

On the Foreign Indirect Investment in Vietnam

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1. Foreign indirect investment in Vietnam in recent years

From 1994 then the Domestic Investment Law was introduced to 2004, the foreign indirect investment in some 70 local companies topped the US\$200-million mark.

Operation of foreign investment funds could be divided into two periods; before and after the Asian financial crisis. The first foreign investment funds made their appearance in 1991, including some of the large scale such as Vietnam Enterprise Investment Ltd (US\$60 million), IDG Ventures Vietnam (US\$120 million), Beta Vietnam Fund (US\$70 million),

proportion of the total foreign investment: 0.9% in 2001; 1.2% in 2002 and 2.3% in 2003 while this proportion in such neighboring countries as Thailand, Malaysia and China varies from 30% to 40%.

Most financial investors put their money in stocks listed on the stock market because of convenience. There is only a few foreign investors with large capital and managerial skills who invested in local companies. Strategic investors account for only 5% in privatized companies.

Although the stake in local companies held by foreign investors was increased from 20% to 30% in 2003,

In recent years, the mechanism for selling shares to foreign investors has been adjusted. Companies could sell shares to foreign companies without asking for permission and the number of industries where foreign investors are allowed to buy shares from increased from 15 to 35. This number, however, is still very limited.

2. Shortcomings

In spite of great efforts by the Government to open local markets to foreign competition, the business climate in Vietnam still implies many shortcomings. Vietnam lacks a per-



The Vietnam Fund Ltd. (US\$60 million), Vietnam Frontier Fund (US\$60 million), etc. Some of them withdrew about US\$250 million in total after the Asian financial crisis broke out. In 2001, the operation of foreign investment funds recovered. At present, there are six investment funds capitalized at US\$241 million. They are of small scale and have gained some experience of the Vietnamese market.

These funds, however, are still new to Vietnam but their presence helps make operations in stock markets more professional. After the financial crisis, the flow of foreign indirect investment started to rise again but it represents only a small

it still fell short of their expectations. Of 24 listed companies in the stock market, only 11 had their shares held by foreign investors. In other companies, they held only small proportions because of poor performance and small scale. The total market value of 24 listed companies was only some US\$222 million. It is very small in comparison with regional stock markets: 1,253 listed companies worth US\$463 billion in China; 236 listed companies and US\$74.59 billion in the Philippines; 419 companies and US\$101 billion in Thailand. In addition, the expected payback from small-scale companies through the stock market is not desirable.

fect and transparent legal infrastructure for foreign investment, which caused worries for both foreign investors and local companies that receive it. Local companies are also reluctant to attract foreign investment because they are afraid of losing the control over their companies and thereby causing possible damage to their own property.

The Vietnamese stock market lacks a legal infrastructure needed for encouraging foreign indirect investment and developing the finance and capital markets.

Regulations on joint stock companies and privatization pay only a little attention to interests of foreign

investors. The Domestic Investment Law limits the proportion of shares held by foreign investors at 30% at most, which prevents them from taking control of local companies. Small capital from investors even doesn't satisfy their need for portfolio management. The Dragon Capital Fund, for example, has attracted some US\$150 million up to the end of 2004 and it planned to invest some US\$2 million per company but the 30% limit only allows it to invest in companies capitalized at US\$100 million at least, and as a result it lack projects to invest in.

This limit is considered as a precaution against foreign investors because most local companies have small capital and lack managerial skills, and this measure has discouraged many foreign investors. Moreover, potential and role of the indirect investment are new to Vietnam and as a result both authorities and the public are not interested in this source of finance.

The tax system gives no incentive to participants in the stock market with the result that many companies are reluctant to take part in this business. Taxes on profit from financial investments are not clear, which makes foreign investors more reluctant.

Many institutions and regulations needed for integrating local stocks and shares into foreign stock exchanges, which makes participation by foreign investing communities in the local stock market riskier.

Financial disclosure is not common among local companies. This situation makes it difficult for foreign investors to find reliable projects. In

addition, most local companies usually have small scale and short term of operation, and therefore they have no condition for receiving foreign indirect investment.

At present, only 35 industries are open to foreign indirect investment. Many businesses that require big investments, such as steel and power production and many services, are not included in the list of these 35 industries while some foreign-invested companies have engaged in them. This is also an unreasonable barrier to the foreign indirect investment.

3. Some suggestions

The Government had better adopt a clear policy to attract the foreign indirect investment, and include this matter in the Investment Law and Securities Law in order to perfect the legal infrastructure in preparation for the international integration. Stock and finance markets must be perfected with a view to facilitating the development of joint stock companies as recipients of foreign indirect investment.

The privatization program in all sectors must be accelerated and all companies are encouraged to go public. The Government has made a pilot scheme to allow some 10 foreign-invested companies to go public in 2005. At present, there are some 3,000 foreign-invested companies capitalized at some US\$20 billion in Vietnam. If they are allowed to go public and get listed on the stock market, the volume of commodities in the stock market will increase remarkably.

The government could think of allowing local companies to list their

shares in foreign stock exchanges and linking Vietnamese stock market with its foreign counterparts. Various kinds of incentives could be given to these companies if need be.

Over-the-counter markets could be allowed to come into being in order to improve the liquidity of shares and provide investors with one more legal market. Measures must be taken to help the Hà Nội Stock Trading Center come into operation to increase the volume of commodity offered.

The legal infrastructure for formation and operation of institutions (rating agencies, mutual funds, auditing companies, etc.) needed for the stock market must be in place in order to ensure the transparency of the market. Governmental agencies couldn't carry out this task by themselves, therefore the presence of these institutions are much needed. Tax incentives could be given to encourage establishment of such institutions if necessary.

The limits on industries where foreign indirect investment is allowed and on the proportion of shares the foreign investors are allowed to hold could be lifted because they are not reasonable and suitable to the international integration that Vietnam is trying to realize.

However, certain limits on foreign investment are still necessary: foreign investors are not allowed to invest in defense industries; their share in such industries as banking, insurance, air transport and telecommunications must be limited because of national security purposes. ■

