**VinaCapital** **Economist’s Note** *February 25, 2021* **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 billion¹**. 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**).

### **Charts**

**Left: Tech Exports as a % of VN’s Total Exports** Shows steep increase post-2010, Samsung doubling investment, SHTP expansion, and COVID impact  
 Scale: 0% to 40%

**Right: VN Workers Employed by FDI Companies (Thousands)** Shows consistent rise from ~500,000 in 2000 to ~4.5 million in 2020  
 Scale: 0 to 5,000

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 countries². 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**:

**Footnotes:**

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 smartphones in Vietnam.
2. “Disentangling Spillover Effects”, *Institute for International Economics* (Javorcik 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.

**[Chart 1: Average EM Tariff Rates]** Graph showing steep decline in average EM tariff rates from 1988 to 2017, from ~35% to below 10%.

**[Chart 2: Vietnam’s FTAs]** Matrix showing Vietnam’s participation in major FTAs, including RCEP, CPTPP, EVFTA, etc.

That said, the tax cuts enabled 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.”

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