The rise of Korean investment in Vietnam

How Korean companies can continue to thrive in an exciting but challenging jurisdiction

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Korean investment in Vietnam has been a success story. Korea remains by far the largest foreign investor in Vietnam. Data from Vietnam's Ministry of Planning and Investment ("MPI") suggests that cumulative Korean foreign direct investment ("FDI") in the period from 1988 to 2016 amounted to USD 50.7 billion, compared to USD 42.1 billion for Japan.

The momentum continued throughout 2016, with new Korean investments totaling USD 5.5 billion, again dwarfing Japan's USD 868 million during the same period[1].

But 2017 begins with some darker clouds on the horizon: Some of this Korean investment has been made in anticipation of Vietnam's accession to the Trans-Pacific Partnership ("TPP"), which the incoming Trump administration immediately pulled out of, making it unlikely that the TPP will survive in its current form. In general, much of the Korean investment in Vietnam is heavily focused on exports, which could also suffer if the U.S., or other countries with significant imports from Vietnam such as China, become more protectionist. And Vietnam itself, although far more welcoming to foreign investment than in the past, is still a difficult country in which to operate. Foreign investors find it difficult to gather information about partners and targets, and must also deal with a complicated bureaucracy, an opaque political structure, and continuing problems with corruption and fraud.

Korean-invested firms tend to be export-oriented and thus contribute significantly to Vietnam's trade balance, in addition to being a major source of employment domestically. Data released by the Vietnam Chamber of Commerce and Industry ("VCCI") suggests that Korean-invested firms in Vietnam in 2016 contributed almost a third of the total value of Vietnam's exports and provided around 700,000 jobs domestically[2]. Bilateral trade ties have likewise been growing continuously stronger from 2013 to 2016, with Korea remaining Vietnam's second-largest source of imports and fourth-largest export market[3].

The positive position of Korean firms in Vietnam is a result of long-standing bilateral commercial relations. Korean FDI came to Vietnam in three waves. Following the normalization of diplomatic relations in 1992, Vietnam experienced a first wave of Korean investment that was primarily focused on labor-intensive manufacturing in the garment and textiles sector. The second wave, starting in the early 2000s, was characterized by the increased manufacture of electronic goods. Most recently, a third wave focused on consumer goods, including retail as well as services[4].

Profiles of Korean investment

Listed Korean conglomerate CJ Group may be a typical example of the third wave of Korean investment in Vietnam. Chang Bok Sang, director of CJ Vietnam, was quoted in the media as saying that the group entered the country in 1998. It now has a dozen member firms in the country, with business interests ranging from food processing to the production of fertilizer and feed, and from TV shopping to film production and distribution[5]. In 2016, it pledged an additional USD 500 million investment in the country, constituting the single largest investment of any Korean firm in Vietnam during the year[6].

However, the most high-profile Korean investor in Vietnam is Samsung, which has been estimated to produce almost half of its smartphones at two factory complexes in Bac Ninh Province and Thai Nguyen Province, near Hanoi in northern Vietnam. In 2015, the company commenced construction on a third complex near Ho Chi Minh City ("HCMC") in southern Vietnam. This third complex focuses on the production of home appliances, with assembly lines for televisions having begun operations in 2016. Samsung will eventually relocate some of its existing production lines from Korea and Malaysia to HCMC[7].

LG Electronics has also invested heavily in the country, opening a new production base in Haiphong, a northern port city, which will manufacture smartphones and televisions. The company has stated that it plans to spend USD 1.5 billion on the complex through 2028[8]. The involvement of companies such as Samsung and LG has helped to persuade suppliers to those firms to invest in Vietnam as well. For example, Seoul Semiconductor Co. was granted a license in 2016 to build a semiconductor production factory in northern Vietnam, constituting an investment of around USD 300 million[9].

Samsung has not only been looking at electronics manufacturing opportunities in Vietnam. For example, the conglomerate's insurance units, Samsung Life Insurance and Samsung Fire and Marine Insurance, have been exploring investments in Vietnam[10]. Other Korean businesses have also been investing in the Vietnamese financial services sector, including Shinhan Financial Group, whose Shinhan Bank Vietnam has been expanding its branch network in key cities across the country and Shinhan Investment, which acquired a local securities trading firm in 2015[11].

Effect of free trade agreements

The Vietnam-South Korea Free Trade Agreement ("FTA"), which took effect at the end of 2015, has further bolstered the countries' bilateral relationship. As part of the agreement, Korea agreed to eliminate 95 percent of its tariff on Vietnamese imports, while Vietnam would reduce 89 percent of its tariffs on Korean imports[12]. The FTA has already had a tangible effect on bilateral trade. Figures from the Korea International Trade Association ("KITA") suggest that Korean exports to Vietnam from January to October 2016 increased by 13 percent year-on-year, with imports from Vietnam increasing by 27 percent[13].

The second key trade pact is the TPP; however, in November 2016, Vietnamese Prime Minister Nguyen Xuan Phuc stated that Vietnam would suspend its ratification of the TPP amid an announcement by newly-elected President Trump that the United States would not go ahead with the deal[14]. World Bank economists had expected Vietnam to be the biggest beneficiary from TPP membership primarily due to its competitive advantage in garment, textiles, and footwear[15].

The apparent demise of the TPP will be a disappointment to Korean investors, as their Vietnamese subsidiaries would have enjoyed preferential access to the U.S. market[16]. However, while there have been reports of smaller Korean garment producers delaying or aborting investments in Vietnam as a result of the non-ratification of the TPP, overall the collapse of the TPP is likely only to slow the trend of Korean FDI in Vietnam rather than reversing the general trend[17]. Most Korean investors are in for the long-term, drawn by Vietnam's prospects as a manufacturing hub and a relatively predictable political environment. They would also be well-positioned to reap the benefits of a future renegotiated version of the TPP, should this eventuate in the future[18].

Increasing attractiveness of Vietnamese market

The attractiveness of Vietnam as a destination for Korean FDI is set to increase further, irrespective of the expected demise of the TPP. As of 2015, Vietnam had a population of 91.7 million, with 69.6 million being aged 15 and above[19]. A young, generally well-educated labor force presents significant opportunity for the next phase of Korean manufacturers. With monthly minimum wages ranging between VND 2.4 million and VND 3.5 million (USD 106 – USD 154), Vietnam remains competitive in comparison with other regional FDI destinations such as Thailand (approximately USD 168 per month) and China (approximately USD 240 per month)[20].

In preparation for the TPP, Vietnamese firms have made significant investments in fixed capital and organizational practices while the new government leaders, appointed in the 2016 Party Congress, have increased the pace of institutional reform[21]. Whereas the country has traditionally been a destination for greenfield investments, these developments make Vietnamese companies increasingly attractive as targets for mergers and acquisitions[22]. Vietnam recorded record numbers in M&A activity in 2016, with a focus on the property, consumer goods, and retail sectors[23].

The country presents opportunities not only in terms of manufacturing capacity, but also in terms of a sizable domestic market. An expanding middle class, reportedly growing at the fastest pace in Southeast Asia and estimated to double by 2020, demands increasingly sophisticated products and services[24]. Korean firms are capitalizing on this trend. Lotte Group, for example, plans to increase its number of retail operations fivefold by 2020, to a total of 60 shopping malls. In 2016, it also rolled out an e-commerce channel[25] and pledged to invest up to USD 2.2 billion in a mixed-use development project in HCMC[26].

Risks to manage

Despite its capitalist outlook – 95 percent of Vietnamese are in favor of a free market system – Vietnam retains an authoritarian political system with socialist characteristics[27]. While Vietnam's middle class is expanding, this has not so far resulted in serious demands for political reforms. Discontent is commonly voiced through the use of social media rather than spilling out to the streets. A rare exception was the case of Formosa Plastics Group, a Taiwanese aluminum producer accused of environmental pollution. Public pressure resulted in Formosa agreeing to pay a USD 500 million fine in 2016[28].

Korean companies have not yet faced problems on the same scale, although some Korean manufacturers have been associated with abusive labor practices that sparked localized protests. In 2015, almost 1,000 workers at a Korean manufacturing firm protested a regulation that restricted them from using restrooms. According to information from the Vietnam General Confederation of Labor, 40 percent of strikes from 2009 to 2014 occurred at Korean-owned companies[29]. Vietnam does not allow independent unions, and state-sponsored unions tend to take an employer-friendly outlook on labor rights.

Vietnam also still has issues with transparency, and foreign investors can find access to information on the country's political system, bureaucracy, or societal norms extremely problematic. Regulations are frequently kept vague or contradictory, exposing businesses seeking permits or approvals to the risk of bribery and corruption. Legal remedy in the face of disputes with government entities or local partners is patchy, with the judiciary viewed by some as susceptible to bribery[30]. Identifying a suitable local partner to help navigate the complex business environment can prove equally challenging, with reliable information being scarce in the public domain.

The problem of corruption has created problems for foreign investors, particularly those with U.S. operations who have to abide by the U.S. Foreign Corrupt Practices Act ("FCPA"). For example, in November 2014, U.S. clinical diagnostic and life science research firm Bio-Rad Laboratories was charged in a Californian court for violating the FCPA. The U.S. Department of Justice alleged that the company made improper payments to foreign officials over a five-year period in order to win business in several jurisdictions, including Vietnam. One of these payments involved Bio-Rad's subsidiary in Singapore, which sold discounted products to distributors in Vietnam who in return used part of the proceeds to bribe Vietnamese officials. Bio-Rad self-disclosed the offenses to U.S. authorities and settled the charges for USD 55 million[31].

Kroll has assisted clients in attempting to pre-empt these kinds of risks through in-depth investigative due diligence. This work might include the identification of counterparty risks, such as whether a potential joint venture partner maintains ties to government officials or faces undisclosed financial or legal problems. In the post-transactional phase, the focus may be on investigating alleged internal misconduct at the joint venture, such as identifying fraudulent practices. Either ahead of or during an investment, Kroll also monitors political and regulatory risks that could adversely affect the sector in which the client is operating.

One recent example of this was a project for a client during its proposed investment into a Vietnamese manufacturer. The focus of the assignment was to provide the client with a detailed understanding of the transaction under consideration, including information around asset valuations and the reason that the target was seeking strategic investment. Additionally, we provided intelligence on other potential investors as well as reputational information on the operations of the target and its subsidiaries, with a focus on issues such as potential unethical conduct, conflicts of interest, fraud, and corruption. The investigation highlighted several key risks, ranging from potentially overvalued assets to potential political influence on the company's board as well as risks of fraud or corruption at subsidiaries.

In such cases, clients can restructure investments to mitigate the identified risks, or even cancel them altogether if the intelligence demonstrates that the investment is unlikely to be as advantageous as it first appeared.

Investing in emerging markets, in Southeast Asia and elsewhere, means being more aware of these various risks and seeking to gather as much information and advice as possible in order to manage and mitigate them. Investors who practice this level of risk management gain a competitive advantage over other investors that venture into emerging markets without sufficient guidance or understanding of conditions on the ground. A number of structural factors, as we have outlined above, are likely to mean that Vietnam will remain an attractive destination for Korean investors. Those that can manage the risks successfully will be best placed to take full advantage of opportunities in this growing and exciting market.

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