



**CANON VIETNAM: IS NEW JAPANESE INVESTOR  
CONFIDENCE IN VIETNAM WARRANTED?**

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## **Background**

In the early 1990's, Vietnam enjoyed solid corporate investment from Japan. Then, in 1997 and 1998, the emergence of the Asian Financial Crisis created an unstable investment environment that forced Japanese investment in Vietnam to slow<sup>13</sup>.

In early 2001, Japanese investment began to re-emerge. Canon Vietnam, a subsidiary of the Japanese company Canon, made a bold move in April 2001 to invest in a US\$76.7 million project for inkjet printer assembly in Hanoi. According to Canon, this was a strategic move to "diversify the company's Asian production base"<sup>10</sup>. Then, on January 24th, 2005, Canon announced its plans to build the largest laser printer plant in the world to be located in the Que Vo Industrial Zone in the northern province of Bac Ninh<sup>22</sup>. This paper examines Canon Vietnam's incremental investments in Vietnam between 2001 and 2005 in an attempt to better understand whether greater Japanese investor confidence in Vietnam is now warranted.

## **Printer Market Prior to 2001**

### ***Demand for Printers***

Leading up to 2001, Japan's laser and inkjet domestic printer markets were increasing at double-digit rates per year. Between 1998 and 1999, Japan's laser printer market increased 14.5% and reached 1.11MM units (EXHIBIT A). In that same time period, Japan's much bigger inkjet printer market reached 4.9MM units (up 46% from the previous year) and was expected to double by 2004 (EXHIBIT C). In total, Japan's printer market reached 407.5B yen in 1999 (up 18.7% from 1998)<sup>1</sup>.

In Japan and around the world, the submarket called "color printers" showed especially high potential. Up 50% from 1999, Japan's color printer shipments reached 120K units in 2000 and were expected to increase roughly 400% by the year 2003. Likewise, the world's color printer shipments were expected to increase from 546K units in 1999 to 2.75MM units in 2003 (also an increase of over 400%). By 2003, forecasts predicted Japan would account for 16% of the world's color printer market.

### ***Driving Factors of Demand***

Lower retail prices, increased demand to print images from home computers and digital cameras, and increased bundling of printers and computers at the point of sale, all contributed to the significant momentum of the printer market leading up to 2001. In 2000, 70% of PCs sold in Japan were bundled with inkjet printers<sup>2</sup>. Serving as yet another signal that demand for inkjet printers was on the rise, overall demand for digital ink was expected to rise 10% annually from 1999 to 2004.

The Freedonia Group, an Ohio market research firm, predicted that overall demand for ink would reach \$5.6B by 2004<sup>3</sup>.

### ***Canon's Prospects***

Canon was the leading producer of laser printers in Japan in 1999, with a 29% market share, (EXHIBIT B) and the world's leading producer of laser printers with a world market share of 60% going in to 2001<sup>4</sup>. In Japan's inkjet printer market, Canon had a 32% market share in 2000 and ranked only behind Seiko Epson (EXHIBIT D). Because of Canon's exceptional printer sales in the beginning of 2001, Canon was able to surpass its 1Q01 goals by 86%. With a ripe and growing market and strong positioning in the industry, Canon's management decided to prepare for the much anticipated growth in sales (and simultaneously reduce risk) by producing a new printer factory in Vietnam.

### **Vietnam Environment Prior to 2001**

#### ***Vietnamese History***

Since the departure of US armed forces in 1973 and the unification of the Vietnamese government in 1975, Vietnam's conservative economic policies constrained Vietnam from reaching its potential. Nevertheless, Vietnam's GDP doubled between 1991 and 2000. In this same time period, the industrial sector grew at an average rate of 11.2% per year and its share of GDP increased from 24% to 37%<sup>5</sup>.

Despite the global recession around the turn of the century, Vietnam experienced a modest increase in GDP between 1999 and 2001 as a result of structural reforms which encouraged investment in the country. Under this setting, in 2001, Vietnam's newly elected political party reaffirmed Vietnam's commitment to economic liberalization and continued to implement many more of these reforms<sup>6</sup>.

#### ***Reforms & Transformation***

One of Vietnam's most impressive economic accomplishments occurred in 2001 when the US-Vietnam Bilateral Trade Agreement was signed. As a result of the BTA, US tariffs on Vietnam were made equal to US tariffs on most favored nations (e.g. Europe, Japan, and other WTO members). This sign of encouragement by a leading WTO economy acknowledged Vietnam's reform efforts and achievements. As mentioned above, Vietnam also announced a multi-year reform program in 2001. Supported by the World Bank's Poverty Reduction Support Credit and the IMF's Poverty Reduction and Growth Facility, Vietnam's reform program vowed to liberalize its trade and investment rules, lower tariffs, and improve transparency.

Although FDI inflows had increased twenty-fold in the 1990's, both the US BTA and the multi-year reform program significantly increased the prospects of continued growth of FDI in Vietnam. By May of 2001, FDI in Vietnam reached \$882MM (2.5 times the corresponding period in 2000)<sup>7</sup>.

### ***World View of Vietnam***

Leading up to 2001, as indicated by Vietnam's poor corruption index (EXHIBIT E), lack of transparency still persisted in Vietnam. As an example of the many hurdles still left to climb, the 2001 Global Corruption Report stated that, "according to the police, only 79 out of the 14,200 cases of smuggling, trading in illegal goods, and tax avoidance reported in 1999 were brought before the courts."

Nevertheless, sentiments around the world were positive regarding Vietnam's investment environment. Vietnam's lower cost of labor (30% less than in southern China), higher worker productivity, solid infrastructure, political stability, and central location made Vietnam an attractive option and a great way to diversify risk away from China and other, more-traditional, Southeast Asian manufacturing options. As stated by the World Bank's Vietnam Country Director in 2001, Andrew Steer:

*With the current progress in policy reform, Vietnam should become an appealing Southeast Asian market to foreign investors... [I strongly believe] in the success of Vietnam's determination to remove obstacles standing in the way of sustainable economic development and a favorable investment environment.*<sup>8</sup>

### **Canon's Initial Investment**

Major evidence of the return of Japanese investor confidence occurred in early 2001, when Canon Vietnam made plans to enter into a US \$76.6 million project to assemble inkjet printers in the Thang Long Industrial Park in Hanoi<sup>9</sup>. Canon Vietnam stated that this was part of its plans to expand inkjet assembly in Asia, with similar development plans in the works for China as well. The initial aspects of the deal were to lease 20 hectares for a factory that would allow for 600,000 of monthly printer capacity intended solely for export<sup>10</sup>. At the time, this was the "largest project licensed into a Hanoi Industrial Park in four years."<sup>9</sup>

In 2001, Vietnam was beginning to see foreign direct investment in its Hanoi industrial parks, specifically the Thang Long Industrial Park (IP) which was designated exclusively for Japanese investment<sup>11</sup>. Legal changes helped to make a more investor-friendly context for IP investment. In October of 2001, Vietnam passed an amendment to the country's land laws that allowed for the right for foreign invested companies to purchase land along with land use rights, giving the companies the ability to mortgage the land to Vietnamese banks<sup>12</sup>. Additional reductions in

administrative bureaucracy, particularly with licensing of foreign investment projects, also contributed to foreign interest in the IPs. Canon Vietnam received its license for the 2001 project from the ministry after only seven days, a record time that sent shockwaves through the FDI community. This was an important signal to the market about the Vietnamese government's serious focus on tackling much needed administrative reform and liberalization of the domestic investment climate.

Canon's initial decision to invest in Vietnam was motivated by the company's need to effectively diversify risk. In order to avoid over-concentration in China, Canon hoped to hedge its risk by investing in Vietnam, betting on the slow but steady improvements in the country's investment environment. Canon saw Vietnam as a socially and politically stable environment with lower labor costs than competing Asian countries. Vietnam offered easy access to skilled workers at low wages, with labor costs 30% lower than in southern China.<sup>13</sup> Vietnamese workers work on Saturdays, and take less national holidays than workers in competing Asian countries, adding additional value. More workers spoke English than in China or Thailand, and defect rate of products were found to be similar to those at plants in Japan. Vietnam also offered a consumer market of 80 million people for future expansion<sup>14</sup>.

In 2002, Transparency International ranked Vietnam as the second most corrupt country in South-East Asia. Despite such risk, Canon made a bet that the government was serious about making needed improvements. As government slogans made clear, "to preserve its power, it must relinquish some"<sup>15</sup>. China's entry into the WTO put significant pressure on the Vietnamese government to speed up the reform process for foreign investment<sup>16</sup>. Across Vietnam, leaders made increasingly vocal claims suggesting a favorable attitude towards stopping corruption as a result of its effects on the strength of their authority. In 2002, Truong Van Cam and 154 other co-defendants were tried under accusations of widespread corruption. Two of the defendants were removed from the Vietnamese Communist Party<sup>17</sup>. In July 2004, Vietnam signed an action plan as part of the ADB-OECD Anti-corruption Initiative for the Asia-Pacific. This initiative included plans for local governments to be able to take constructive action against bribery and promote integrity. The initiative complemented other reforms to make government heads more accountable and policy and procedure transparency<sup>18</sup>. Such evidence justified Canon's claims that Vietnam was making a serious effort to battle corruption.

The Vietnamese investment environment was also showing marked improvements, as Vietnam became a member of the World Intellectual Property Organization. Furthermore, under Vietnam's

agreement with the BTA (Bilateral Trade Agreement), the country was obligated to form its own system of protecting and enforcing intellectual property rights in compliance with the TRIPS agreement of the WTO. In 2001, the Vietnamese government issued a new resolution to open the real estate, import services and domestic distribution sectors to foreign investment. Under new strict laws protecting intellectual property rights, organizations and individuals faced fined of VN\$1-3 MM, an increase from earlier fines of VN\$0.5-2 MM. As another major step to battle intellectual property issues, Vietnam entered into its 8<sup>th</sup> round of negotiating to enter into the WTO in June 2004. During this process, Vietnam agreed to comply with the WTO's Trade Related Aspects of Intellectual Property Rights<sup>19</sup>. By April 2003, Vietnam had attracted US\$39 billion of foreign direct investment, due in part to its increasing emphasis on greater enforcement of intellectual property rights<sup>20</sup>.

Vietnam made great efforts to improve upon its investment environment to encourage a return of Japanese investment. Canon Vietnam's entry into Vietnam in 2001 was a positive signal to other multinational corporations, and clearly helped to establish a major successful investment project in the country. In April of 2003, Canon Vietnam reported revenues of US\$24.5 MM from the inkjet project since its operations launched in November 2002. This provided great encouragement for Canon "to do long-term business in Vietnam".

### **Canon's Secondary Investment in 2005**

In January, 2005, Canon announced plans to invest 5 billion yen (US\$50 million) to build a laser printer plant in the Que Bo Industrial Park in the northern Vietnamese province of Bac Ninh<sup>21,22</sup>. The zone was located 40 kilometers north of Hanoi, and less than 3 hours drive from Vietnam's northern border with China<sup>23,24</sup>. Construction is scheduled to begin in April of 2005, and Canon intends the plant to be running by 2007. The new plant will produce low-cost laser printers for export primarily to the US, Europe and Japan. The laser printer plant is expected to produce eight million units a year, representing over 15% more than Canon's current factory in China and enough to meet 35% of the global demand for laser printers<sup>25,26</sup>. The plant is also anticipated to employ 3,000 people, elevating Canon's total work force in Vietnam to 12,000, more than its facilities in China and Thailand<sup>27,28</sup>. The plant is billed to be the largest laser printing plant in the world, cementing Canon's significant investment posture in Vietnam<sup>29</sup>.

Whereas Canon's initial investment in 2001 was fraught with risk, this new investment reflected a significantly improved Vietnamese investment climate. At the close of 2004, 43 projects valued at nearly \$US2.1 billion were submitted to the Vietnamese government and awaiting licenses early

in 2004<sup>30</sup>. Canon's reinvestment decision in 2005 reflected the success of previous investments in the country. In 2003, Canon reported export revenues of over \$200 million, a 143% increase over the previous year. This represented 53% of FDI export turnover in Hanoi for the year, and established Canon as major engine of growth in the country<sup>31</sup>.

Vietnam continued to offer a number of distinct advantages for Canon. Central to Canon's decision to reinvest in the country was the company's continued need to hedge global risk. As Sachio Kageyama, general director of Canon Vietnam, commented, "We in the Canon group wanted to avoid concentrating our production bases too much in China."<sup>32</sup> Other benefits of Vietnam included skilled, low wage workers, improved public infrastructure, and an increasing willingness of the government to establish a friendly investment climate. Strong geographic positioning was also important, as Canon's new laser printing plant was to be located further north in Vietnam, giving the company better access to suppliers and distributors in China and other Southeast Asian countries. As Canon's president and CEO summarized, "We highly appreciate the quality of local human resources, the political stability as well as the strategic location of the country compared to other marketplaces where Canon is based such as mainland China, Thailand, Malaysia and Taiwan."<sup>33</sup>

Canon followed an incremental investment strategy, preserving future option value in each decision. In July of 2004, three years after Canon's initial investment, Canon built a second factory in Hanoi to boost production of ink-jet printers, committing to sink an additional \$100 million over the following three years to finance the inkjet franchise.<sup>34</sup> Less than a year later, Canon made the decision to build its laser printer factory in Vietnam. This staggered approach to investment worked to motivate government change in the investment climate by offering continued rewards for positive government action. Following each investment, Canon assessed the government's progress on improving the investment environment before sinking additional capital. This government strategy centered on aligning the Vietnamese government's incentives with those of the company. Canon sent strong signals to the Vietnamese government that good behavior would be rewarded, continuously leveraging its ability to affect investment decisions of other multinational corporations. With the power to act as a credible spokesperson for the Vietnamese investment climate, Canon forced the Vietnamese government to make improvements in infrastructure, tariff policy, and tax reform

Despite major improvements in Vietnam, there are a number of reasons to remain concerned about Canon's investment strategy in 2005. One significant worry is that Canon overreached in

working out deals to benefit the company. Tax exemptions are one example. For the first four years of profitability for Canon Vietnam, the company is exempted from paying any corporate income taxes. In the subsequent five years, Canon receives a 50% reduction in the corporate tax rate.<sup>35</sup> The company's lease agreement also suggests overreach: Canon's lease of 20 hectares of land in the industrial park will be fixed at \$20 per square meter until 2052.<sup>36</sup> While seemingly favorable, these overly generous deals could feed a growing sense of distrust, resentment and inequity if the Vietnamese government feels it is not gaining from Canon's success. Such deals appear to be structured to invite change when future governments take office, and may send contradictory signals about Canon's trustworthiness as a partner.

Labor and environmental practices may also create difficult non-market conditions for Canon Vietnam. In December of 2003, hundreds of Canon's Vietnamese workers went on strike to protest the company's labor regulations, complaining that Canon violated agreed upon labor contracts. Workers alleged they worked unreasonable hours, including overtime without pay. Allegations also claimed Canon operated in a polluted environment, and that the company often fooled inspection delegations. Canon explained the wage unhappiness as resulting from falling output of the company. The company director general, in discussing the strike, noted that working time had been reduced from eight to seven hours per day, and that wages of workers had been cut by 30% as a result.<sup>37</sup> No other data could be found on the events, suggesting the strike was settled quietly. Nevertheless, it suggests that Canon may not take be taking non-market risks seriously.

That same month, Canon Vietnam won a labor dispute in Vietnam's Supreme Court. The dispute arose over the costs of two months of training for a 26-year old Vietnamese worker who was dismissed after taking an additional week to care for his sick mother. Canon sued the man for \$3,000, a lofty sum for a day laborer without a job.<sup>38</sup> Although the government settled in Canon's favor, poor treatment of workers could jeopardize Canon's investment in the future.

Additional risk stems from Canon's move to bring more of its parts suppliers into Vietnam. Procurement of parts has been difficult, and Canon has encouraged Chinese and Taiwanese suppliers to relocate in Vietnam.<sup>39</sup> Two Japanese parts suppliers, Seiyo and Dragon Zet, were convinced to build factories in Que Vo IP to produce the equipment and tools necessary to manufacture printers, and other are apparently following their lead.<sup>40</sup> While this should successfully lower costs and reduce inefficiencies, it creates new risks of expropriation by locating more of the production chain in-country. With suppliers located in the same industrial park as the

manufacturer, the Vietnamese government can expropriate both without fear of losing access to essential inputs.

### **Current Non-Market Analysis of Canon Vietnam's Investments**

Despite existing risks, Canon has followed a relatively thoughtful approach to investment in Vietnam. This section provides a brief summary of Canon's strategic response to non-market issues in Vietnam.

#### ***Institutions and market failures***

At the time of Canon's investments, market institutions within Vietnam were weak relevant to other Southeast Asian countries (EXHIBIT F). In response to weak institutions and the risk of market failures, Canon needed to determine whether or not to make (produce internally) or to buy (acquire on market). Canon relied on suppliers outside of Vietnam for initial sourcing of materials and supplies. It also relied on internal technology that needed no input from Vietnam. Canon has since encouraged a number of suppliers to establish operations within Vietnam. While this provides new cost and efficiency benefits, it also exposes Canon to additional risks of market failure and expropriation.

#### ***Contractual problems***

Given the sheer scope of Canon's investments, it is clear that some of Canon's costs would be sunk and prone to the hold-up. Canon relied primarily on a reputational strategy and promise of incremental investment in order to mitigate this risk. As a major investor firm from a major investor country, Canon had significant reputational leverage to enforce supportive behavior by the Vietnamese government. Vietnam, in turn, had a strong incentive to lure Japanese companies to establish a foothold in Vietnam rather than its powerful neighbor China.

Canon's multi-stage investment consisted of three related printer investment projects that promised jobs and other benefits to the Vietnamese people. Canon made each investment dependent on government improvements to the investment climate. Every time the Vietnamese government reached a significant milestone towards a free market economy, Canon implemented an additional investment as a reward.

#### ***Property rights problems (Investor protection)***

The fickle policies of the Communist Party in Vietnam present real risks of expropriation for investors. Before land reform laws were passed, residents and investors were permitted to buy and sell the rights to use land, but the state retained authority to reclaim any land at any time. By making public its intention of continuing to build newer, bigger factories, Canon was able to reduce the risk

of expropriation in the short term. Rather than entering Vietnam with partners, Canon retained total control of its investments. This eliminated the expropriation risks of asset stripping, transfer price games and equity dilution. In addition, given the enormous size of Canon's investments, external leverage through an international body was not needed to enforce a reputational strategy.

Canon could have reduced risks of expropriation even further by borrowing money from the Vietnamese government to finance its investments. Greater consciousness of the potential to overreach in making deals could have also protected Canon from future expropriation. Canon's initial reliance on suppliers outside of the country offered additional expropriation protection. The move to bring suppliers into Vietnam creates additional risk of expropriation.

***Property rights problems (Intellectual property protection)***

The most basic strategy in order to limit the risk against weak IP protection is to use sensitive technologies in countries where IP protection is strong. Canon followed such a strategy, as its initial investment in ink jet printers involved a technology that was not specifically sensitive to intellectual property theft at that time. Canon has most likely followed a strategy of complementarity by importing the most sensitive parts (printer heads and chips), though we have not found evidence of such practices. Obfuscation and staging strategies may also have been employed. The Vietnamese government's apparent commitment to enhancing IP laws reinforced Canon's comfort in investing in the new laser printer factory. The improvement in IP laws certainly played an important role in Canon's decision of transferring more advanced technology to Vietnam.

***Corruption problems***

Given the relative improvement experienced by Vietnam in the control of corruption from 2000 to 2002 (despite its decline until 2000) we can infer that this improvement has also played an important role in subsequent investments made by Canon. However, it must be noted that Vietnam occupies a worse position as compared to the other regional – East Asia – players (see EXHIBIT G).

Canon Vietnam used reputational and multi-stage development strategies to help protect itself from corruption. Canon was very successful at leveraging future investment prospects by making public its future investment plans well in advance of the starting date. In addition, Canon established a strong relationship with the Vietnamese government that aligned the incentives of both parties. As a result, it was in the government's best interest to see that the investment was not held up by unnecessary regulations.

### ***Political power***

Following the basic decision tree with weak institutions presented in class, Canon investments could be considered safe investments. First, “the political leaders’ incentives can be made to align with Canon goal” (i.e. build an export factory). Second, “the current leadership is stable” (see EXHIBIT H).

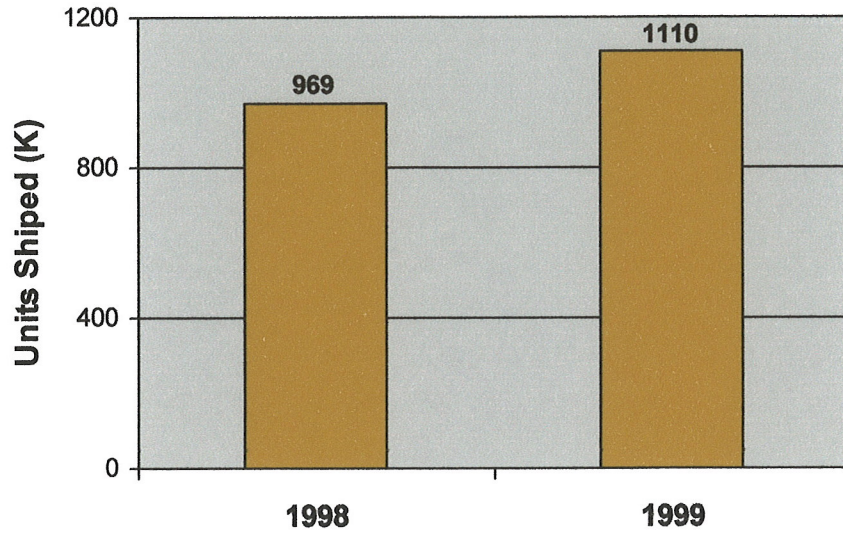
Canon was very successful at aligning the incentives of political leaders with those of the company. The goal of the Communist party was clearly to stay in power (obvious motive) while preserving some form of communism (ideological motive). Canon helped to satisfy both goals to ensure the success of its projects. Canon actively conveyed to the government the significant benefits of its investments for the local population in term of wages and benefits. It also made clear its support of other investment by helping to encourage additional investment from other MNC’s. Promotion of the success of the economy helps maintain the governments hold of power. In addition, Canon carefully avoided any ideological confrontation with the communist government while making clear that common business procedures must be followed.

### **Conclusion**

In conclusion, Canon has provided strong evidence that there are considerable investment opportunities to be pursued in Vietnam, and that such investments can be very successful given the Vietnamese government’s continued implementation of market reforms. Canon’s multi-stage investment in Vietnam provided strong incentives to the Vietnamese government to make needed changes to the local business environment. The enormous size of Canon’s investments had significant reputational consequences, both positive and negative, for Vietnam, and spurred the government to ensure adherence to new market reform measures. Each reform, in turn, helped spark greater confidence on the part of Canon. New land acquisition and IP laws encouraged the company to engage in a series of bigger investments with more advanced technologies. As a result of Canon’s investment in Vietnam, the country has improved its investment climate dramatically and seen a corresponding increase in FDI. While still risky, renewed Japanese investor confidence in Vietnam is warranted given strategic management of risk. Canon’s incremental investments in Vietnam over the last five years have been instrumental in establishing a less risky business environment.

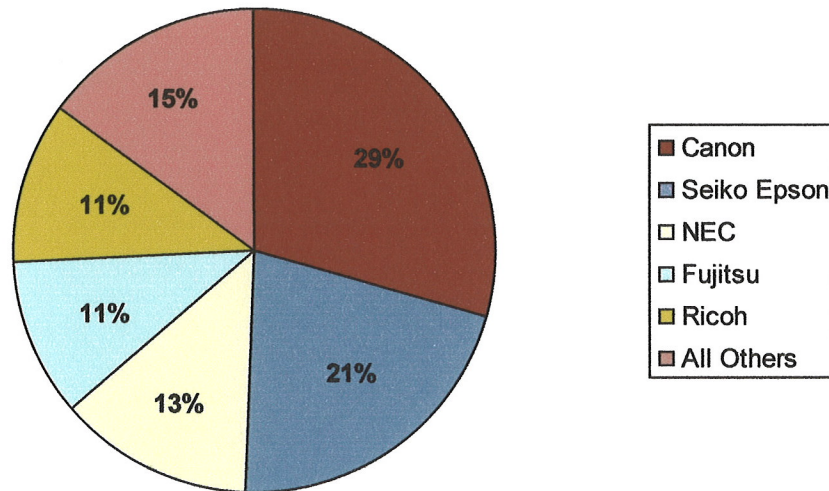
**EXHIBITS:**

**Exhibit A: Japan's Laser Printer Market**



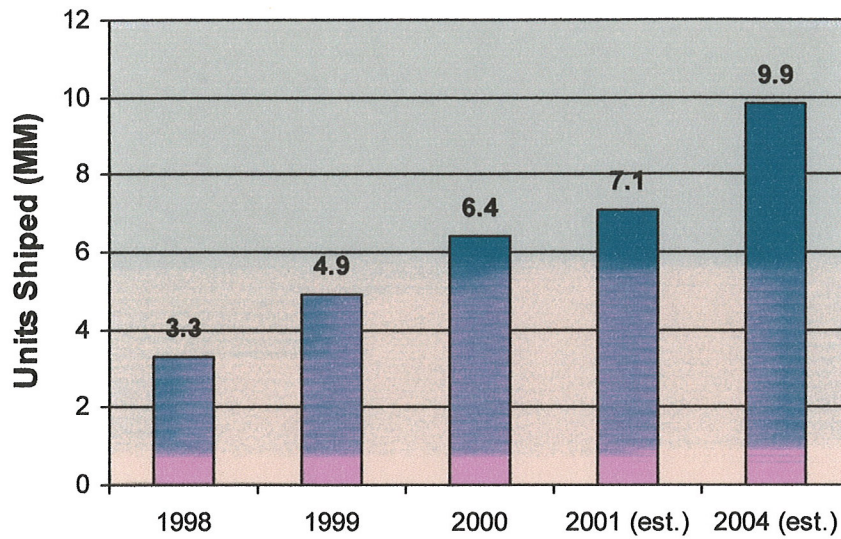
*Source: AsiaPulse News, 6/2000*

**Exhibit B: Japan's Laser Printer Market Share (1999)**



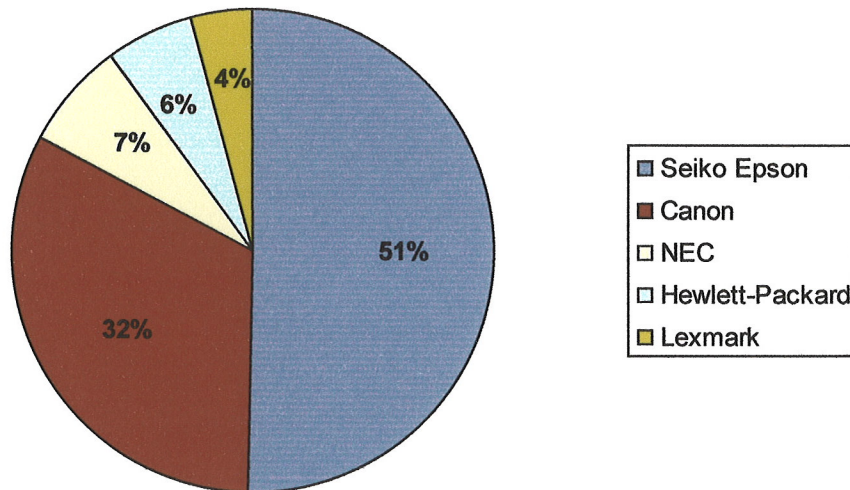
*Source: Office Equipment & Products, 1/2001*

**Exhibit C: Japan's Inkjet Printer Market**



Source: AsiaPulse News, 6/2000

**Exhibit D: Japan's Inkjet Printer Market Share (2000)**



Source: Nikkei Weekly, 8/2001

**Exhibit E: The Corruption Perceptions Index**

	<b>2001</b>	<b>2000</b>	<b>1999</b>	<b>1998</b>	<b>1997</b>
<b>Vietnam</b>	2.6	2.5	2.6	2.5	2.8
<b>China</b>	3.5	3.1	3.4	3.5	2.9
<b>Indonesia</b>	1.9	1.7	1.7	2.0	2.7
<b>Malaysia</b>	5.0	4.8	5.1	5.3	5.0
<b>Taiwan</b>	5.9	5.5	5.6	5.3	5.0
<b>Thailand</b>	3.2	3.2	3.2	3.0	3.0
<b>Japan</b>	7.1	6.4	6.0	5.8	6.6
<b>United States</b>	7.6	7.8	7.5	7.5	7.6

*Source: Transparency International*

Exhibit F

**Ethics indices: Country averages 2002**

(Note: Theoretical range of indices 0–100%)

	(CICC)	(GLCC)	(CEI)	(PSEI)	(JLEI)	(CGI)
Vietnam	28.9	39.3	34.1	29.7	35.0	38.1
China	43.6	49.4	46.5	42.1	42.0	35.3
Hong Kong SAR	90.8	59.1	75.0	82.2	82.3	69.2
Indonesia	38.2	42.4	40.3	47.3	39.9	44.7
Japan	78.7	46.2	62.4	62.0	75.9	79.2
Korea, (South)	41.9	31.0	36.4	40.9	48.5	55.4
Malaysia	66.8	47.1	56.9	58.6	77.5	66.7
Philippines	20.8	7.4	14.1	7.6	17.7	48.9
Singapore	93.3	72.6	83.0	92.7	89.9	80.9
Taiwan	69.3	44.6	57.0	65.9	65.1	72.1
Thailand	45.8	11.6	28.7	36.3	52.8	49.7

Source: D. Kaufmann et al. "Governance Matters III: Governance Indicators for 1996–2002." *World Bank Policy Research Working Paper 3106*, 30 June 2003  
<http://www.worldbank.org/wbi/governance/pubs/govmatters3.html>

Note: For all indices, a higher value implies a higher ethical standard/rating given by the country's enterprise sector. The percentage value reflects the share of the country's enterprises providing a satisfactory rating. Given the margin of error in this type of index, it is not warranted to perform seemingly precise comparisons across individual countries having ratings that do not differ vastly from each other, thus, it is also not appropriate to utilize these indices for precise country ratings.

**Legend**

**CICC (Corporate Illegal Corruption Component):** Percentage of firms in the country that give satisfactory ratings (answers 5, 6 or 7) to the questions on corporate ethics, illegal political funding, state capture cost, average of frequency of bribery in procurement and active capture, corruption in banking (average of formal money laundering and bribery for loans), and percentage firms reporting 0 percent procurement and administrative bribe shares.

**GLCC (Corporate Legal Corruption Component):** Percentage of firms in the country that give satisfactory ratings (answers 5, 6 or 7) to the questions on influencing legal political funding and undue political influence.

**CEI (Corporate Ethics Index):** Percentage of firms in the country that give satisfactory rating (answers 5, 6 or 7) to the questions on index calculated as the average of the percentage of firms' Corporate Illegal Corruption Component and the Corporate Legal Corruption Component.

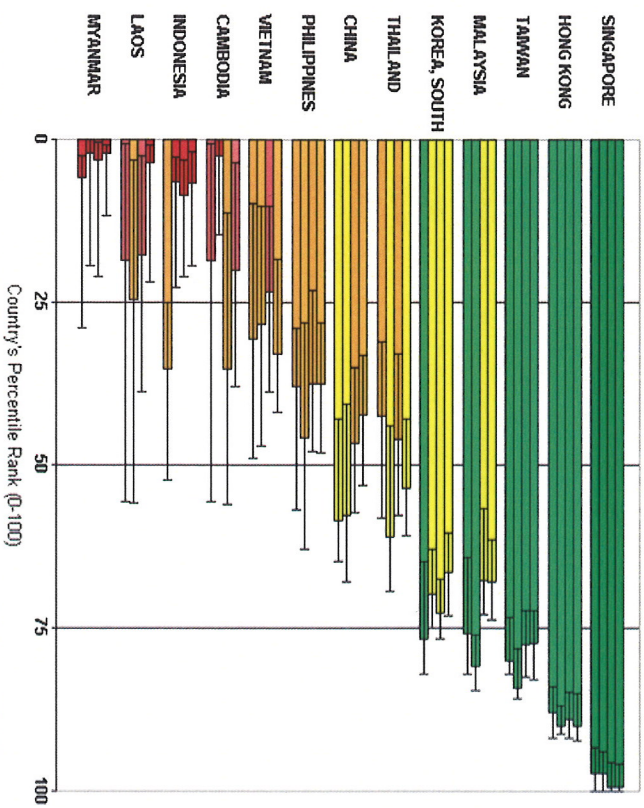
**PSEI (Public Sector Ethics Index):** Percentage of firms in the country that give satisfactory ratings (answers 5, 6 or 7) to the questions on honesty of politicians, government favoritism in procurement, diversion of public funds, trust in postal office and the average of bribe frequencies for permits, utilities and taxes.

**JLEI (Judicial/Legal Effectiveness Index):** Percentage of firms in the country that give satisfactory ratings (answers 5, 6 or 7) to the questions on judicial independence, judicial bribery, quality of legal framework, property protection, parliament effectiveness and police effectiveness.

**CGI (Corporate Governance Index):** Percentage of firms in the country that give satisfactory ratings (answers 5, 6 or 7) to the questions on protection of minority shareholders, quality of training, willingness to delegate authority, nepotism and corporate governance.

## Exhibit G

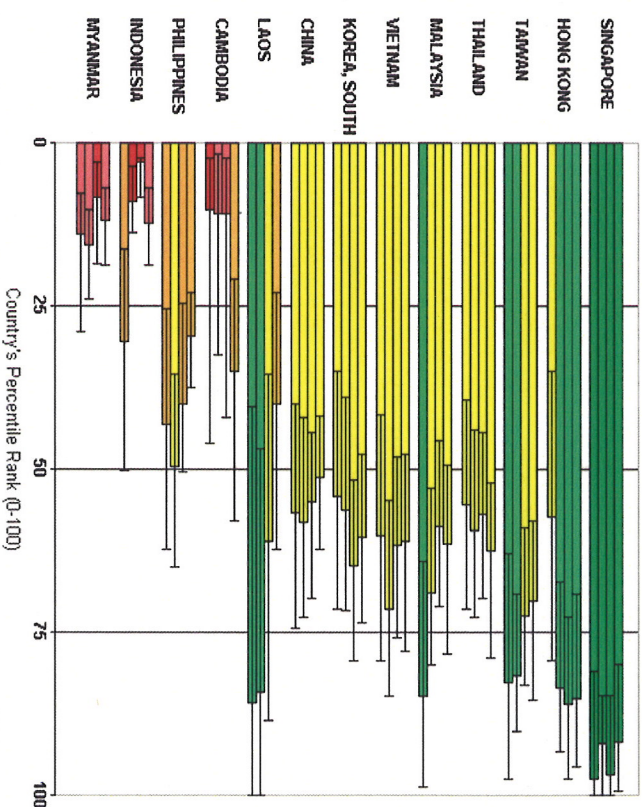
**Control of Corruption** (East Asia region, 2002)  
Comparison between 2002, 2000, 1998, 1996 (top-bottom order)



Source: D. Kaufmann, A. Kraay, and M. Mastruzzi, 2003, *Governance Matters III: Governance Indicators for 1996-2002*.  
Notes: The governance indicators presented here reflect the statistical compilation of responses on the quality of governance given by a large number of enterprises, citizen and expert survey respondents in industrial and developing countries, as reported by a number of survey institutes, think tanks, non-governmental organizations, and international organizations. The aggregate indicators in no way reflect the official position of the World Bank, its Executive Directors, or the countries they represent. As discussed in detail in the accompanying papers, countries' relative positions on these indicators are subject to margins of error that are clearly indicated. Consequently, precise country rankings should not be inferred from this data.

## Exhibit H

**Political Stability** (East Asia region, 2002)  
Comparison between 2002, 2000, 1998, 1996 (top-bottom order)



Source: D. Kaufmann, A. Kraay, and M. Mastruzzi, 2003, *Governance Matters III: Governance Indicators for 1996-2002*.  
Notes: The governance indicators presented here reflect the statistical compilation of responses on the quality of governance given by a large number of enterprises, citizen and expert survey respondents in industrial and developing countries, as reported by a number of survey institutes, think tanks, non-governmental organizations, and international organizations. The aggregate indicators in no way reflect the official position of the World Bank, its Executive Directors, or the countries they represent. As discussed in detail in the accompanying papers, countries' relative positions on these indicators are subject to margins of error that are clearly indicated. Consequently, precise country rankings should not be inferred from this data.

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