businesses. These scenes give a glimpse into the double-sided nature of

Vietnam, a country that is seeking economic growth through industrialization while still remaining an agricultural country. That Japanese companies, particularly manufacturers, have come to Vietnam in search of cheap labor has long been a talking point. Although factors such as the rise in the consumer price index and the worldwide economic recession that arose in the USA are casting a shadow over



Fig. 1—Scenes from Hanoi, Ho Chi Minh City, and Mekong Delta Region in Vietnam.

Scene outside a Hanoi eatery (a), power lines in Hanoi (b), street scene near Ben Thanh market in Ho Chi Minh City (c), view of Ho Chi Minh City from the offshore development center of Hitachi Information Systems, Ltd. (d), and travel by boat in the Mekong Delta region (e) (Photographs were taken during 2008).

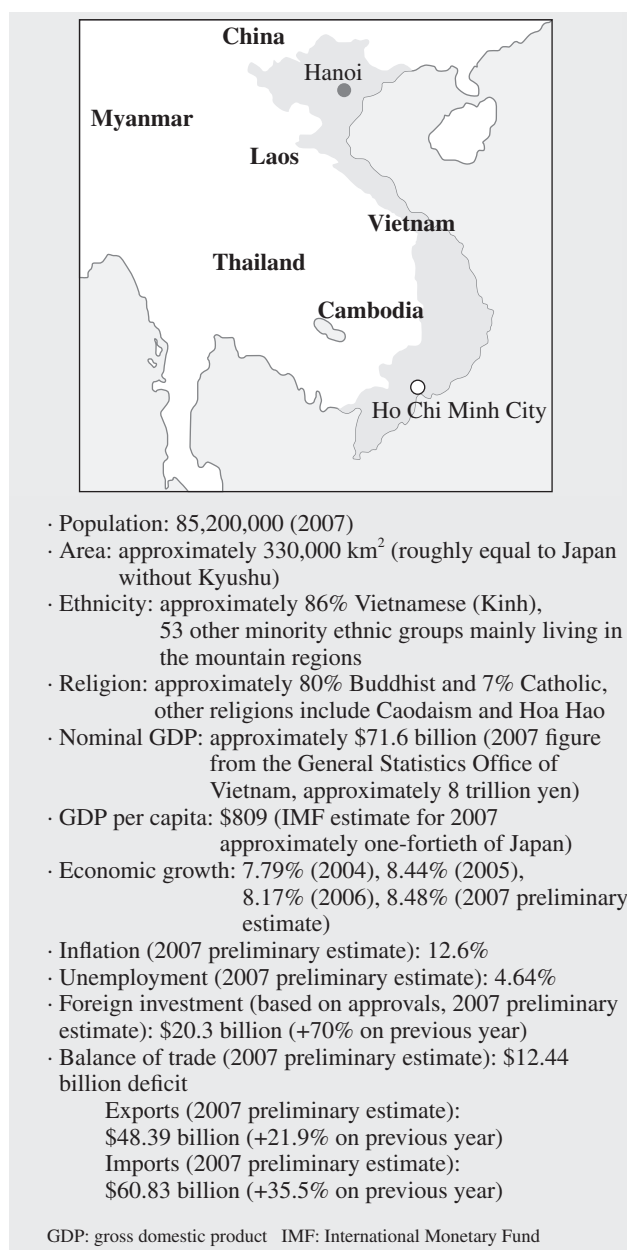


Fig. 2—Key Facts about Vietnam.

A map of Vietnam and a list of key facts are shown. The capital Hanoi in the North is the political center of the country whereas Ho Chi Minh City in the South is its economic heart.

this growth, the level of foreign investment remains strong. Given the broad agreement reached on an Economic Partnership Agreement between Japan and Vietnam in September 2008, the country will remain one to watch for Japanese companies in the future (see Fig. 1).

This article considers Hitachi Information Systems, Ltd. (HIS)'s view of the emerging economy of Vietnam and describes how it hopes to go about establishing an IT (information technology) services business.

TABLE 1. Top 10 Sources of Actual Direct Investment into Vietnam
In addition to development aid from Japan, Vietnam receives direct investment from numerous different countries.

No.	Source of investment	No. of projects	Total investment*	Capital*	Actual commitment*
1	Japan	1,004	16.9	4.8	5.1
2	Singapore	597	15.2	5.2	3.9
3	Taiwan	1,884	19.3	7.6	3.1
4	South Korea	2,022	15.2	5.6	2.8
5	Hong Kong	492	6.3	2.3	2.2
6	The Netherlands	94	2.6	1.5	2.0
7	British Virgin Islands	371	10.9	3.7	1.4
8	Malaysia	272	7.9	3.0	1.1
9	France	206	2.4	1.4	1.0
10	Thailand	182	5.7	2.3	0.8
Total (including other sources)		9,368	1,306.8	48.8	29.3

Source: Documents from the Hanoi Center of the Japan External Trade Organization and data from the Ministry of Planning and Investment (from 1988 to December 19, 2008)

* billion dollars

VIETNAM AS MODEL EMERGING ECONOMY

Brief History of Vietnam and Its Relationship with Japan

The origins of Vietnam as a nation are said to be in the Bronze Age culture of the Red River Delta region around the 6th century BC (before Christ) and since that time the country has a long history as a subject nation under various Chinese dynasties and later French rule.

Although Vietnam gained independence after the end of the Second World War in 1945, circumstances related to the Cold War led to the country being split into North and South. Its current status as the Socialist Republic of Viet Nam was established in 1976, the year after the end of the Vietnam War. After that, the country became isolated from the rest of the world for a time during the Third Indochina War. In 1986, the 6th congress of the Communist Party of Vietnam adopted the Doi Moi policy of incorporating market economics into socialism whereby reform and liberalization of the economy was undertaken under the direction of the state. Vietnam became a member of Association of Southeast Asian Nations (ASEAN) in 1995 and joined the AFTA (ASEAN Free Trade Area). In 1996, the objective of becoming an industrial country by 2020 was formally adopted. Other active measures taken to encourage market liberalization include joining the World Trade

TABLE 2. Trend in Corporate Membership of Japanese Business Associations in Vietnam

In October 10, 2008, a Japan Business Association was established in the central-region city of Da Nang, joining the existing associations in Hanoi and Ho Chi Minh City. In addition to its 418 full members, the Japan Business Association of Ho Chi Minh City (JBAH) also has 31 companies that have joined as associate members.

(No. of companies)

(Fiscal year)	2000	2001	2002	2003	2004	2005	2006	2007	2008
JBAV	115	109	123	132	145	166	199	246	335
JBAH	212	231	242	254	264	275	311	358	418
JBAD	–	–	–	–	–	–	–	–	37
	327	340	365	386	409	441	510	604	790

JBAV: Japan Business Association in Vietnam

JBAD: Japan Business Association of Da Nang

Source: Documents from the Hanoi Center of the Japan External Trade Organization

TABLE 3. ICT Industry in Vietnam (2002 to 2006)

The level of the ICT (information and communication technology) industry in Vietnam is still low.

(million dollars)

	Software and services			Hard-ware	Total
	Domestic market	Outsourcing/export	Sub-total		
2002	65	20	85	550	635
2003	90	30	120	700	820
2004	125	45	170	760	930
2005	180	70	250	1,150	1,400
2006	255	105	360	1,380	1,740

Source: Ho Chi Minh City Computer Association (2007)

Organization (WTO) in 2007.

Economic cooperation with Japan was restored in November 1992. The ODA (official development assistance) aid budget reached a total of 105,300 million yen in 2007, including yen loans, grant aid, and technical assistance. This makes Japan currently the largest aid donor to Vietnam. Fig. 2 gives a summary of key facts about Vietnam.

Arrival of Japanese Companies

Looking at recent economic conditions in Vietnam, although macroeconomic risk factors are evident, including the bursting of the bubble in real estate and stock prices, and inflation caused by economic overheating and excess liquidity due to inflows of foreign capital, the potential for growth and the existence of a cheap but high quality labor supply are attractive to foreign businesses and the “second Vietnam investment boom” continues. In

2008, approvals for direct investment by foreign companies were granted in 1,171 cases, reaching a new record of \$60.3 billion (compared to a peak of \$9.8 billion in 1996 during the first Vietnam investment boom between 1994 and 1998). Of these, 105 applications totaling \$7.3 billion were for new investment by Japanese companies.

As of 2008, the cumulative total of actual foreign direct investment was \$29.3 billion. Broken down by country and region, the \$5.1 billion of actual investment from Japan made it the largest source of investment, indicating that Japanese companies have a relatively strong presence in Vietnam (see Table 1). After Japan, the next largest sources of investment were \$3.9 billion from Singapore (second highest), \$3.1 billion from Taiwan (third highest), \$2.8 billion from South Korea (fourth highest), and \$2.2 billion from Hong Kong (fifth highest). The top five sources of investment accounted for approximately 58.4% of total investment.

Approvals for direct investment by Japanese companies were on a rising trend between fiscal 2000 and 2008, with investment primarily targeted at manufacturing in the North and South. The number of companies with membership of the Japan Business Associations in Vietnam has been rising since 2000 reaching a total of 790 companies. This total includes 335 companies belonging to the Japan Business Association in Vietnam, 418 companies belonging to the Japan Business Association of Ho Chi Minh City, and 37 companies belonging to the Japan Business Association of Da Nang (see Table 2). In terms of industry categories, automotive and electrical parts manufacturing makes up more than half of activity in the North whereas textiles, clothing, and food processing tend to be concentrated in the South.

State of ICT in Vietnam

The ICT (information and communication technology) industry in Vietnam is still in its infancy, and when compared to elsewhere in the Asia region its level is below that of countries like Singapore, Malaysia, and China. A 2007 survey of the ICT market by the Ho Chi Minh City Computer Association put its size at only about \$1.7 billion in 2006 (see Table 3). Given the immaturity of the ICT industry, the Vietnamese government has been active in building infrastructure and fostering the ICT industry and associated human resources with a central role to be taken by leading players in government, industry, and academia based

on the “Strategy on Vietnam information and communication technology development till 2010 and orientations towards 2020” (Prime Minister’s Decision No. 246/2005/QD-TTg of Oct 6, 2005), and over a short time period the government has put in place measures including the enacting of an information technology law (in January 2007), the promulgation of guidelines on the associated detailed rules (in May 2007), and the establishment of law on intellectual property rights. The future outlook for Vietnam includes healthy economic benefits from foreign direct investment, the kick starting of a new ICT industry particularly amongst the younger generation, and a rise in private business. These indicate that the country’s potential for growth will remain strong.

GLOBAL STRATEGY OF HITACHI INFORMATION SYSTEMS

Changes in Global Strategy

Established in 1959, Hitachi Information Systems, Ltd. celebrated its 50th anniversary in June 2009. Throughout its existence, the company has been providing data processing services to customers in Japan. As globalization has led to increasing numbers of its customers expanding internationally, the company has experienced increasing demand for services to overseas operations as well as in Japan. Despite this, the proportion of the company’s total sales accounted for by overseas sales was still less than 1% as of the end of the 2007 fiscal year. In response, the company has taken up the challenge of entering fields in which it has no past experience and shifted from a global strategy based primarily in IP (international procurement) to one that will deliver greater growth. A Global Strategy Promotion Office was established in the Corporate Strategy Division in April 2008 to act as a planning and operations department dedicated to handling overseas business.

Globalization Policy and Region Selection

The following three key policies were established to promote global business operations (see Fig. 3).

(1) Business collaboration with local partners

Business collaboration are to be undertaken with trustworthy local partners.

(2) Separate business models for emerging and developed countries

The services to be offered by the company were restricted based on different business models respectively for emerging and developed countries.

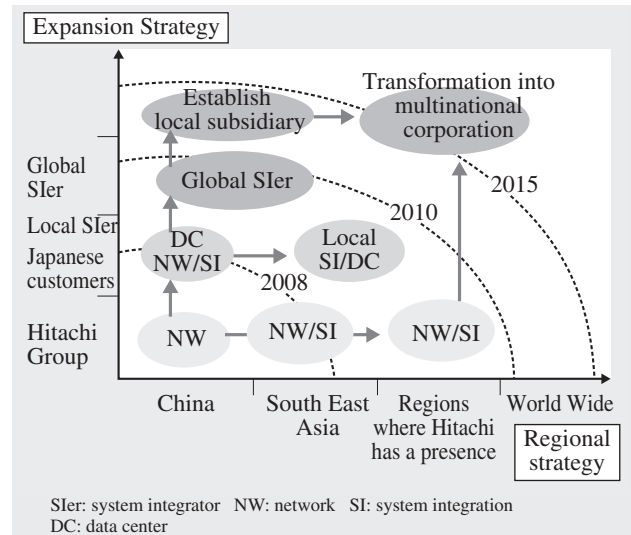


Fig. 3—Global Expansion Concept.

The overall CAGR (compound annual growth rate) of 22% is strong, particularly for software which has a growth rate of 33%. The basic policy was to formulate a strategy based around Hitachi’s NW, SI, and DC service business framework.

The focus in emerging economies is on infrastructure, including IT, whereas the aim in developed countries is to expand business based on advanced technology.

(3) Closer Partnership with the Hitachi Group

After working with the International Strategy Division at Hitachi, Ltd. to collect information from Crossborder Japan Co., Ltd., with whom an outsourced consultancy contract was agreed, Japan External Trade Organization (JETRO), Center of the International Cooperation for Computerization (CICC), and elsewhere, we decided to place the primary focus for its emerging economy model on Vietnam which, despite the underdeveloped state of its ICT market, has advantages that include a strongly growing economy, a positive attitude toward Japan, and political stability.

Partners in Vietnam

HIS started using the FPT Software Joint Stock Company (F-Soft) in Vietnam as a software supplier in 2005. F-Soft is an export-oriented software development company affiliated with The Corporation for Financing and Promoting Technology (FPT), a large corporate group in Vietnam.

In addition to F-Soft, the FPT group also includes FPT Information System Company Ltd. (F-Is), a company that supplies data processing services inside Vietnam. The services supplied domestically by F-Is are similar to those offered by HIS and it

was identified as a suitable Vietnamese partner based on past procurement dealings with F-Soft and the similarity of the companies' businesses. Partnership-related activity has already started aimed at establishing a relationship of trust between the companies.

Partnership Proposal

Since 1997, F-Is has grown in step with the IT market, expanding its business through sales of hardware and Microsoft Corporation products, and through software development and associated maintenance, primarily for local finance-sector companies. In recent years, it has responded to the arrival of foreign businesses by lifting its sales to multinational corporations as well as domestic companies.

After collecting information indicating that the focus of parent company FPT was on operating data center as a service as well as hardware sales and software development, HIS proposed a business collaboration in the data center sector that is the core business of HIS. Before commencing the service, contact was maintained on a twice-monthly basis to deepen mutual understanding, including visiting the data center operated by F-Is and holding meetings on site and via videoconferencing.

At the time, a housing service (known as "colocation") was supplied by the F-Is data center. Hitachi proposed the creation and pioneering of new Vietnamese markets by supplying its own monitoring and operations technology to expand the range of services offered and this led to the agreement of a memorandum of understanding on the business collaboration in December 2008.

INITIATIVES FOR EXPANDING SERVICES

Vietnam Strategy

Data centers are the core business of HIS and the memorandum of understanding agreed by the companies establishes this sector as the main area of activity, with the joint venture initially to involve the supply of data center management and operations technology. The next step is to extend the business collaboration into other solution fields while maintaining the good relationship with F-Is and FPT.

In the area of sales in particular, the plan is to establish a clear division of responsibility for marketing with FPT utilizing its contacts in the Vietnamese government and state sector businesses, and with HIS dealing with Japanese companies in

Japan while F-Is is responsible for operations in Vietnam.

Establishing a cooperative relationship between Hitachi and FPT Group is also important and this joint venture is to be used as an opportunity to undertake activities that will boost gains from synergy.

Expanding into Other Regions

While using Vietnam as a base from which to expand the data center business into the Southeast Asia region, Hitachi also has active plans for further business expansion and is continuing to collect information about partners and markets in other regions such as India and the Middle East.

CONCLUSIONS

This article has considered HIS's view of the emerging economy of Vietnam and how it hopes to go about establishing a data processing services business.

Hardware makes up approximately 80% of the ICT market in Vietnam while the information services sector is still underdeveloped. As the process of fleshing out a business plan for this market is strongly influenced by economic trends, HIS plans to keep a close eye on the situation as it expands its operations. Having established a business in the mature domestic market of Japan, HIS is now seeking through this new joint venture to work with a partner to establish and pioneer developing market. HIS will continue to maintain a relationship of trust, substantiate each individual issue, and conduct itself in a way that allows Vietnam and both companies to share in the benefits.

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ABOUT THE AUTHORS**Hideki Takagi**

Joined Nippon Business Consultant Co., Ltd. (currently Hitachi Information Systems, Ltd.) in 1984, and now works at the Global Strategy Promotion Office, Corporate Strategy Division. He is currently engaged in the business plan in the Asian rising countries.

**Yoshiyuki Oba**

Managing Director, Crossborder Japan Co., Ltd. Started his career at the Japan Finance Corporation for Small and Medium Enterprise, and then worked at the Embassy of Japan in Vietnam, Sanwa Research Institute Ltd. (now Mitsubishi UFJ Research and Consulting Co., Ltd.), and Tokyo Small and Medium Business Investment & Consultation Co., Ltd. In April 2008, he became the Managing Director of Crossborder Japan Co., Ltd. He is a senior research analyst at The Japan Economic Research Institute, a visiting research fellow at Waseda University's Vietnam Research Institute, a charter member of TiE (The Indus Entrepreneurs) Tokyo, etc.