

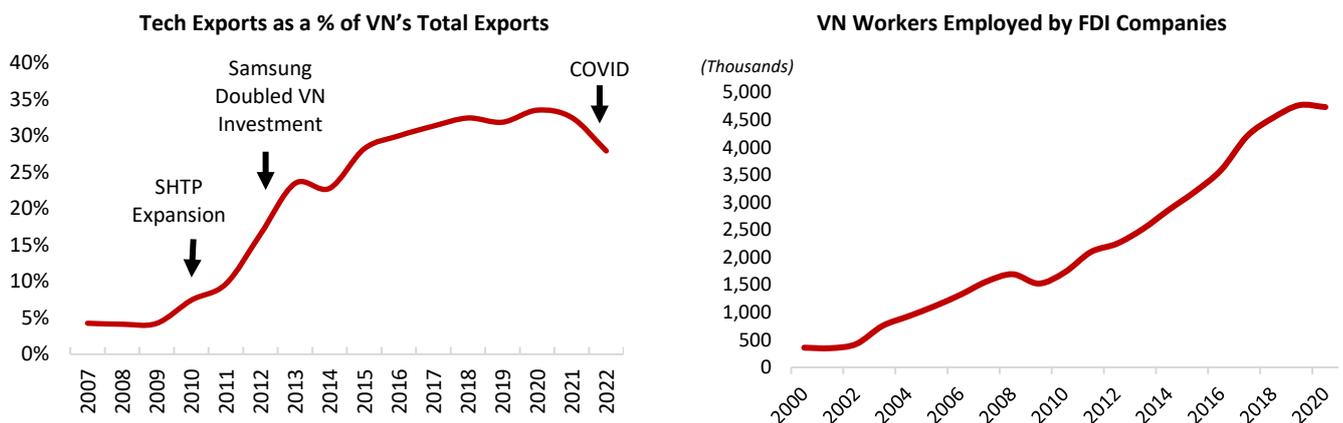
Michael Kokalari, CFA
Chief Economist

Vietnam Continues To Attract High-Quality FDI

Last week, Samsung announced that it will invest another USD920 million in Vietnam, which will lift its total investment in the country to more than USD19 billion.¹ Samsung is Vietnam's single largest foreign investor by far; it makes about half of its smartphones in Vietnam, including the widely anticipated S22 phone which will go on sale this week. When announcing this latest investment, Samsung Vietnam's CEO Choi Joo Ho said, "Samsung has complete confidence in Vietnam's investment environment and will never change its business strategy in the country."

Samsung made its first small-scale Vietnam investment in 2008 and started aggressively ramping up its investments four years later, when it doubled the amount of money it had poured in the country to USD1.6 billion. Samsung's FDI ramp-up coincided with a surge of investments by other high-tech firms that started around 2010, the most notable examples of which were Intel's USD1 billion in 2010 and LG Electronics USD1.5 billion in 2013. In addition to those three high profile projects, there were a plethora of smaller investments by companies such as Jabil Circuits and Nidec to set up factories in industrial parks, including the Saigon High Tech Industrial Park (SHTP).

The demand from high tech companies to lease industrial land in the SHTP was so strong that after 2010, the industrial park doubled its physical size to over 600ha (which was subsequently increased to over 900ha). Those investments drove a three-fold increase in the number of Vietnamese workers employed by FDI companies and dramatically improved the composition of Vietnam's exports, as can be seen below (note that Samsung contributes about one-quarter of Vietnam's exports).



The jobs FDI factories created over the last 10 years helped propel the development of Vietnam's nascent middle class, partly because the wages that those multinational companies pay workers are typically about 20% above comparable wages in the local private sector. In addition to providing employment opportunities, Vietnam's vibrant foreign-invested sector is setting the stage for the formation of many home-grown companies that will supply those FDI manufacturers with "medium tech" products (e.g., precision ball bearings and high tolerance, tempered glass) that are currently imported but could be produced locally.

Further to that last point, there is a deep body of research on the "spill-over" economic benefits from FDI companies to local industry in China and other developing countries²³. One conclusion of that research is that many mid-level managers who work at an FDI company for over five years aspire to start their own companies around that time; this is also about how long it takes before the local employee of an FDI company has acquired sufficient knowledge that they are able to transfer their knowledge to local industry.

Finally, we have often mentioned in our research reports and webinars that the primary attraction for firms to set up factories in Vietnam is the fact that wages here are two-thirds below those in China and the quality of the workers is comparable to that of China, according to surveys by Japan's JETRO and others. Last week, Samsung Vietnam's current CEO

¹ The company's latest investment will nearly double its investment in the Samsung-Electro-Mechanics Vietnam (SEMV) factory that produces the printed circuit boards, camera modules and other parts needed to manufacture smart phones in Vietnam.

² "Disentangling Spillover Effects", *Institute for International Economics* (Javoricik and Spatareanu, 2005)

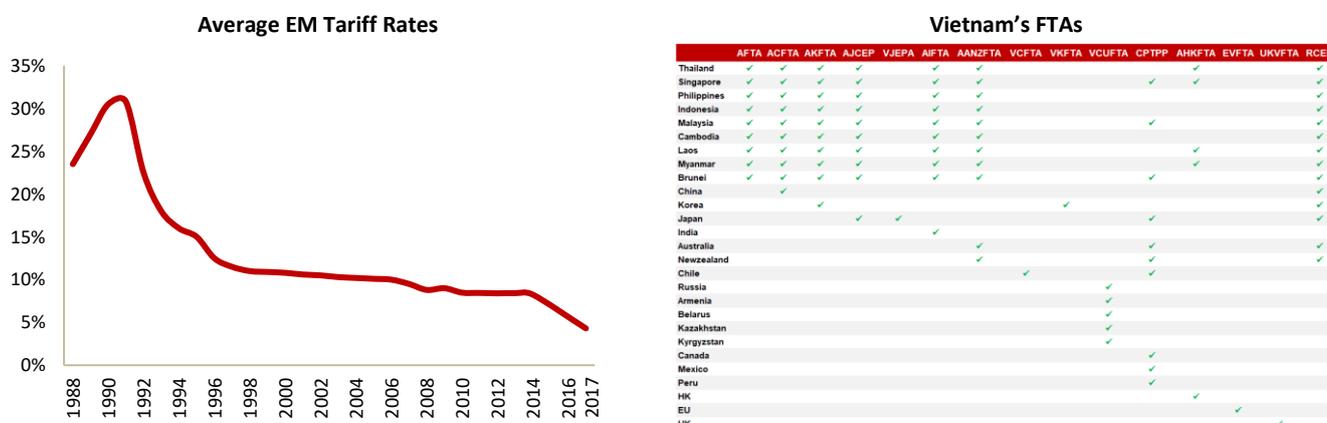
³ <https://www.brookings.edu/blog/africa-in-focus/2015/11/19/understanding-fdi-spillover-mechanisms/>

commented that Vietnam's high quality human resources, as well as its social and political stability, are the key factors that give the company confidence in the country, and Samsung's previous Vietnam CEO once commented that the productivity of Vietnamese factory workers is about 80% that of South Korea's, but wages in Vietnam are only about 20% of those in Korea.

All of that said, Vietnam's geographic proximity to the supply chains of Asia is also an important factor in attracting the high-quality FDI inflows that are driving the improvement in the composition of Vietnam's exports. We also hear anecdotally that firms feel that their intellectual property (IP) is more secure in Vietnam than in China, and that Vietnamese workers are more reliable and have more enthusiasm than those in the country's regional competitors for FDI. Finally, Vietnam's membership in numerous free trade agreements also makes companies more comfortable to pour FDI into Vietnam, which is discussed below.

Free Trade Agreements and Vietnam's Improving Export Composition

Vietnam is a party to 15 free trade agreements (FTAs), including the RCEP pact that came into effect this year. The key motivator for countries to enter FTAs is to slash import and export tariffs, which explains why EM tariff rates plunged over the last 30 years, and why Vietnam has joined so many FTAs. Vietnam's exports and imports equate to ~200% of GDP, which is the highest level of any country in modern economic history, apart from city-states like Singapore and Hong Kong.



That said, the tax cuts entailed by FTAs have had less of an impact in improving the composition of Vietnam's exports than the fact that they have improved the business environment in Vietnam – which is particularly true for newer FTAs like the EVFTA and CPTPP which address “non-tariff barriers”. According to research from the IMF and others, improving a country's business environment has a bigger impact on attracting high quality FDI to that country than do tax cuts, and the commitments Vietnam has had to meet in order to join so many FTAs are an example of this, in our view.⁴

Conclusions

Vietnam continues to attract high-quality FDI, which in-turn has been driving the improvement in the composition of the country's exports since 2010. That surge of FDI inflows boosted employment in Vietnam, which helped drive the emergence of the country's vibrant middle class, and we expect the emergence of local industries to supply “medium tech” production inputs to those FDI companies in the medium-term, partly enabled by the fact that Vietnam's membership in numerous FTAs is catalysing the improvement of the country's business environment.

All of these long-term GDP growth drivers also have important direct and indirect implications for stock market investors. For example, FDI inflows directly drive the performance of industrial land and related businesses, and VinaCapital's portfolio managers have held positions in leading industrial park developers such as KBC and SZC for years. Our flagship VVF UCITS fund is also a long-term holder of GMD (ports & logistics) and BWE (water supply and waste treatment). We expect both companies to maintain double-digit earnings growth over the next 2-3 years. We note that BWE currently has a 30% share of the industrial wastewater business in Binh Duong Province and is looking to expand to HCMC's other industrial suburb, Dong Nai, where it hopes to also gain a 20-30% market share over the long term.

Finally, since FDI has played an important role in lifting domestic personal incomes, VVF has also invested in Vietnam's leading retailer MWG, since the fund was established. From 2014 to 2021 MWG achieved 33% CAGR profit growth and is expected to grow its earnings by more than 30% this year.

⁴ According to the IMF, “tax incentives are not critical” to attracting FDI and “cannot substitute for political stability, good macroeconomic fundamentals, the availability of infrastructure, and a sound legal framework”.

Disclaimer

© 2022 VinaCapital Fund Management JSC (VCFM). All rights reserved. This report has been prepared and is being issued by VCFM or one of its affiliates for distribution in Vietnam and overseas. The information herein is based on sources believed to be reliable. With the exception of information about VCFM, VCFM makes no representation about the accuracy of such information. Opinions, estimates, and projections expressed in this report represent the current views of the author at the date of publication only. They do not necessarily reflect the opinions of VCFM and are subject to change without notice. VCFM has no obligation to update, amend or in any way modify this report or otherwise notify a reader thereof in the event that any of the subject matter or opinion, projection or estimate contained within it changes or becomes inaccurate.

Neither the information nor any opinion expressed in this report constitutes an offer, or an invitation to make an offer, to buy or to sell any securities or any option, futures, or other derivative instruments in any jurisdiction. Nor should it be construed as an advertisement for any financial instruments. This research report is prepared for general circulation and for general information only. It does not have regard to the specific investment objectives, financial situation or particular needs of any person who may receive or read this report. Investors should note that the prices of securities fluctuate and may rise and fall. Past performance, if any, is no guide to the future.

Any financial instruments discussed in this report may not be suitable for all investors. Investors must make their own financial decisions based on their independent financial advisors as they believe necessary and based on their particular financial situation and investment objectives. This report may not be copied, reproduced, published, or redistributed by any person for any purpose without the express permission of VCFM in writing. Please cite sources when quoting.