Chapter 1

Foreign investment trends and performance

This chapter reviews trends in foreign direct investment in Viet Nam using various national and international data sources. It looks at the performance of foreign investment relative to neighbouring and regional economies and its impact on the local economy. It also includes a specific section on trends in mergers and acquisitions and one assessing how foreign direct investment statistics are compiled in Viet Nam.

By all accounts, foreign direct investment (FDI) in Viet Nam is booming. Global flows are still below their 2007 peak, while FDI inflows in Viet Nam are at record levels and growing. This trend shows no signs of abating, on the back of further reforms and given the high and sustained volumes of registered foreign capital in projects a share of which will eventually be implemented. Much of this investment has come from Asia, suggesting that investors from Europe and North America have substantial scope to expand their presence in Viet Nam, which will add further to the growth. Manufacturing is the most important sector for FDI, as investors benefit from market access in third markets. The recent conclusion of negotiations on the EU-Viet Nam FTA is likely to provide further scope for export-oriented investments.

Owing to the importance of manufacturing for export, the share of greenfield investments in total FDI is high. In mature markets, mergers and acquisitions (M&As) are the preferred entry mode for foreign investors. Cross-border M&As have been less prevalent in Viet Nam for several possible reasons: the absence of targets owing to the prominence of state-owned enterprises and the slow progress in equitisation; the previous existence of an overall 49% cap on foreign ownership in publicly listed companies, which has been partly removed by Decree No. 60/2015/NDD-CP of 26 June 2015[1]; the uncertainty surrounding which activities performed by the target firm would face equity restrictions; and complex administrative procedures. It remains to be seen how the recent removal of the 49% foreign equity limit will affect trends in M&A activities.

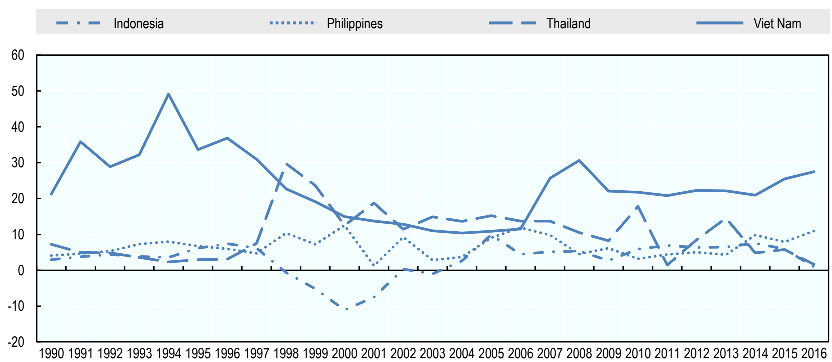
By sector, most M&As involving foreign investors have been in the finance and insurance, oil and gas, metals and steel, and food and beverage sectors. Even within these sectors, however, the share of foreign-owned firms in total assets remains small. These M&As can be an important vehicle for raising total factor productivity in acquired firms and in restructuring and consolidating whole sectors of the economy, such as the banking sector.

Long-term trends in FDI in Viet Nam

Foreign investment and export-led growth have been central to Viet Nam's development strategy over three decades. The exact nature of reforms affecting FDI will be discussed in the next chapter, but the importance of reforms and of ever-increasing international commitments can easily be seen in Viet Nam’s performance over time in attracting FDI. Within roughly five years of the initial reforms covering FDI, FDI as a share of gross fixed capital formation in Viet Nam had surged from 0.5% to almost 50% (Figure 1.1). This pace could not be sustained, but even at its trough in the early 2000s, Viet Nam's performance exceeded that of both Indonesia and the Philippines. Indeed, except for the decade after the Asian financial crisis when Thailand attracted considerable FDI inflows relative to domestic investment, FDI inflows into Viet Nam have represented a far higher share of gross fixed capital formation than in the other populous ASEAN members (Indonesia, Philippines and Thailand).

Another way of looking at Viet Nam's relative FDI performance within ASEAN is to consider its share of the total stock among the same four ASEAN members. Viet Nam's share grew from almost nothing in 1990 to almost 25% just over a decade later as a result of *Doi Moi* reforms. This rising share was further sustained by the Asian financial crisis which affected other ASEAN members, particularly Indonesia. Viet Nam's share has now stabilised at 15%, given the strength of recent inflows into both Indonesia and the Philippines but is still above its share of ASEAN4 GDP (11%).

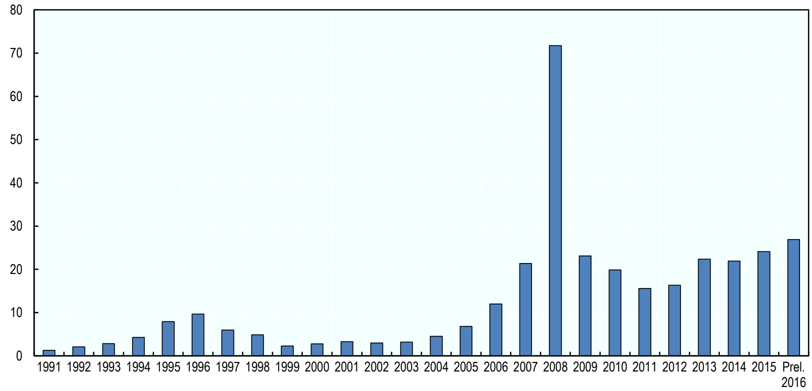
Figure 1.1. **ASEAN4 FDI inflows as a share of gross fixed capital formation**



Source: UNCTAD

The sharp rise in FDI relative to domestic investment in the 1990s seen in Figure 1.1 is partly the result of the relatively small size of the Vietnamese economy at the time. While the number of FDI projects has been growing fairly steadily, if sporadically, since the early 1990s, much of the growth in the value of registered capital in FDI projects occurred around the time of Viet Nam's accession to the WTO in 2007 (Figure 1.2). Registered capital represents the planned investment in a project over time and is more a measure of investor sentiment than of actual investment. Investors sometimes have an incentive to inflate the total amount so that they will not have to reapply in the future, and some projects never go ahead. Nevertheless, the sharp increase in registered capital in 2007 (exceeding total registered capital over the previous decade) demonstrates the importance of WTO membership, not only for the liberalisation which it caused but also as a signal of an improved investment climate.

Figure 1.2. **Total registered foreign capital in Viet Nam**
(USD million)



Source: GSO

The trend in implemented capital tells much the same story (Figure 1.3) in terms of a sharp increase in foreign investment around the time of WTO accession which was sustained in subsequent years, as part of the USD 70 billion of registered capital in 2007 was eventually invested. There nevertheless remains a wide discrepancy between the capital registered in FDI projects and the amount actually implemented. In total, only 44% of total registered capital has actually been realised as investment, representing on average just over one half of total registered capital in any given year. The ratio of realised to registered capital can vary for many reasons – it is common for investors to commit less capital than initially registered with the authorities – but it does suggest that Viet Nam could do even better in attracting FDI if it could pursue policies which facilitate investment. For example, Tran (2009) attributes the large and increasing gap between registered and realised capital prior to 2008 to the deep decentralisation at the time. This implementation gap and the likely causes will be considered in more detail in subsequent chapters.

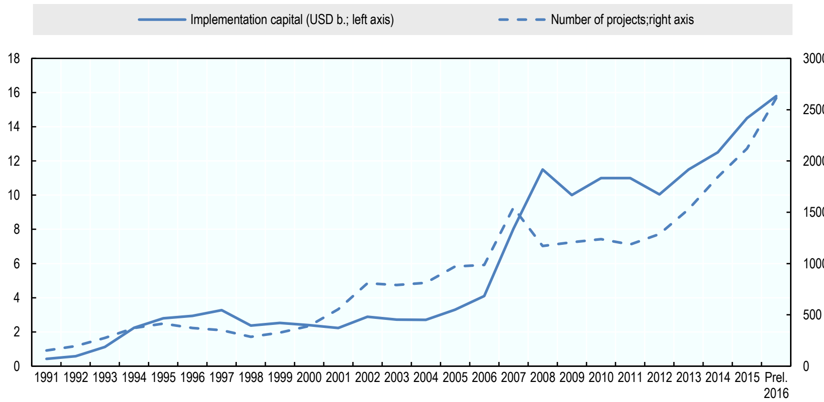
Table 1.1. **FDI in Viet Nam by source country, end 2015**

	Number of projects	Total registered capital (USD m.)*	
TOTAL	20 069	281 883	
Korea	4 970	45 191	16.0%
Japan	2 914	38 974	13.8%
Singapore	1 544	35 149	12.5%
Chinese Taipei	2 478	30 997	11.0%
British Virgin Islands	623	19 275	6.8%
Hong Kong, China	975	15 547	5.5%
Malaysia	523	13 420	4.8%
US	781	11 302	4.0%
China	1 296	10 174	3.6%
Netherlands	255	8 265	2.9%
Thailand	419	7 728	2.7%
Cayman Islands	67	6 392	2.3%
Samoa	150	5 772	2.0%
Canada	147	5 253	1.9%
UK	241	4 739	1.7%
France	448	3 423	1.2%
Russian Federation	113	2 080	0.7%
Switzerland	111	2 045	0.7%
Brunei	187	1 905	0.7%
Luxembourg	40	1 857	0.7%
Australia	357	1 653	0.6%
Germany	260	1 394	0.5%
British West Indies	11	1 148	0.4%
Turkey	13	729	0.3%
Denmark	118	682	0.2%
Belgium	63	552	0.2%
India	118	440	0.2%
Seychelles	41	418	0.1%
Indonesia	46	397	0.1%
Italy	69	357	0.1%
Mauritius	43	325	0.1%
Philippines	72	324	0.1%
Finland	14	321	0.1%
Other	549	2 689	1.0%

* Including supplementary capital to licensed projects in previous years.

Source: GSO

Figure 1.3. **Realised FDI projects, 1991-2016**



Source: GSO

Most foreign investment comes from Asia…

The four largest investors in terms of registered capital are all from East Asia (Table 1.1), with ASEAN representing 21% of the total and the rest of Asia 50%. Investment from Europe and North America represents only 15% of the total, barely more than that attributed to offshore centres – although some European and American investment might come through these centres or through Singapore and hence might be underestimated in the bilateral figures.

…and involves manufacturing and real estate

Over one half of the cumulative stock of registered capital is in the manufacturing sector, followed by real estate (Table 1.2) with the share of manufacturing even higher in recent annual inflows. This finding is very different from that provided by statistics on cross-border M&As, as will be shown later. To the extent that M&As do not go through the same channel as registered capital, it suggests that much of the market-seeking investment in services involves acquisitions of local companies. Registered capital is more likely to reflect greenfield investment, as foreign multinational enterprises establish affiliates in Viet Nam to supply global value chains.

Table 1.2. **Total FDI by sector, end 2015**

	Number of projects	Total registered capital (USD m.) *	Share (%)
Total	20 069	281 883	
Agriculture, forestry and fishing	521	3 655	1.3%
Mining and quarrying	97	4 448	1.6%
Manufacturing	10 764	162 773	57.7%
Electricity, gas, stream & air conditioning supply	109	12 568	4.5%
Water supply, sewerage, waste management	43	1 353	0.5%
Construction	1 264	10 894	3.9%
Wholesale and retail trade; vehicle repair	1 735	4 602	1.6%
Transport and storage	505	3 829	1.4%
Accommodation and food service activities	445	11 950	4.2%
Information and communication	1 263	4 224	1.5%
Financial, banking and insurance activities	82	1 334	0.5%
Real estate activities	500	50 896	18.1%
Professional, scientific and technical activities	1 926	2 103	0.7%
Administrative and support service activities	170	413	0.1%
Education and training	240	710	0.3%
Human health and social work activities	111	1 767	0.6%
Arts, entertainment and recreation	143	3 622	1.3%
Other service activities	151	742	0.3%

(*) Including supplementary capital to licensed projects in previous years.

Source: GSO

Trends in FDI in Viet Nam from a home country perspective

Another way of assessing trends in FDI in Viet Nam is to look at what major home countries report investing. Understanding patterns of international direct investment is becoming increasingly difficult owing to the rise of special purpose entities and pass-through investments in third countries for fiscal reasons, to benefit from the protection of an existing treaty or simply because a large MNE will have regional headquarters which might undertake the investment on behalf of the global MNE. US investors in many ASEAN countries, for example, may invest through their affiliates in Singapore.[2]

Investors based in OECD countries account for 44% of total registered capital in Table 1.1. Table 1.3 shows the stock of FDI from OECD countries based on home country reporting. Companies from OECD countries had invested a total of USD 36 billion as of the end of 2015. This amount is equivalent to 29% of the total registered capital attributed to OECD investors in the Vietnamese statistics. As with the GSO figures, investors from Japan and Korea are the most active, representing two thirds of the total stock of FDI from OECD countries.

Table 1.3. **FDI position of OECD member countries in Viet Nam**

(2015 or nearest year; USD m.)

OECD total	35 755
Australia	996
France	592
Germany (2014)	574
Italy	451
Japan	13 072
Korea	12 547
Netherlands	3 816
Switzerland	605
United Kingdom (2012)	1 674
United States	1 285
Other OECD	151

Source: OECD FDI database

Tables 1.4 and 1.5 provide more information for individual home countries, Japan and the United States. While the manufacturing sector represents almost two thirds of the total stock of Japanese FDI in Viet Nam, particularly transport equipment, electric machinery and metals, the most important sector overall is finance and insurance. The importance of this sector does not come out in the FDI data provided by Viet Nam, probably because investors enter through acquisitions of shares in existing companies and therefore do not register their capital through the same channel. The importance of finance and insurance will come out more clearly later in the data on mergers and acquisitions. Table 1.4 also provides an estimate of the rate of return on Japanese investment in Viet Nam by sector (defined as the ratio of total income receivables over total outward FDI positions). The highest returns by a wide margin are in transport equipment, construction and in the precision machinery and food industries.

Table 1.4. **Stock and rate of return of Japanese FDI in Viet Nam by industry**

	Outward FDI position, end 2014(USD m.)	Income receivables over outward FDI position*
Total	**13 703**	**6%**
Manufacturing	8 710	7%
Food	419	12%
Textile	82	3%
Lumber and pulp	274	2%
Chemicals, pharmaceuticals	652	2%
Petroleum	549	-
Rubber and leather	575	-
Glass and ceramics	558	4%
Iron, non-ferrous, and metals	1 068	2%
General machinery	911	4%
Electric machinery	1 132	6%
Transport equipment	1 576	19%
Precision machinery	511	12%
Non-manufacturing	4 993	4%
Farming and forestry	5	0%
Fishery and marine products	0	
Mining	0	
Construction	28	17%
Transport	61	5%
Communications	32	0%
Wholesale and retail	303	1%
Finance and insurance	3 779	5%
Real estate	545	1%
Services	125	3%

Source: OECD calculations based on Bank of Japan

Table 1.5 provides activities data on US MNE affiliates in Viet Nam which can yield further insights into the nature of their investment. By any measure, the presence of US MNEs in Viet Nam lags behind that in other large ASEAN member states. Value added (gross product) is still low, as are exports to the United States, employment and affiliate sales. Only 61 US-owned affiliates in Viet Nam have assets, sales or net income above USD 25 million.

Table 1.5. **Activities of US MNEs in selected ASEAN countries**

(2014; USD m. except employment)

	Affiliates #	FDI stock (2015)	Assets	Sales	Emp.
Indonesia	187	13 546	78 548	33 761	135 900
Malaysia	277	13 959	73 326	52 942	179 600
Philippines	175	4 724	39 262	24 918	326 800
Thailand	254	11 295	65 027	69 944	187 900
Viet Nam	61	1 285	11 525	5 810	53 700

only those affiliates with assets, sales or net income > USD 25 million

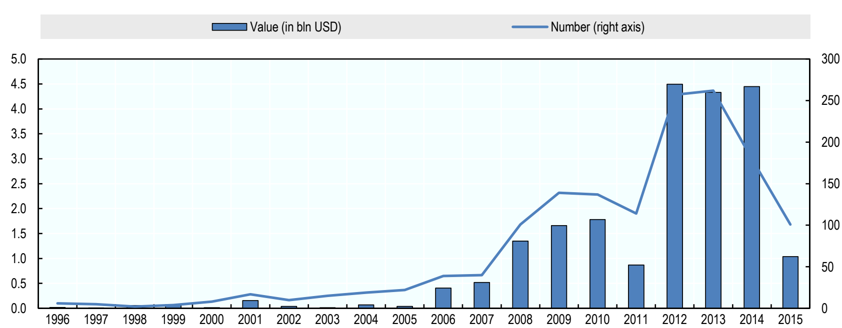
Source: Bureau of Economic Analysis, US Department of Commerce.

Mergers and acquisitions

M&A markets have grown dynamically in Viet Nam over the past ten years...

The overall activity in M&As has increased dynamically in Viet Nam since 2005, with almost no activity prior to that date (Figure 1.4). While there were on average 14 M&A deals annually between 1996 and 2005 with a total value of USD 90 million, the number increased to 143 M&A deals a year between 2006 and 2015 and a total value of USD 2.3 billion each year. The annual growth in the total value of completed M&A transactions has been faster in Viet Nam than in comparable ASEAN economies, reflecting both rapid increases and the small size of the Vietnamese M&A market.

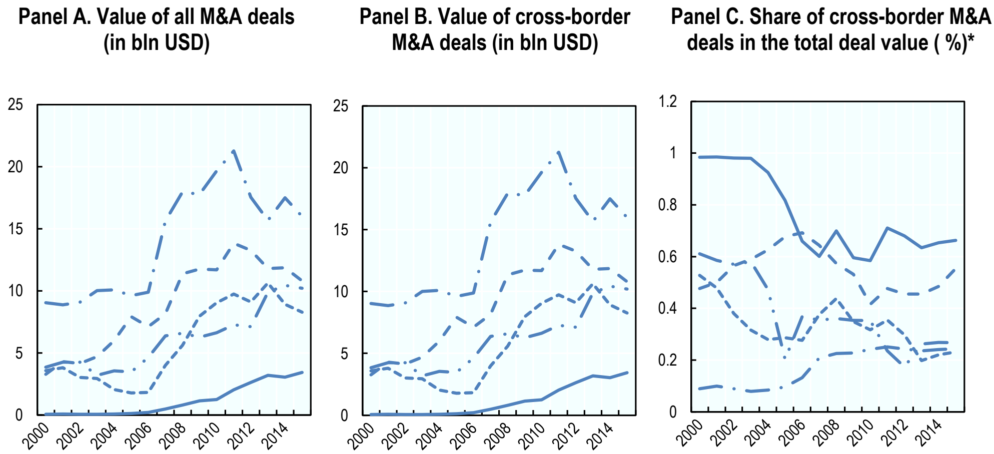
Figure 1.4. **M&A deals involving a Vietnamese target firm, 1995-2015**



Note: Deals are identified as cross-border when the target and the acquirer are of different nationality.

Source: OECD calculations using Dealogic M&A data.

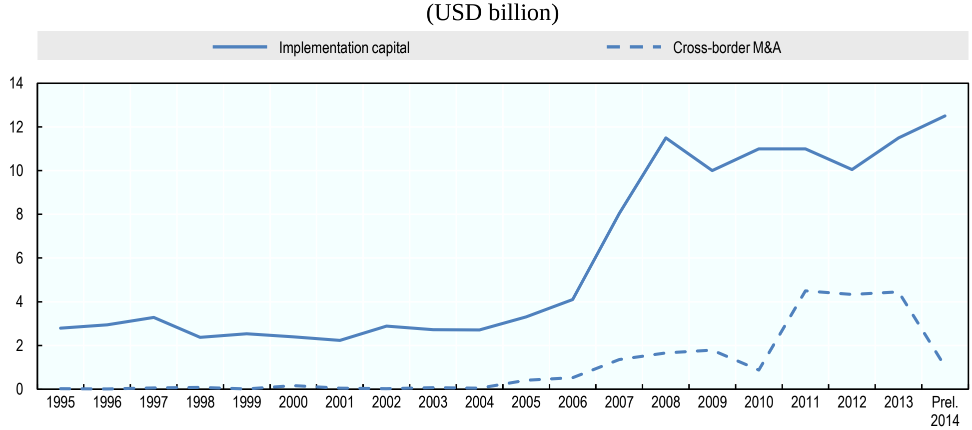
Figure 1.5. **M&As in the ASEAN 5***



*ASEAN 5: Indonesia, Malaysia, Philippines, Thailand and Viet Nam

Source: OECD calculations based on Dealogic database.

Figure 1.6. **Realised FDI projects and cross-border M&A in Viet Nam, 1995-2014**
(USD billion)



Source: Dealogic M&A database and GSO.

About 60% of the M&A deals concluded between 2006 and 2015 were cross-border in nature, and the average share of cross-border M&A deals has decreased both in terms of the total number of deals and the total deal value over time. Despite the decline, Viet Nam still registers a higher share of cross-border M&A in total M&A than comparable ASEAN economies (ASEAN 5) and has followed the trend experienced by other economies with a similar market size (Figure 1.6). Among the reasons for a relative decline in foreign participation in the M&A market in Viet Nam may be the process of maturing of domestic firms that increasingly engage in M&A deals to increase their scale and competitiveness, a decline in privatisations over time and a relatively slow process of equitising state-owned enterprises (SOEs) in recent years, a lack of suitable targets for corporate control in sectors of interest to international investors (including due to a large SOE presence) as well as the existence of persisting barriers to cross-border M&A activity in Viet Nam, discussed later.

A higher share of total M&A in Viet Nam involves foreign acquirers than in other ASEAN5 countries while total M&A activity in Viet Nam is much less than in its four peers (Figure 1.5). This performance is in stark contrast to Viet Nam's strong record in attracting FDI. The low level of M&As is likely to reflect in part a relatively under-developed capital market, but may also be a legacy of earlier restrictions on foreign equity shares in Vietnamese listed companies which were lifted only in 2015, as well as other regulatory barriers. To the extent that cross-border M&A transactions can facilitate corporate restructuring and productivity growth, Viet Nam may consider whether some of its existing policies are not unduly impeding M&A activity. Box 1.1 considers the question of whether M&As contribute to higher firm performance in the host economy, while Box 1.2 looks specifically at studies attempting to measure the impact of FDI on Viet Nam's economic performance.

Comparing cross-border M&A values with implemented capital in greenfield or expansion projects involving foreign investors reveals that very little of the entry of foreign investors in Viet Nam to date has been through the acquisition of a share in a local company (Figure 1.6).

Box 1.1. **Do mergers and acquisitions contribute to higher firm performance**

As with greenfield FDI, cross-border mergers and acquisitions (M&A) can be an important source of capital and act as a catalyst of structural change in the economy. This can take place through the market entry effect, *i.e*. the entry of new foreign market participants and provision of goods and services that were previously unavailable, and the associated increased competitive pressures on local firms, or an improved access of the acquired firms to the MNE supplier and client networks, technologies as well as superior management and corporate governance practices (so-called technology and know-how transfer). The entry of foreign firms, which the theoretical literature expects to be on average more productive than domestic firms (*e.g*. Melitz, 2003, Helpman *et al*., 2004), can hence generate productivity increases in particular firms, market niches or sectors. There may also be an improvement in the level of management or corporate governance practices as a result of the entry of global firms that are subject to global standards.

Box 1.1. **Do mergers and acquisitions contribute to higher firm performance** (cont.)

Given these theoretical assertions as well as a preoccupation of the general public with the differential impact of M&A and greenfield FDI on host economies, a rich empirical literature on the subject has emerged. Generally, studies find a positive impact of cross-border M&A on the total factor productivity of the acquired firm, while in some countries or sectors insignificant results are found.[1] More generally, results tend to vary depending on the sector in which the M&A takes place (*e.g*. Girma and Görg, 2002), investor characteristics (*e.g*. Benfratello and Sembenelli, 2002; Chen, 2008), the absorptive capacity of domestic firms (Girma, 2005; Girma *et al*, 2007) as well as the policy environment in the home and host economies (Wang and Wong, 2009; Albuquerque *et al*., 2014).

Evidence also suggests that cross-border M&A can be a powerful tool for facilitating corporate restructuring and improving managerial and corporate governance practices in developed and developing countries, including in Viet Nam. For example, Rossi and Volpin (2003), using data from 49 countries between 1992 and 2002, including Viet Nam, find that cross-border take-overs facilitate convergence in corporate governance regimes across countries and facilitate corporate restructuring. Albuquerque *et al*. (2014) using firm-level data on cross-border M&A and corporate governance in 22 developed countries also find that cross-border M&As are associated with subsequent improvements in the governance, valuation, and productivity of the target firms' local rivals. The positive spillover effect is stronger when the acquirer is from a country with stronger shareholder protection. A relatively recent survey of firms involved in FDI projects in Viet Nam also confirms that the access to managerial capabilities gained through cross-border acquisitions is considered an important source of the surveyed firms' competitiveness (Nguyen *et al*. 2004).

Lastly, being an additional source of capital and facilitating market consolidation, cross-border M&A can also help alleviate financing constraints of the acquired firms and facilitate domestic investment and greenfield FDI in the future. Indeed, empirical results confirm this prediction. For example, Calderón *et al*. (2004), using annual M&A and greenfield FDI data for the period 1987-2001 and a large sample of industrial and developing countries find that higher M&A is typically followed by higher greenfield FDI and domestic investment. Greenfield FDI is also found to be followed by increased cross-border M&A in developing countries. This finding highlights the interdependence in different modes of market entry by foreign firms and policies that facilitate different forms of investment.

Hence, cross-border M&A can play a positive role in facilitating restructuring of domestic firms and industries. These effects are nevertheless far from automatic and require the right regulatory environment. Cautionary tales, including those found in Asian economies, show that the reduction of barriers to cross-border M&A needs to be accompanied with improvements in the domestic regulatory framework, in particular in relation to competition and corporate governance, to achieve desired effects (Mody and Negishi, 2000). Governments, hence, have an important role to play in both facilitating and setting the right regulatory framework for all firms, both domestic and foreign, to participate in the domestic market for corporate control.

1. For example, Lichtenberg and Siegel (1987) find positive effects on the acquired firm's productivity in the US; Conyon et al, 2002 in the UK; Arnold and Javorcik, 2005, in Indonesia; Bertrand and Zitouna, 2008, in France. Meanwhile, Harris and Robinson (2003) find no significant impact in the UK and Girma and Gorg (2002) and Schiffbauer (2009) find positive results in selected industries only.

Recent regulatory changes may facilitate a pick-up in cross-border M&A activity in Viet Nam…

Some evidence suggests that the regulatory environment and administrative procedures in Viet Nam may have been one of the factors impeding cross-border M&A activity. For example, as outlined in Chapter 2, the horizontal statutory restriction limited the purchases of shares in local targets by foreign investors to minority stakes only until the reforms associated when WTO membership came into effect (2005-09).[3] Only in 2005, did the *Law on Investment* and the *Law on Enterprises* allow foreign investors to purchase stakes in Vietnamese targets without any limitations, provided that they were not subject to the list of conditional sectors[4] and were not public companies.[5] In the case of public enterprises, the maximum equity limit was raised to 49% in 2007 (from 30%), but remained capped at 49% until 2015.[6] In addition, the list of conditional sectors has been relatively large and the lack of legal clarity has made it difficult for investors to ascertain the extent of conditions that applied (see Chapter 2), further limiting the opportunities for cross-border M&A transactions in some sectors.

Box 1.2. **The economic impact of FDI in Viet Nam**

Econometric studies, often involving many countries, have a mixed record in linking FDI inflows to economic growth. This has not been the case in Viet Nam. Given that rapid and sustained economic growth in Viet Nam coincided with a dramatic expansion of FDI in the economy, it is perhaps not surprising that many studies have found a link between the two. Hoang *et al*. (2009) find a strong impact of FDI on economic growth, even if it does crowd out domestic investment to some extent. Foreign direct investment can exert a positive influence on growth through many channels: X-efficiency, technology transfer, human capital development, exports and capital accumulation. The authors find that the additional capital brought in through FDI is the only one that explains the improved growth performance. Other studies using different methodologies and at different points in time find a similar positive effect. These include Nguyen and Hemmer (2002) and Tran Tong Hung (2005). Hoa (2004) and Nguyen (2006) both find a positive impact of FDI at the provincial level. Doan Nguyen Phuc (2003) looks at the period 1988-2003 and finds that economic growth largely depends on the FDI sector.

Hoi and Pomfret (2010) estimate the impact of FDI on wages paid by domestic private firms in Viet Nam and find strong evidence of horizontal wage spillovers from foreign to domestic private firms, despite different labour market conditions and firm characteristics. They find that "wage levels in domestic private firms are higher in sectors where there is a higher presence of foreign firms (horizontal wage spillovers), and domestic private firms with backward linkages to foreign firms can gain productivity spillovers and pay higher wages (vertical spillovers)" (Hoi and Pomfret, 2010). Nguyen *et al*. (2006) find that FDI not only increases the capital stock but also improves investment efficiency throughout the economy. FDI is found to increase the overall labour productivity of Vietnamese firms but not for SOEs.

Even with progressive liberalisation and reduction of outright restrictions on foreign participation over the past ten years, significant legal uncertainty around cross-border M&A transactions in Viet Nam persisted in the past. For example, when a foreign investor acquired a share in a local company, it was difficult to predict which business lines of the acquired company would be allowed to be maintained, and which would have to be shed due to the restrictions on foreign ownership (US State Department, 2015: 5). Lastly, the administrative procedures for obtaining approval for undertaking cross-border M&A deals have been lengthy and burdensome, further adding to the transaction costs faced by foreign investors interested in M&A in Viet Nam (see Chapter 2).

The recent reforms to the *Investment Law* and *Enterprise Law*[7] and related regulations may facilitate cross-border M&A activity in Viet Nam in the future. The lifting of the maximum equity limits for foreign acquisitions of public companies in Viet Nam, except for conditional business lines[8], is seen as an important landmark and is likely to boost the number of acquisitions involving Vietnamese targets in coming years. The new *Investment Law* and the implementing legislation[9] which reduces the number of conditional sectors and clarifies the extent of sectors in which foreign investments are subject to special conditions, may help improve investment opportunities for some M&A investors and reduce the legal uncertainty surrounding cross-border transactions. The improved definition of foreign investor embedded in the new *Investment Law* can have a similar effect. Lastly, the removal of the obligation for foreign-owned M&A investors seeking to buy minority shares in non-conditional sectors to undergo a lengthy and complex registration procedure[10] can also ease the administrative burden on foreign-owned M&A investors. While the true test will come once all the implementing regulations are available and the new rules start to be applied by the Vietnamese authorities to particular transactions, the direction of the recent regulatory changes is likely to facilitate cross-border M&A activity in Viet Nam and has already provoked a perceptible amount of enthusiasm among investors.

…with a likely strong demand for cross-border acquisitions in financial and other services

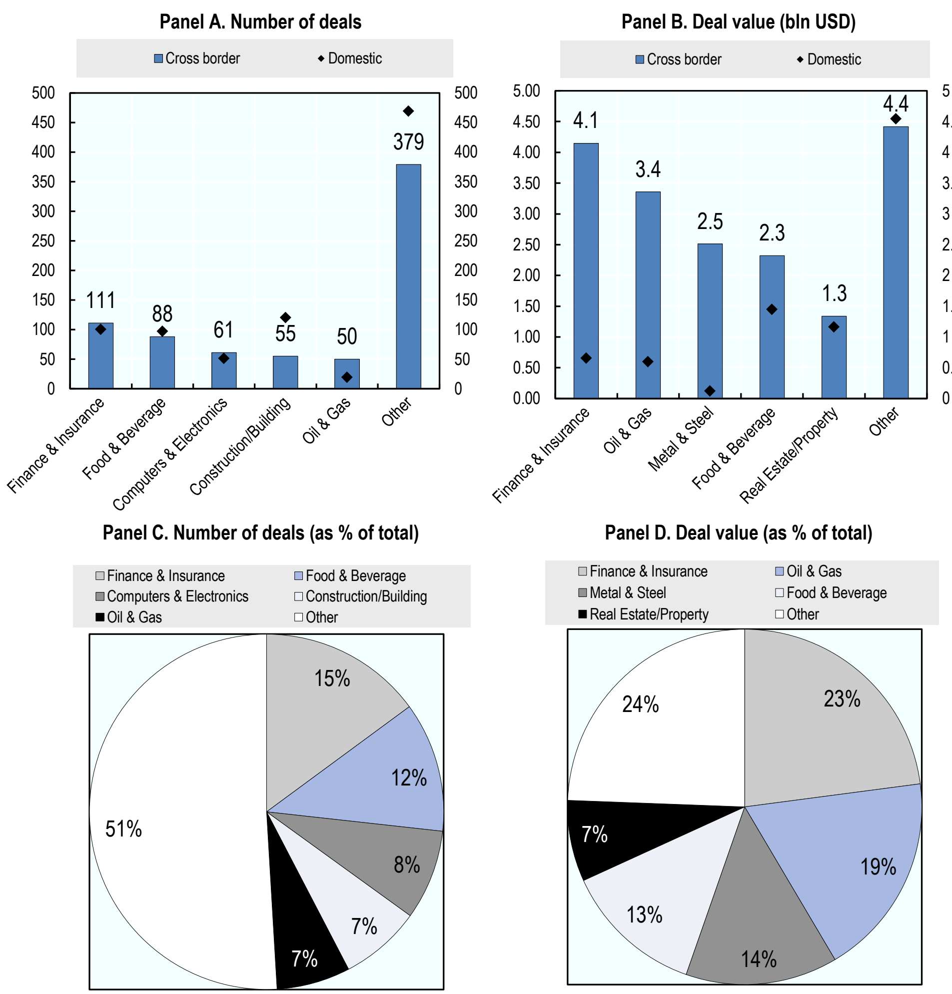
The effect of recent reforms may be particularly prominent in some sectors, in which investment opportunities have been limited to date. Thus far, finance and insurance sector, oil and gas, and metal and steel have been the most important sectors in terms of total value of M&A deal value registered between 1995 and 2015 (Figure 1.7), accounting jointly for over 50% of the total cross-border activity, followed by the food and beverage, computers and electronics, and real estate sectors. Acquisitions in all the services sectors mentioned above were largely limited to minority stakes due to the existing restrictions on foreign equity mentioned above and in Chapter 2.

With the recent changes in maximum foreign equity limits in public companies and other reforms, such as the planned and on-going equitisation process of a number of SOEs and the intensified reform in the financial sector, the financial sector could experience more M&A activity in the coming years. Several large state-owned banks in Viet Nam (*e.g.* Vietcombank and Military Bank) have announced their willingness to enter a partnership with a strategic foreign partner. Foreign banks also have an appetite to enter the Vietnamese market to service foreign-owned investors in other sectors. With some of the implementing regulations still pending, it remains to be seen if the sector-specific limitations on foreign ownership in the sector will be removed.[11]

Beyond the formal rules covering foreign firms in the sector, the speed of progress in SOE equitisation and broader financial sector reform will also influence the degree to which investment opportunities become available to foreign firms. Most recently, progress in selling off state-owned assets has been slow – only about a fifth of SOEs planned for equitisation in 2015 were sold off (see Chapter 4). In addition, domestic SOEs have also acquired targets in the financial sector in Viet Nam, in some cases tightening rather than relaxing government control. For example, according to data published by the National Assembly[12], 47 of the most powerful state-owned conglomerates and large corporations raced in 2006-08 to invest in the financial sector.[13] The limited number of initial public offerings and the heavy SOE presence in some sectors may have also obstructed the emergence of new investment opportunities for M&A activity in the sector by foreign firms. As a result, despite the on-going reforms in the financial sector in Viet Nam, the share of foreign banks in total commercial banking assets has remained small, at 10% in 2015 and has remained stable over the past decade.[14]

Greater foreign participation in the country's financial sector may allow for the development of more sophisticated or more competitive financial products and assist in the process of financial deepening (Box 1.3), thereby facilitating the process of restructuring of the sector. The shortage of capital for private-sector firms in Viet Nam has been well documented[15] and is reflected in the available rankings and firm surveys. While several global market players have been able to enter the Vietnamese market, such as Morgan Stanley, HSBC, Standard Chartered, Deutsche Bank, BNP Paribas, Société Générale, the fact that they were allowed only minority equity stakes has reduced the opportunities for meaningful changes to internal management and corporate governance systems in the acquired firms.

Figure 1.7. **Cross-border M&As involving a target firm in Viet Nam, 1995-2016**



Source: OECD calculations using Dealogic M&A data

Box 1.3. **Potential role of foreign banks in the development of local financial markets**

The opening of the financial sector to foreign participation is often accompanied by concerns from national authorities and local players. The typical fear is that foreign-owned banks will not serve SMEs and rural clients, and that their likely superior performance will allow them to cherry-pick clients, weakening local banks. While it is true that often the client profile of foreign-owned banks differs considerably from that of local banks (especially when foreign-owned banks face regulatory restrictions limiting their retail presence or their business strategy), it is often the case that a higher penetration of foreign-owned banks in the market is associated with greater access to finance by SMEs from local banks. When facing higher competition by foreign banks in the upper segments of the market, often local banks tend to increase their emphasis on the SME sector.

In general, foreign banks have positive effects on competition, stability and financial development in host countries. The positive effects of foreign banks are associated with lower costs of financial intermediation, as well as lower rents; increased access to financial services, even for SMEs as explained above; enhanced economic and financial performance of borrowers as a result of the introduction of new and more diverse products and services, as well as up-to-date technologies, improved marketing skills and corporate governance, and know-how spillovers; accelerated domestic reform as a consequence of pressures on governments to increase transparency, and improve regulation and supervision to international best practice levels; and greater financial stability as foreign banks are generally more capable of absorbing shocks occurring in the host market, and hence providing a more stable source of capital, particularly in the case of greenfield subsidiaries. Foreign banks also contribute to reduce connected lending as these banks are usually not as politically-connected as local banks.

Foreign bank presence may also sometimes have a potentially disruptive effect, however, depending on their funding strategy. Evidence suggests that allowing foreign-owned banks to access local deposit markets to fund host country operations is more likely to be beneficial for financial development and stability in times of crisis. Foreign-owned banks relying more heavily on international funds tend to reduce lending more sharply than locally-funded banks in the case of shocks to the parent bank, such as in times of global or home country crisis. However, in some cases, foreign banks can also contribute to minimise financial stress in times of host country crisis through their internal capital market.

The magnitude of the effects of foreign bank entry on development and efficiency in the financial sector also depends on some conditions. Limited general development and entry barriers can hinder the effectiveness of foreign banks in facilitating the expansion of financial services. Limited participation of foreign banks, relative to total banking system, also seems to produce fewer spillovers, suggesting a possible threshold effect. For instance, in relation to risk management practices, foreign banks are likely to enjoy superior risk management capacity, which the local supervisor can draw on to accelerate technology transfer to the local market. Also when a larger number of foreign banks relative to domestic ones exist, foreign banks seem to play a more …/

Box 1.3. **Potential role of foreign banks in the development of local financial markets** (cont.)

important role in financial intermediation. In contrast, they tend to be niche players when less important in number. The size of institutions also matters. Larger foreign banks are associated with greater effects on access to finance by SMEs, as well as healthier parent banks are associated with higher credit growth. In certain cases, cherry-picking by foreign-owned banks can also undermine overall access to financial services, particularly in low-income countries where relationship lending is important, by worsening the remaining credit pool left to domestic banks, which can hurt their profitability and willingness to lend. These are only a few characteristics of foreign bank entry implications for financial sector development. Other home and host country characteristics, as well individual bank characteristics, play a role in the impact of foreign bank entry on host country financial development and should be carefully taken into consideration by regulators.

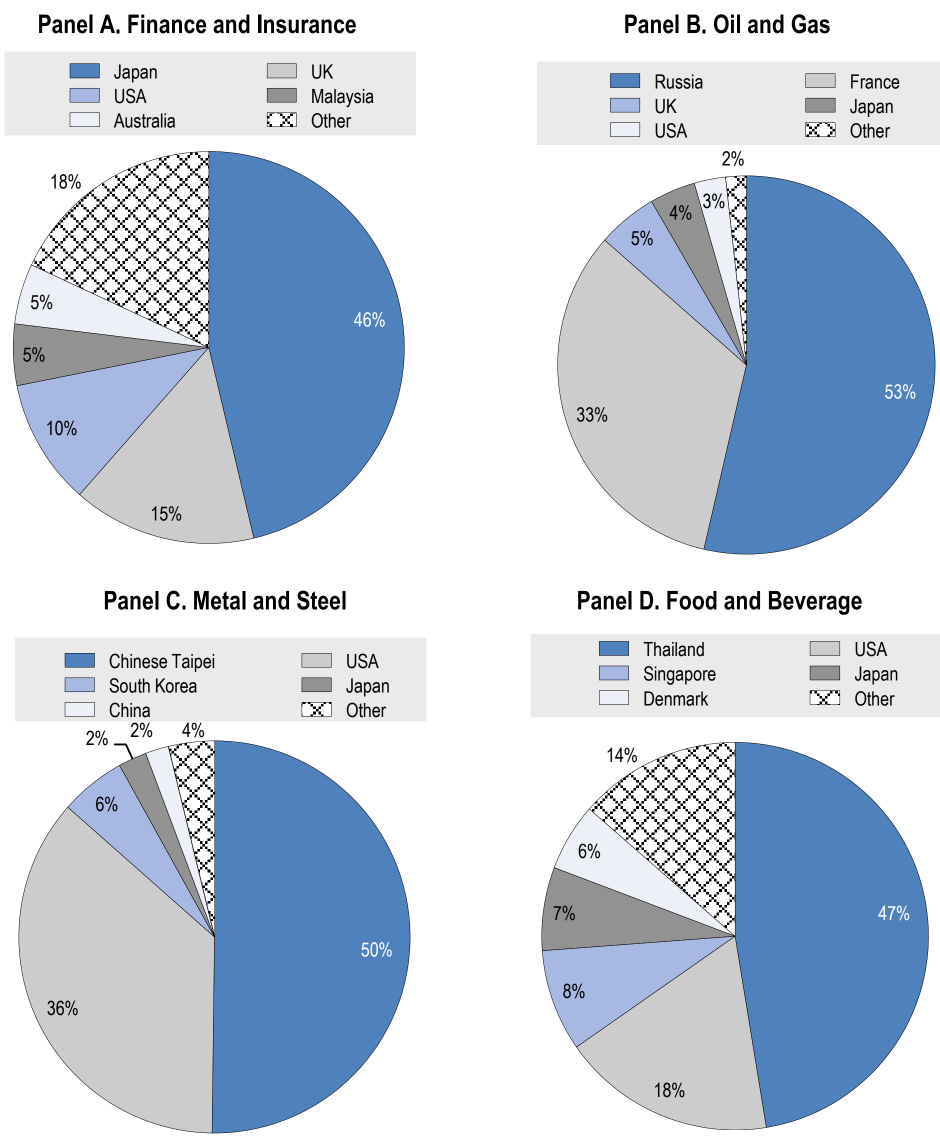
Source: Based on the literature review in Claessens and van Horen (2012), as well as on the World Bank and IMF (2005) and presentations by Stijn Claessens, Ralph De Haas and Maria Soledad Martinez Peria during the OECD Experts Meeting on Financial Services held at the OECD on 30 November 2012.

…in which OECD investors are likely to play a prominent role and can facilitate restructuring.

Within the financial sector and other key sectors for cross-border M&A activity in Viet Nam, such as oil and gas and metal and steel, investors based in OECD countries play a prominent role (Figure 1.8). For example, acquirers from Japan accounted for nearly half of all acquisitions between 1996 and 2016 in the finance and insurance sector, followed by the United Kingdom (15%) and the United States (11%). In oil and gas, investors from France (*i.e.* Technip SA and Perenco SA) have been the second largest source of investment, after the firms from the Russian Federation (*i.e.* LUKoil OAO and Rosneftegaz OAO). In steel and metal sectors, Chinese firms dominate (*e.g.* China Steel Corp and Mayer Steel Pipe Corp), but investors from the United States have also been prominent, accounting for 36% of the total deal value in the sector. Lastly, in the food and beverage sector in Viet Nam, investors from Denmark (*e.g.* Carlsberg) have been the second largest source of foreign investment through M&A in the sector after Thailand. Therefore, while investors from the region remain important in the cross-border M&A market in Viet Nam, OECD investors have also been prominent, particularly in value terms (Figure 1.9). To the extent that recent reforms and the expected increased cross-border M&A activity offer new investment opportunities, investors based in OECD countries may further rise in prominence.

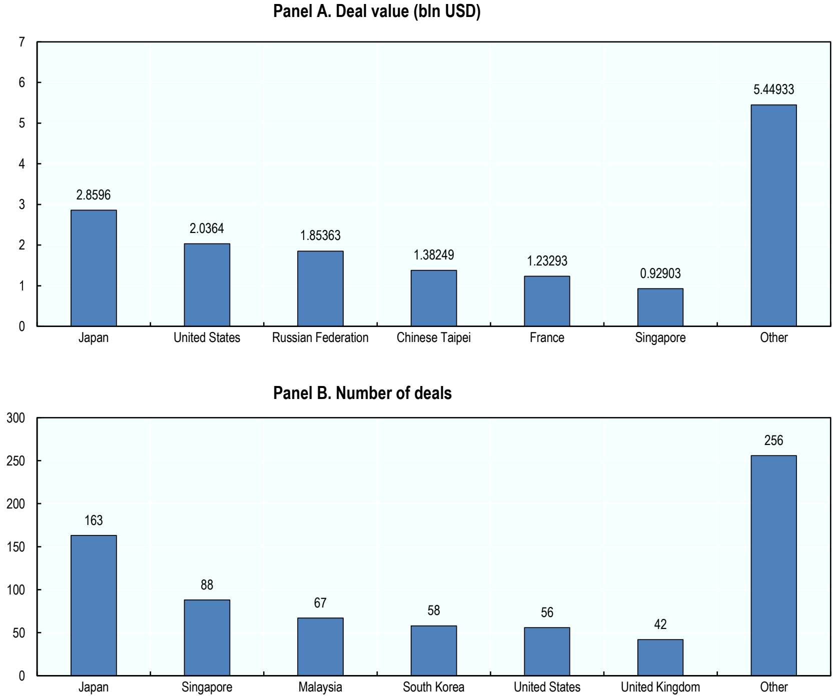
Figure 1.8. **Value of M&A deals in Viet Nam by acquirer's nationality, 1995-2015**

(% of total cross-border M&A in each sector)



Source: OECD calculations using Dealogic M&A database.

Figure 1.9. **Dominant acquirers in Viet Nam by nationality, 1995-2015**



Source: OECD calculations using Dealogic M&A database.

Notes

1. For more information, see endnote No. 3 of the Assessment and Recommendations.
2. Tran (2005) cites an MPI study from 2005 revealing that 50-81% of US FDI came through subsidiaries in Singapore, Mauritius, Bermuda, the Netherlands and Hong Kong, China (amounting to over USD 800 m. of capital).
3. Law No. 59-2005-QH11 on Investment, dated 29 November 2005; Law No. 60-2005-QH11 on Enterprises, dated 29 November 2005; Decision No. 238-2005-QD-TTg of the Prime Minister, dated 29 September 2005; Decree No. 139/2007/ND-CP (Decree 139) on the 2005 Enterprise Law and 2005 Investment Law.

4. The list of conditional sectors (*i.e.* sectors in which investments were subject to additional conditions) was fixed at the time by Decree 108/2006.

5. Public companies in Viet Nam refer to companies that (i) have carried out a public offering, or (ii) have no less than 100 shareholders and VND 10 billion of contributed charter capital or (iii) are listed in the stock market. The maximum foreign equity limit in public companies was raised from 30% to 49% in 2007 and remained capped at 49% until the most recent reform in 2015 (Decree No. 60/2015/ND-CP)

6. Decree No. 60/2015/ND-CP issue by the Government on June 26, 2015 removed the maximum foreign equity cap and allowed foreign investors to acquire majority stakes in public companies in Viet Nam.

7. The new Law on Investment No. 67/2014/QH13 and the new Law on Enterprises No. 68/2014/QH13, took effect on 1 July 2015, replacing the 2005 Law on Investment and the 2005 Law on Enterprises.

8. Decree No. 60/2015/ND-CP dated June 26, 2015.

9. In the new Investment Law of 2015, the Government has specified a list of sectors where investment (both domestic and foreign) is banned and where investments are subject to conditions (which are to be specific in the implementing regulation). The number of so-called conditional sectors has also been reduced, from 386 to 267. A decree, recently published, also includes a list of sectors where foreign investment specifically is subject to conditions.

10. Due to the reform, an “investment registration certificate” (IRC) is no longer required for an M&A transaction by foreign investors when the target does not operate in a conditional sector for FDI (*i.e.* sectors listed in the Law that require a prior approval based on specific conditions to be settled by regulations) or when the acquisition does not result in the investor holding a stake of 51% or more in the target company.

11. The supporting regulation to the new Investment Law and Decree No. 60/2015/ND-CP will decide what conditions will apply to sectors subject to conditions, and what the degree of conditions will be.

12. Hong Anh “National Assembly discusses P&L story of state-owned conglomerates,” VNExpress Online, November 9, 2009 as cited in Vuong et al. (2009: 28)

13. This included, among others, which included transactions undertaken by Vietnam Post and Telecommunications Corporation, Vietcombank, and Petrovietnam.

14. IMF (2014), ADB (2014), Vietnam Banking Industry (2015).

15. See, for example, Vuong, 1997(a) and 1997(b), Vuong and Nguyen (2000), and Pham and Vuong; (2009).

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Annex 1.1

Compiling FDI statistics in Viet Nam

Foreign direct investment is one of the principal ways that economies integrate into the global economy. It is not only an important channel for exchanging capital across countries, but also for exchanging goods, services, and knowledge and serves to link and organise production across countries. FDI provides a means to create stable and long-lasting relationships between economies, and it can be an important vehicle for local enterprise development. FDI has grown rapidly in recent decades and both the destinations and sources of FDI have expanded with globalisation. Internationally harmonised, timely, and reliable FDI statistics are essential to assess the trends and developments in FDI activity globally, regionally, and at the country level. The usefulness of FDI statistics depends on several dimensions of quality: *i*) alignment with international standards; *ii*) accuracy and credibility; *iii*) timeliness; and *iv*) accessibility.

FDI is one of the major types of investment included in the balance of payments (BOP) and international investment position statistics. The International Monetary Fund (IMF), in its *Balance of Payments and International Investment Position Manual, 6th edition* (BPM6), and the OECD, in its *Benchmark Definition of FDI, 4th edition* (BMD4), present recommendations for compiling FDI statistics. The recommendations of the two agencies are aligned, but the OECD offers supplemental series that are particularly useful in analysing globalisation. The recommended measures of FDI statistics in these guidelines produce meaningful FDI statistics that are part of the larger System of National Accounts and, so, ensure that FDI statistics are compatible with other important economic statistics. Following the recommendations in the international guidelines is critical to producing relevant and coherent FDI statistics.

This section describes the current system for compiling FDI statistics in Viet Nam, including a discussion of recent and planned improvements in these statistics. It concludes with an assessment of the FDI statistics of Viet Nam along the quality dimensions discussed above and makes recommendations for further enhancing the quality of these statistics.

Current system for compilation of FDI statistics in Viet Nam

Viet Nam compiles two sets of FDI statistics. The first set of statistics is compiled by the Foreign Investment Agency (FIA), which is part of the Ministry of Planning and Investment (MPI), and covers licensed FDI projects. These project-based statistics cover the number of projects licensed, the total registered capital, and the total implemented capital and are presented at the aggregate level as well as by main industry sector according to International Standard Industrial Classification (ISIC) Rev. 3 and by main counterpart economy. These data also cover overseas projects by Vietnamese companies. The second set of FDI statistics is compiled and disseminated by the State Bank of Viet Nam (SBV) as part of the Balance of Payments statistics. The project-based FDI statistics of the MPI differ from the BOP FDI statistics of the SBV in terms of coverage, definitions, classifications and concepts but are an important data source for the SBV.

Overall, Vietnamese FDI statistics are based on sound data sources, are timely, and are easily accessible on several different website and databases, but they are not completely in line with international standards. Some important gaps in coverage could be closed by developing a dedicated FDI survey. Building on the existing cooperation between different agencies in Viet Nam would further enhance FDI statistics and lead to the development of additional statistics that would help to understand the role that FDI plays in the globalisation of the Vietnamese economy. Recommendations for improvement are included at the end of this section.

FDI statistics by the MPI

The MPI has the authority to collect data through surveys from all registered enterprises with foreign capital. The provincial authorities are also authorised to manage, license, and collect the FDI data of companies with foreign capital. The MPI collects the information gathered from its surveys and from the provincial authorities along with information from investment approval authorities and uses it to produce a monthly report on foreign investment. MPI also uses information from other ministries, including the Ministry of Industry and Trade and the Ministry of Justice, and banking authorities in compiling its data. The monthly report is available 10 days after the end of the reference month. The data are so timely because foreign investors must register on-line so the data are continuously updated. These project-based FDI statistics are publicly disseminated through the General Statistics Office (GSO) website; they are also reported to the ASEAN Secretariat. MPI also produces quarterly and annual reports and revises the data as more up-to-date information is obtained.

These statistics present both registered and implemented capital, which cover both equity and debt investments. Data on registered capital by partner economy are available, but not data on implemented capital by partner economy at this time. The registered capital by partner economy statistics are by the country of the immediate investor, but information on the country of the ultimate investor is also collected. While these data are not publicly available, they can be provided for internal use upon request. The data on registered capital are also available by economic activity based on ISIC Rev. 3.

Lastly, in addition to the data on registered and implemented capital, MPI produces data on the contributions of foreign-owned firms to trade and employment, based on the surveys conducted, and provides data on the total exports and imports of foreign-owned firms and the total employment of foreign-owned firms. Such statistics are very useful for understanding the role that foreign-owned firms are playing in the economy.

FDI Statistics by SBV

The project-based statistics discussed above are an important data source for the SBV in compiling its FDI statistics. The MPI gives data on the foreign capital contribution to registered foreign enterprises to the SBV on a quarterly basis. The SBV adjusts these data to match the BOP concepts. For example, the MPI data distinguish between foreign and domestic capital but do not distinguish foreign capital between capital from the foreign parent companies and capital from unaffiliated foreigners. FDI only covers foreign capital from foreign parent companies; any foreign capital raised from unaffiliated parties is classified elsewhere in the BOP accounts. In addition to the MPI, the other main data sources for the SBV include the banking system and the tax authorities. The SBV gathers information on dividends paid by foreign-owned enterprises from the tax authorities, but these data exclude companies that are tax-exempt. As a result, these data are not complete enough to produce reliable estimates of total income and dividends, leading to gaps in series.

Since 2005, the SBV has published data on outward FDI of Vietnamese companies based on the data provided by the MPI. The SBV publishes its statistics on its website and submits the data to the IMF. The SBV also makes adjustments to the registered capital data by country it receives from MPI so that they can provide data on FDI by partner country to the ASEAN Secretariat.

Recent and planned improvements

Recent amendments to Viet Nam's investment laws had direct effects on the data collected by MPI. For example, prior to the recent amendments, the MPI was limited in its ability to collect data on M&As to those where the foreign investor acquired more than 50% of the domestic company, but it now has the authority to collect data on those M&As that involve ownership of less than 50% and is developing a mechanism to collect this information. This is an important improvement because the 10% ownership criteria to distinguish direct investment from other forms of investment is a crucial feature of the international guidelines for FDI statistics. Lastly, the MPI began an electronic data collection vehicle in 2016 but needs to improve the uptake by respondents.

Currently, the MPI only publishes data for registered capital by partner country, but there can be substantial differences between the amounts of implemented and registered capital. MPI has begun to collect data so that implemented capital by country can be presented. Once the quality and completeness of the data reporting have been determined to be sufficient, they will begin to publish these statistics. It would also be good to start publishing the statistics on implemented capital by economic activity as well as the only statistics currently published by economic activity are registered capital.

The SBV is working with the IMF to develop a survey that can be used to collect data to close some of the important gaps in coverage in their FDI statistics. This survey would provide the data needed for Viet Nam to participate in the Coordinated Direct Investment Survey.

Assessment of the compilation of FDI statistics in Viet Nam

There are several very positive aspects to the system for compilation of FDI statistics in Viet Nam that provide a strong foundation for the production of high-quality FDI statistics. These include:

- A legal framework authorising the collection of data from foreign-owned firms as well as overseas Vietnamese investors. These surveys are mandatory, which is critical to ensuring that the coverage and response rates are sufficient to ensure the quality of the statistics. The agencies collecting the data are also required to ensure the confidentiality of the information, which can help to boost response rates.

- Some of the key data sources are very timely, including the permits that are registered in an on-line system enabling continuous updating. Introducing further electronic data collection vehicles will help to enhance the timeliness of the data. The SBV compiles BOP statistics on a quarterly and annual basis and publishes the statistics within three months of the end of the reference period. This meets the requirements of the IMF's Enhanced General Data Dissemination System.

- Strong data sharing and working arrangements between different agencies. Due to the multi-faceted nature of FDI, it is often important for different government agencies to work together to provide the data needed to compile the statistics. There is already a good working relationship for the collection and sharing of FDI-related data between different agencies in Viet Nam as shown by the collaboration between the MPI and the SBV, but also as evidenced by the cooperation between the GSO, MPI, the Ministry of Trade and Industry, and other ministries. This builds a strong foundation for the compilation of FDI statistics.
- The SBV is working with the IMF to improve the data sources and compilation methods for their FDI statistics. This could lead to the development of a survey of FDI that the SBV could use to close gaps in coverage and introduce further enhancements in their FDI statistics.
- The collection of data on the employment and trade of foreign-owned firms is very useful and can play an important part in understanding the role that foreign investment is playing in the domestic economy.
- The statistics are readily available on both the SBV and GSO websites. The SBV submits the data to the IMF, and both the SBV and MPI submit data to the ASEAN FDI database.
- Both the MPI and SBV participate in activities related to FDI statistics as part of ASEAN. The ASEAN Secretariat FDI statistics group is an important vehicle for improving FDI statistics in the ASEAN region by, for example, enabling the sharing of best practices between compilers in different countries. It also affords countries an opportunity to compare bilateral statistics which is a useful way to detect potential issues with the statistics.

As a result, the FDI statistics of Viet Nam are timely and accessible. The statistics that are published are based on sound data sources, but, despite these strong foundations, there are still improvements that could be made. A closer alignment with international standards, would enhance the comparability of the FDI statistics with other domestic statistics as well as with the FDI statistics of other countries. The latter suggestions for improvement would produce additional FDI statistics that would provide additional information on the role of FDI in the global integration of the economy.

- *Close the gaps in coverage by including reinvested earnings*. The SBV does not include reinvested earnings in its FDI financial flow statistics which can be an important source of financing for foreign-owned firms, especially as those investments mature. Given the size and maturing of foreign investment in Viet Nam, it is likely that reinvested earnings are a substantial portion of the recorded equity capital and debt flows. For example, a pilot study of 300 companies conducted by the SBV with the IMF found that reinvested earnings accounted for up to 40% of implemented capital in 2015. As a result, there could be a considerable understatement of the amount of FDI in Viet Nam in the official statistics.

- *Include data on FDI income flows*. Currently, Viet Nam does not disseminate income flows as part of its FDI statistics. The information on income flows is important to assess the profitability of FDI in Viet Nam and in assessing the impact of FDI on the current account.

- *Develop FDI position statistics for Viet Nam*. International Investment Position statistics are becoming increasingly important in assessing the vulnerabilities of economies to financial crises and other shocks. While FDI financial flow statistics are important for assessing the new international investment links being created, it is the FDI position statistics that shed light on the role that the cumulative foreign investments over time are playing in the economy. Lastly, FDI positions can be useful in analysing such things as the profitability and rate of return on FDI in the host economy.

- Currently, the SBV only compiles statistics according to the asset/liability presentation but should *consider also presenting statistics according to the directional principle*. While the asset/liability presentation is in line with the recommendations in BPM6 for aggregate FDI statistics, the directional presentation is still useful because it shows both the direction and degree of influence of foreign investors in the economy. This could be done by collecting information on reverse investment—that is, investment from foreign-owned firms in their parents.

- Viet Nam should continue to work with the IMF to improve its data collection and compilation system for FDI statistics to close these gaps and to eventually participate in the Coordinated Direct Investment Survey (CDIS) which is an important tool for comparing

FDI position statistics for a large number of countries. It requires that the FDI positions by partner country be presented on a directional basis to enable cross-country comparisons.

- The international guidelines call for presenting all FDI statistics—financial and income flows and positions—by detailed partner country and by industry according to the directional principle. The directional principle is considered to be the most meaningful basis for analysis since it shows the direction of influence—inward or outward investment—as well as the degree of influence. The SBV should also develop FDI flow statistics by partner country. Not only would these statistics be more comparable to those of other countries, but they would provide information on the origin of direct investors in the Vietnamese economy.
- Collecting information on the ultimate owner by the MPI could be very useful for the SBV to incorporate into their FDI statistics. The presentation by ultimate owner provides information on the country of the investor who ultimately controls the investment, which is an important piece of information for policymakers. Because a data source already exists for this information, it could be relatively easy to implement for Viet Nam.
- FDI statistics by economic activity—both FDI flows and positions—are also important to understand the sectors of the economy that foreign investors are attracted to. For example, FDI position statistics by economic activity can identify those sectors of the economy where foreign investors play the largest role. Such statistics could be developed from a dedicated FDI survey and from information on implemented capital by economic activity if the MPI were to make such data available.
- The need to link what were previously considered separate data sets, such as trade data, FDI data, and other business statistics has become more apparent. Such linked datasets enable a better analysis and understanding of the interconnections between economies and the role that FDI plays. Many advanced countries struggle to create these linked datasets because of laws and regulations that limit the sharing of data between agencies. Viet Nam has an advantage in that many of the agencies responsible for these different data sets are already cooperating. Indeed, Viet Nam already publishes information on the employment and trade of foreign-owned firms. These working arrangements should be formalised in law or official agreements, such as a memorandum of understanding, between the different agencies involved if they have not already done so.

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