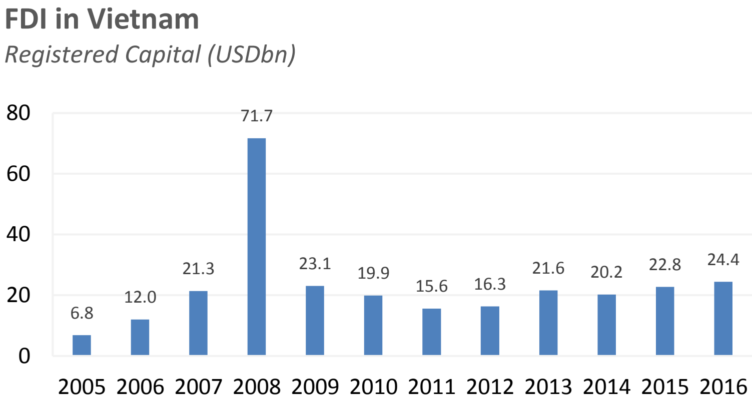
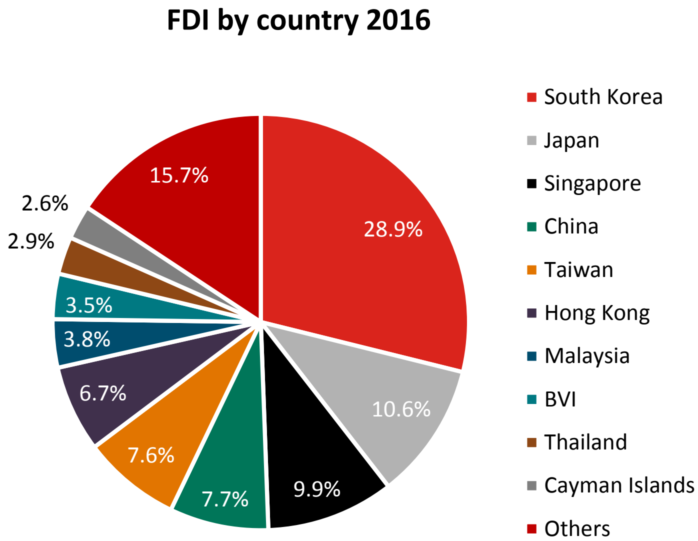
Foreign direct investment propels Vietnam's economy

Vietnam recorded another stellar year for foreign direct investment (FDI) in 2016, with USD24.4 billion registered. That figure is 7% higher than 2015's robust haul of USD22.7 billion.

The strong 2016 result was a pleasant surprise to some observers, who believed that Vietnam would have a difficult time matching 2015's FDI total because that year featured a number of large-scale projects, including a power plant, as well as the diminished prospects of the now-dead Trans-Pacific Partnership (TPP), which clearly was the impetus for some earlier investment, particularly from overseas companies in the textile and apparel industry.



South Korea retained its crown as the top source of FDI, with Samsung and LG among the largest investors in Vietnam, followed by Japan and Singapore.



Nearly two-thirds (64%) of 2016's FDI went toward manufacturing, while auto/ motorcycle wholesale and retail took 8% and real estate took 7%.

In addition to Samsung and LG, firms such as Sanyo, Sony, Fujitsu, Panasonic, Keppel and CapitaLand also announced significant investments into Vietnam in 2016.

But there is a downside…

The important role of FDI in Vietnam's economy is clear: The FDI sector contributes nearly 20% of Vietnam's GDP[1]. Foreign companies produce more than two-thirds of Vietnam's exports[2] -- with Samsung contributing 22.7% of total exports[3].

All of which begs the question, "where are the Vietnamese companies?" They are for the most part struggling to compete, leading some to believe that the economy could effectively be hollowed out should these trends continue. We believe these concerns are valid, but that there are two ways to address them:

1. Continue to privatize state-owned enterprises (SOEs): Although the pace of privatizations has accelerated, SOEs still contribute about one-third to Vietnam's GDP[4] despite constituting

[1] "Navigating Vietnam," CIMB, February 3, 2017
[2] Ibid.
[3] "Samsung contributes 22.7% to Vietnam's exports," *Vietnam Net Bridge*, January 21, 2017
[4] "Vietnam to retain state control of enterprises in national security and defense," *VN Express*, June 3, 2016

approximately 40 percent of investment. Further, productivity in foreign enterprises is five times higher than SOEs, according to the IMF.

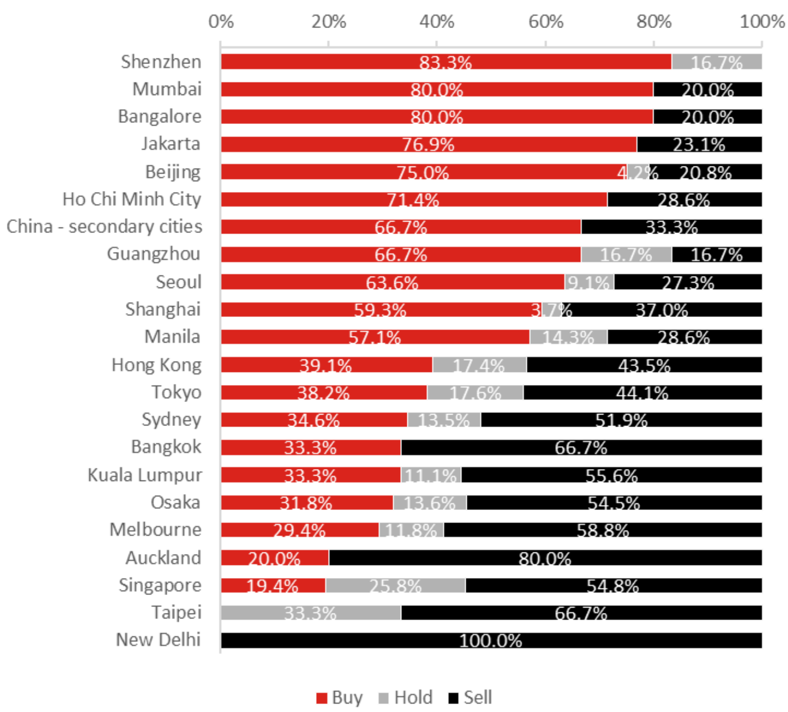
2. Level the playing field: When foreign companies invest in Vietnam, they often receive tax breaks, ready-made or built-to-order infrastructure and other incentives; plus, their cost of capital is lower. In contrast, Vietnamese companies do not generally receive the same favorable considerations, putting them at a disadvantage from the start. The government should consider ways to extend incentives to private Vietnamese enterprises so that they have a better chance to compete.

3. Invest in brand building: Vietnam does not lack for successful companies, and the entrepreneurial spirit of Vietnamese people is strong. But there are few well-known companies that have invested in marketing and branding to the degree necessary to stand out, namely Vinamilk and FPT, which are both equitized companies that are leaders in dairy and IT, respectively. VietJet (airline) and Mobile World (consumer electronics retail) are private companies that have profitably grown. They and a handful of other local brands are proof that it is possible to build distinct brands and identities that are popular with consumers and more importantly, generate good returns for investors. If Vietnamese do not rise to the challenge, then there is a very real possibility that foreign brands could dominate significant parts of the economy.

How can investors play the FDI story?

Vietnam's FDI story is very positive, but how might investors profit from it? One way we believe investors could participate is via the property market. Multinational corporations are building and/or leasing space for research and development, manufacturing, and distribution in and around HCMC in the south, Haiphong and Hanoi in the north, and increasingly near Danang in the central region. These properties will be in strong demand for the foreseeable future as multinationals continue to expand their manufacturing operations in Vietnam, either in addition to operations in China or as a replacement altogether. A study from the US-based Urban Land Institute found that investors ranked HCMC among the top cities for investment prospects, and overwhelmingly favored buying industrial and distribution property.

Industrial/distribution property buy/hold/sell recommendations, by city



Source: "Emerging Trends in Real Estate, Asia Pacific 2017", Urban Land Institute

To serve Vietnam's growing manufacturing sector, the USD50 billion logistics industry has also undergone rapid expansion, growing ~20% per year, with expected sustained growth of 20-24% for at least the next 5-10 years[5]. Throughput at Vietnam's ports is expected to grow by more than 10% in 2016[6]. These forecasts speak to the need for new distribution and warehouse facilities.

Mapletree and a handful of other regional players have been active in this sector, although in a fairly modest way, and we believe there could be an opportunity for someone to roll up a number of these

[5] Vietnam Logistics Business Association
[6] Vietnam Maritime Administration

properties into a fund that could generate solid yields for investors.

Conclusion

During the first two months of 2017, a total of USD3.4 billion in FDI was recorded, a 21.5% increase compared to the same period a year earlier. While the country could see lower investments from companies operating in the textile and garment sector – which was seen to be one of the greatest beneficiaries of TPP – continued investment from technology companies along with real estate developers could balance that out. Further, there is a growing chorus calling for the country to focus on attracting higher quality investments, with an eye on high-tech. These cleaner, higher value-add investments are ultimately of greater benefit to the country's ongoing development, although they will require further investment in education to ensure the labor pool for more sophisticated work is ready. Nevertheless, it appears that FDI flow will continue to be strong over the next few years as Vietnam solidifies its position as a new manufacturing hub in ASEAN.

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