Michael Kokalari, CFA
Chief Economist

Understanding Vietnam's Foreign Ownership Limits (FOLs)

Foreign investors are limited in the number of shares they can purchase in most of the 763 companies listed on the HCMC and Hanoi stock exchanges due to foreign ownership limits. Prior to 2015, the Government set the FOLs for most listed Vietnamese shares at 49% (or 30% for certain strategic sectors) to prevent foreign investors from exerting disproportionate control on Vietnamese industry. From 2015, about half of those companies have been allowed to set their own FOLs.

Fewer than 40 listed companies chose to completely eliminate restrictions on foreigners buying their shares (by lifting their FOLs to 100%) for reasons discussed below, although those names include some of the largest publicly listed companies in the country such as the consumer giants Vinamilk and Vietnam's biggest beer company, Sabeco. Finally, the Government still restricts the total ownership stakes foreign investors are allowed to take for companies in over 50 sectors, including:

Restricted Sectors	Maximum FOL	Prominent Stocks/Tickers
Banks	30%	VCB, CTG, BID, TCB, VPB, MBB
Airlines	34%	VJC, HVN
Real Estate	50%	VIC, VHM, NVL, VRE, DXG, KDH
Oil & Gas	50%	GAS, PLX, PVS, PVD
Construction Materials	50%	HPG, HSG, HT1

Implications for Foreign Investors

When a listed Vietnamese company has "*reached its FOL limit*" (i.e., the proportion of shares available for purchase by foreign investors are already owned by foreigners), and a new foreign investor wants to buy shares in the company, that new investor must purchase the shares from a foreigner already holding the shares. The existing investor typically demands a premium above the prevailing market price, triggering a mark-to-market loss for the new investor. For example, if investor 'A' pays investor 'B' a price for 'XYZ' stock that is 5% above the prevailing market price, then the new investor 'A' will immediately record a 5% mark-to-market loss on the transaction, while the existing investor 'B' will show a 5% windfall gain.

Over the last 10 years, we (and many others) have observed that the Vietnamese stocks which trade with FOL premiums tend to have high earnings growth and/or ROEs. This tendency helps explain why sophisticated foreign investors are willing to enter into investments for which they will show an upfront "loss". Also, passive ETFs listed on stock exchanges outside Vietnam do not buy Vietnamese stocks that have reached their FOLs, which helps explain why those ETFs have consistently, and significantly underperformed the VN-Index (ie. they are missing some of Vietnam's best performing businesses).

Next, if a stock's FOL premium is above 7% (i.e., outside the +/- 7% daily trading band), the transaction must be consummated off exchange - which entails onerous documentation issues. VinaCapital's PMs do not buy such stocks in off-exchange transactions, given their lack of transparency, and because our strong relationships with local brokers enables us to opportunistically accumulate shares with full FOLs in certain situations (such as ESOP share issuance). Finally, note that we have sold shares in our portfolios at premiums as high as 50% to other foreign investors in the past.

FOL Premiums Have Collapsed

In the past, the stocks that were the most popular with investors (such as Mobile World Group) traded at FOL premiums as large as 40-50%, and the premiums on most names foreign investors sought to buy ranged from ~7% to 30%. However, the premiums for most stocks that reached their FOL limits have subsequently collapsed to around 0-3% at present, with the exception of a few very popular tickers such as TCB, MWG, and ACB that are currently trading with circa 7% FOL premiums.

The collapse of FOL premiums was partly prompted by last year's launch of an ETF comprised of stocks that have either reached their FOLs, or are close to hitting their FOLs. This circa USD600 million AUM exchange traded fund[1] is a domestic entity that faces no limitations purchasing Vietnamese stocks, and foreign investors are able to purchase 100% of the ETF's outstanding shares, so the structure enables foreign investors to indirectly buy a basket of stocks that have reached their FOLs. The ETF's purchases of those stocks is the main factor that helped shrink FOL premiums across-the-board, although the market's overall strong performance may have also played a secondary role in compressing FOL premiums.

[1] VinaCapital offers two actively managed offshore funds, VAF and VVF, that invest a substantial portion of their NAV in FOL stocks.

Most Vietnamese Companies Still Have 49% FOLs

In 2015, Vietnam's Government began allowing companies to raise (or lower) their FOLs in a process that entails the company conducting a shareholder vote at an AGM/EGM and then filing an application to change the company's existing FOL with Vietnam's State Securities Commission (SSC). However, companies that did not go through the process outlined above retained their legacy 49% FOLs, which helps explain why about 90% of the companies on Vietnam's two main stock exchanges have FOLs that are essentially unchanged since before the 2015 FOL liberalization.

The main reasons companies may not have opted to lift their FOLs include:

1) **The company is not close to reaching its foreign ownership limit**. Over three-quarters of Vietnam's 100 largest listed companies have ample room for foreigners to buy shares (i.e., at least 5% of outstanding shares are available for purchase by foreigners), reducing the incentive for those companies to raise their FOLs.

2) **Existing shareholders want to retain control of the company**, fearing that foreign investors with superior financial resources could exert disproportionate control on the company's operations, among other reasons.

3) **Some companies may be commercially disadvantaged** if foreign investors own more than 50% of their shares (e.g., the company may find it more difficult to borrow from local banks or face other operational issues).

Further to that last point, we are aware of some companies which enthusiastically embrace foreign investors, but have limited their FOLs to 49%, or taken steps to lower their FOL back down to 49% after having previously raised it to 100%.

The Future of Vietnam's FOLs and the Path to EM Status

The most common reason why Vietnamese companies forgo raising their FOLs is that they do not perceive sufficient benefits from lifting the foreign ownership restrictions on their shares, and are thus unwilling to expend the resources entailed to do so. At the beginning of 2021, a new legal framework came into effect that introduces two possible resolutions to this situation: 1) Non-Voting Depository Receipts, and 2) changes to the 2015 FOL regulations that are currently being applied.

Non-Voting Depository Receipts (NVDRs) were introduced in Thailand over 20 years ago to address some of the issues discussed above, and recently Vietnamese Government officials often discuss this possible solution publicly. However, a lack of clear and specific guidance from those officials, coupled the fact that a plethora of operational issues must be solved in order to implement NVDRs is fueling speculation that Vietnam will eventually follow an approach that is similar to how Foreign Ownership Limits work in Korea.

Specifically, Vietnam's "Restricted Sector" approach to FOLs is comparable to that of Korea, but in Korea foreigners can own up to 100% of the shares of companies that are not in restricted sectors. In our understanding, Vietnamese Government officials are considering[2] a regime in which local companies that are not in restricted sectors would default to having no restrictions on foreign investors buying their shares, but those companies would then have the option of seeking shareholder approval to lower their FOLs.

Finally, whichever option the Government uses to address the FOL issue, we believe it is likely to lead to Vietnam being included in the MSCI-EM index within the next three years because Vietnam's restricted FOLs are widely understood to be a major remaining hurdle to Vietnam being included in the MSCI-EM index.

Conclusions

The Government's 2015 foreign ownership limit liberalizations enabled about half of Vietnam's listed companies to determine their own FOLs, but few have actually done so for a variety of reasons. Solving the FOL issue should pave the way for Vietnam to join the MSCI-EM index, which would in-turn be a major catalyst for foreign investment inflows into Vietnam's stock market. Furthermore, relaxing foreign ownership restrictions will also facilitate a significant increase of inflows over the longer term, given that sophisticated foreign investors are enamored by Vietnam's strong secular GDP growth, high corporate earnings growth, and impressive stock market performance.

[2] In our understanding, the new legal framework that came into effect at the beginning of 2021 *theoretically* removes FOLs for companies that are not in restricted sectors, but the accompanying "Decrees" that are required to *actually implement* laws on a day-to-day basis within the Vietnamese legal system have *not been enacted*. Similarly, the new laws that came into effect at the beginning of 2021 mention NVDRs, without specifying when and how NVDRs would be implemented in Vietnam. All of that said, the new securities law, and new investment law do address other important issues, such as information disclosure requirements by local companies to investors.

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