Vietnam
Opportunity and Challenges

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About Control Risks

**Investment Risks** - Analysis and forecasting of country, sector, political, policy, regulatory, social and operational risks

**Integrity Risks** - Due diligence and business intelligence in support of M&A, portfolio investments, and post transaction forensic investigation for fraud, corruption …

**Security Risks** - Consultancy in the design and implementation of corporate and project crisis management and security strategy.
“China + 1” ??

- Political system
  - CCP/CPV
  - SOEs dominate economy
  - Official labor union
- Highly productive labor
- Entrepreneurial spirit
- Overseas diaspora
- North/South differences
- FX controls
- Export driven development model
- Corruption, land issues

- Vietnam is the size of Guangdong Province
  - But with an economy 10% as large
Dissimilarities are key

- Political power diffuse and decentralized
- Macro economic stability
  - Double digit inflation – dong devalued 6x since 2008
  - ½ the GDP held in gold or US dollars
  - Min wage increases of 25-70%
- Industrial ‘scale’ – 1000+ central SOEs
  - Uncompetitive but 40% of GDP
- Demographics
  - 70% rural - 60% under 35
- Infrastructure
- No FDI ‘one stop shop’
- Result = sub optimum growth, supply constraints, inflation
Political outlook

• The Communist Party of Vietnam – one party state

• Policy divergence, internal discord – shared interests prevail

• Decentralized - local government/party more powerful than center

• State-sector inefficiencies linger – high inflation persists

• Rising living costs – worker discontent and strikes to continue – business blamed

*Political and social stability in the medium term - economic performance will underwhelm*
The Economy

- Expect GDP to grow 5-6% in 2012 / 13
  - *Inflation target* single digits vs 20% in 2011
  - Export growth 15%+/- vs 30+% 2011
  - Expect *dong* to weaken 3-5% in 2012
- Current credit contraction
  - Loans:GDP still 118%
  - R/E and construction slump
  - NPLs and group liquidity at issue
- Restructuring of bank sector and SOE ‘re-direction’
  - Since 2006, at least 25% of bank loans went to R/E and stock market
  - From April SBV will publish NPL and other bank data – 10 commercial banks forced into restructuring
  - New policy emphasis on loans to agriculture sector in bid to ease inflation and increase rural incomes
- FDI actual down 35% in 2011 to USD11.5 billion
  - Electronics assembly, footwear/textiles (Asian FDI) cornerstone
  - Benefits from EU crisis as low cost supplier
Investment attractiveness

- Previous optimistic business sentiment down slightly recently as reform efforts stall, macroeconomic picture clouded
- Foreign entrants are often caught between state groups and large private groups founded by Russian ‘returnees’
- Consumer spending 25% growth p/a
- Since October all contracts in VND
- Most attractive for
  - export manufacturing
  - consumer products, franchising & financial services

103rd
Vietnam’s ranking (out of 183 economies) in the World Bank’s 2012 Ease of Doing Business survey
Red tape

• Starting and operating a business is still problematic

• “Vietnam is not for the feint of heart….it’s easier to do a deal in Cambodia”

• High-profile initiatives to cut red tape have failed to bring tangible gains to business; WTO membership has had a negligible impact in this respect

• Dealings with authorities frequently lack transparency
  • capricious regulatory interpretations and policy inconsistencies

“(Local) government officials make it their business to create obstacles which only they can resolve – it is their raison d’être…..they’ve been doing it for hundreds of years”

F&B investor with 20 years history in Vietnam and dominant market share - joint venture with HCMC People’s Committee
Corruption

- Corruption is pervasive throughout every layer of government and society.

- 2005 Law on Anti Corruption (LAC) requires asset disclosure by 250,000 state functionaries

- Systemic change – and real independent watchdogs required but not expected

- In routine business operations, firms are most likely to encounter corruption when dealing with tax or customs officials.

- Mitigation measures – zero-tolerance and robust internal controls and staff training as key corporate strategies

112\textsuperscript{th} Vietnam’s ranking (out of 182 economies) in Transparency International’ 2011 Corruption Perceptions Index
Legal system

- Vietnam’s judiciary is governed directly by the state and intervention is common. The system is poorly resourced and with little experience of handling commercial disputes between foreign and local firms.

- In the event of legal dispute with a partner or contractor, judges typically rule in the favour of the local parties, even if the law does not support such verdicts.

- Contracts are often unreliable foundations for dispute resolution; renegotiations are often sought after signing; new demands suddenly imposed.

166th

Labor

- A large and inexpensive pool of unskilled and semi-skilled labour, but a shortage of skilled workers and managers
- Cheapest labor in Asia after Bangladesh – 50% of China’s average wage – but systemic rigidities (tribunals for dismissal)
- Really ‘two countries’ with little mobility between the two extremes
- Most labour disputes relate to demands for pay increases amid rising living costs; low-end manufacturing most affected, esp. in advance of Tet holiday.
- Allowing workers to vent against a foreign firm helps obscure government failure to control inflation; strikes are thus tolerated
Labor Disputes

- Labor disputes in Vietnam are generally dealt with through informal channels with district or provincial level authorities before strikes are called.
- But disputes have increased partly as a result of inflation creating financial pressures on poorer workers.
- Peak of industrial action in 2008 (oil and property boom) but global economic crisis led to 70% drop in strikes, then peaked again in 2011 at 978

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Share of total %

- State-owned: 21.4% 10.0% 5.1% 2.1% 1.6% 5.3% 1.0% 0.2% 0.0%
- Foreign-owned: 54.3% 61.1% 65.7% 73.2% 74.2% 69.1% 73.6% 79.5% 81.1%
- Private domestic: 24.3% 28.9% 29.3% 24.6% 24.2% 25.7% 25.4% 20.3% 18.9%

Source: MOLISA: Report of the National Industrial Relations Committee (various years)
Infrastructure

- Heavy investment (up to 9% GDP) over the last decade has led to improvements in infrastructure, esp. power generation
  - Assisted by PPP law of 2010
  - 3 power plant investments of US$1billion+ in 2011

- But many roads remain unpaved, bridges are weak and ports often inadequate – it costs 10x more to build one km of road in Vietnam than it does in the USA

- Electricity extends to all urban areas, but takes new businesses time to obtain and wavering price controls will see costs rise in 2012

- Communications infrastructure is reliable, but insecure (subject to monitoring)
Summary

• Large cap investors
  • Your partner/vendor will probably be the industry regulator or dominant SOE as well

• Challenges for other direct investors – “The 3 ‘i’ s”
  • Inflation
  • Infrastructure
  • Interference (incl corruption)

• Portfolio/passive investors
  • S-term = retail / brands
  • M-term = real estate
  • L-term = infrastructure

“You’ll make money here but only as much as they want you to … the right partner is everything”

US investor with 17 years in country experience across industries
Case Studies

Pre-transaction business intelligence project for a sovereign wealth fund considering a strategic investment in a Vietnamese real estate and construction firm. This included an assessment of the issues associated with land clearance, corruption and commercial claims.

Multi-jurisdictional litigation support project to enable a client to contest a potentially fraudulent claim involving major state owned players in the Vietnamese maritime sector.

Market entry projects for clients in the energy, infrastructure, real estate, hospitality, financial, logistics, maritime and retail sectors seeking to enter the Vietnamese market. This involved an assessment of factors including the trajectory for subsidiaries of state-owned enterprises following a shift in policy, the competence of these subsidiaries, political exposure, and corruption risks.

Conducted an investigation into a prospective defence agent in Vietnam. The investigation found that the ultimate beneficial owners were an individual blacklisted by European agencies for corruption and silent business partner who was a serving government official. The company was also selling equipment for a firm blacklisted in the US for its sale of missile systems to Iran.
Case Studies II

• Control Risks investigated a small telecommunications vendor operating from a residential address in Vietnam. Our client, an international telecommunications company, was considering appointing the company as its agent in Vietnam. Site visits to the alleged registered business addresses did not reveal any evidence of an operational company. Further enquiries revealed that the director of the company had lost his business licence on the grounds of tax evasion and involvement in the illegal trafficking of electronics goods from China.

• Control Risks was commissioned by a multinational defence corporation to conduct reputational checks on an existing vendor in Vietnam. Despite the sensitive nature of the industry, Control Risks was able to identify the company’s shareholding structure, retrieve corporate records, and conduct discreet enquiries with sources active in the sector. Our enquiries revealed that the director of the company had been asked to leave his previous position at a European embassy on allegations of corruption and unethical business dealings.

• An investment management company instructed Control Risks to carry out reputational checks on a potential business partner for a real estate venture in Vietnam. The individual was a European expatriate residing in Vietnam. Control Risks undertook extensive enquiries into the individual’s political links, current and previous business interests and perceived integrity, and confirmed that he was reputable and enjoyed strong political connections. Our client then commissioned a follow-up investigation focusing on two Vietnamese shareholders in the partner company, including the head of a local bank. Our enquiries revealed that local public officials were hidden shareholders of the bank, which gave the individual significant political influence on the provincial level. The other individual had served with distinction in the Vietnamese military and enjoyed high-level access in national political and military circles as a result.
Case Study: Social and Corruption Risks

The Problem
• A multinational Client wishes to invest a new factory at an industrial park. Client is concerned with potential social risks that might affect the factory operations and damage the Client’s reputation and ‘touch points’ for corruption in the process as a result of UK Bribery Act.

The Solution
• Control Risks was engaged to conduct a comprehensive social and corruption risk assessment to inform policy planning at Client headquarters and operating procedures as site
• Prioritised the primary & secondary social and corruption risks and recommended mitigation measures:
  • Discrimination against migrant workers
  • Workplace disputes
  • Access to skilled workers
  • Licensing, imports (corruption)
An international consultancy