Risky business

Karl Derek John, chairman the TCK Group, offers some prudent advice on investing in Vietnam

Making an investment decision is not easy at the best of times. In the current environment, with financial markets going up and down like a yoyo and well-known financial houses changing hands, it is even more difficult. Add to that, investment in a foreign land that not so long ago, opened itself to the world and it is a very difficult task.

Vietnam joined the World Trade Organisation (WTO) on January 11, 2007, as its 150th member. It assumed the role of President of the United Nations Security Council for the month of July 2008. The World Bank ranks Vietnam 91st out of 178 economies, in terms of ease of doing business.

Vietnam stepped onto the global stage quickly and has been described as the next economic tiger in East Asia. Whilst stepping into the limelight, Vietnam has had to face a number of global issues affecting most economies and a few home-grown ones also.

So far, the Vietnamese government has taken positive steps to combat these issues but with limited experience of how global markets work and the mechanism of a market-orientated economy, the leadership has a difficult job.

The booming property sector has recently come under pressure. Analysts described it as a bubble waiting to burst. Banks using short-term capital to meet long-term loan demands of the real

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estate sector, have lent considerable funds to domestic developers.

Banks are under pressure to reduce their exposure and are now limiting loans to experienced developers with Grade A projects in prime locations. The Government has taken steps to shore up local banks and prevent foreign influences making a difficult time, more so.

FOREIGN INVESTMENT

A consultant said at a recent investment conference that 40 per cent of foreign direct investment (FDI) goes to the real estate sector. At the same conference, another consultant said FDI in the first nine months of 2008 was $47 billion, half of which was in real estate. The experts differ, by 10 per cent, as to how much goes to real estate.

This goes to show that whilst there is much information around, the accuracy cannot be relied upon. It's also a question of quality of research. Investment decisions are made on reliable information and accurate market valuations. Market values are often based on an owners' perception, which at times bear no comparison to reality. At TCK Group, we spend considerable time and money to check information with at least three sources, before passing to our investors.

Another mainstay of investment decision-making is transparency, in the legal system and in corporate information. In the run-up to WTO admission, 118 laws were passed affecting areas such as real estate, housing, land law and foreign investment. As of next year, all real estate transactions should be undertaken at licensed, "Real estate Transaction Counters" and brokers must have permits.

Laws enacted by the government are open to interpretation by ministries, who issue implementing circulars. The National Assembly has recently promulgated new rules on corporate and individual taxation, plus for the first time allowed a limited number of foreigners to own apartments (not houses).

This means that there are many new rules of the game to consider. No sooner has one decided a development strategy, new issues arise that requires a change. As example, a law was passed to stop pre-sales of apartments, before infrastructure works are complete. This caught many developers, with ongoing projects, by surprise.

Inflation is another factor that recently surprised developers. The cost of building materials, especially steel, has sky-rocketed. Add to that, human greed. The recent Wall Street Crisis is an obvious demonstration of what can happen, when greed kicks in!

Having obtained quality information, the foreign investor has to navigate the bureaucratic maze of getting projects and designs approved. Although this is supposed to become a shorter process, in reality there are still hurdles to overcome. These include financing options, corruption, differing agendas between joint venture (JV) partners, administrative delays in clearing current occupants, obtaining permits and shifting market conditions.

DOMESTIC PARTNERS

A JV is the most common form of business relationship, accounting for about 70 per cent of foreign investment, creating a limited liability company through shared ownership by Vietnamese and foreign partners.

Before choosing a potential partner, one needs to examine the sector of interest and the major players. There are many factors to consider, such as the capability and as with most Asian countries, the connections of the potential partner.

It's possible to work very well with a Vietnamese partner, if both of you are on the same page and there is mutual

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buy-in. One has to take into consideration, the Vietnamese psyche and know how things operate at a local level. It helps to know something about Vietnamese history and culture. In order to do that, the foreigner needs to plug into a reliable network.

Of course it's obvious that there has to be benefit for all, taking into consideration the participation or contribution made by each party, so all sides feel it is an equitable partnership. Often, potential partners forget this.

That said, reaching mutual understanding is often the hardest thing to do. It should never be assumed that a Vietnamese counterpart understands foreign thinking or even what is said!

Cultural differences, communication and language barriers are the most common problem. Language is always open to interpretation in different ways and quite often an interpreter is the root cause of misunderstandings. A good interpreter is worth their weight in gold! Even intonation can cause a problem, when emphasis is put on a word and the other party is not a native speaker. The emphasis can come across as an aggressive form of communication.

In many cases, the domestic JV partner has obtained the land through a murky process, which makes it difficult for the foreign partner to understand. Often, the local idea of what constitutes a financially-viable project falls short of foreign expectations. In some cases, master planning and designs have been completed by the time a foreign investor shows up, so one has to work with them or spend a lot of time to try to get amendments passed by local agencies.

COMING TOGETHER

Because foreign investors cannot lease land directly from a Vietnamese individual, acquiring a project is a difficult task that's often complicated by murky dealings. If the land is held by an individual, they need to return it to the state and a lease agreement needs to be concluded between the foreign investor and the concerned People's Committee.

If the project is owned by a Vietnamese company, this is a relatively simple process because the foreign investor can acquire the company. Difficulties arises because there are specific requirements upon foreign investors, if their project fall under a 'conditional sector' and real estate is one of those.

In Vietnam, the most common form of acquisition to date, particularly for foreign investors, has been the transfer of legal capital. In most cases, foreign investors have sought to hold shares in existing joint ventures and wholly foreign owned enterprises.

Pre-WTO, there was little understanding of M&A activity and many regulations, none of which were conducive to M&A, plus there were numerous restrictions on licensing, taxation and foreign investment. Approval of foreign investment seemed to be handled case-by-case, causing confusion to foreigners. In general, foreign share holdings were capped at 49 per cent and 30 per cent of chartered capital in listed and unlisted enterprises respectively.

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Regulations and guidance on M&A transactions were considered inadequate and industrial relations law was considered too employee-friendly, an obstacle for many foreign investors wanting to invest in Vietnam. Thus, the government's attempt to dispose of SOE's has not been too successful.

Post-WTO, the situation has changed, legal changes have been made and M&A activity has flourished. However, there is still room for improvement in the legal framework.

As economic reform takes place and changes are made to investment and taxation laws, bringing them into compliance with WTO commitments, the M&A regulatory environment in Vietnam will change significantly thereby stimulating growth and encourage foreign investment.

Current taxation provisions are seen as an impediment to foreign investment. As taxation law becomes more developed and easier for foreign investors to understand, it's expected that foreign investment will increase, thereby further stimulating M&A activities. Transparency in accounting and financial reporting is expected to remain an issue for some time.

It's very hard to conduct any form of due diligence in Vietnam, especially of a financial nature because of inadequate record-keeping and incomparable accounting practices.

Political stability is a key factor affecting M&A activities and this is where Vietnam presents an attractive option to foreign investors. As tourism authorities say in their promotional materials, Vietnam is a safe destination.

Investment is an art of managing risk and time to get a desired return. In Vietnam, time can be very elastic and stretched during the simplest of processes. Perceived risk, pre 2008, was lower than most places in the world. Vietnam had a stable government, undergoing many positive changes, and there had been continuous growth.

Now Vietnam is in a cycle, just like the rest of the world and needs to rapidly improve all aspects of its processes, if it is to continue to attract long term investment. There needs to be the realisation that only long term investment for sustainable benefits will help Vietnam truly develop. Over speculation and short term views will hinder this development.

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