INVESTMENT ANALYSIS OF VIETNAM

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Summary

Vietnam has changed in the last thirty years from an agrarian country to a service and manufacture country leader in the world in growth and economic activity. The country has a communist system legally but, in the practice, the country has a liberal policy in the economy signing the Trans-Pacific Free Trade Agreement but maintaining the political control under the rule of one party. The country offers opportunities and risks for individual and corporation with the intention to invest.

Introduction

Vietnam is known in the world as the country where United States of America lost a war in the XX century against a communist country, but Vietnam in 1986 definitively broke with the communist economic model, which was generating an inflation rate of 700% per annum and a huge budget deficit. The Renovation or Doi Moi was a program of profound reforms, not only economically, but also, though to a lesser degree, politically. With economic renewal and, following the collapse of the Soviet Union, Vietnam intensified during the 90s and until now, the model of market economy, abolishing the subsidy policy and bureaucratic control of the economic process, to give broad participation of social forces, rejecting statist and inefficient system of price control and rate of multiple exchange and promote an open economy with prices and exchange rates determined by the market, opening to private property investment incentives foreign.
All this has led to rapid industrial growth, agricultural, construction and exports that place the country at present, as the second largest rice exporter behind Thailand and coffee, after Brazil.
Today Vietnam is regarded as the fastest growing economy worldwide. The private sector accounts for two-thirds of GDP and enjoys a dynamic trade opening after the country joined since 2007 in the World Trade Organization.

Background

Vietnam is an Asian country located in South East Asia, the official name of the country is the Socialist Republic of Vietnam. The country is consequence of the reunification of the north and south Vietnam after the end of the Vietnam War where the United Stated of America had participation and when the north army defeated the South army, supported by the USA and the reunification of the country was possible under a communist government. The country started in 1986 a reform path, similar to the reform path followed by China in 1979 (Asian Development Bank, 2016). The country abandoned the five-year plan system followed by the communist parties of the world and introduced reforms increasing the participation of the private property and multinationals in the national economy. The country had from 1986 until 2016 an average growth of 7% in the gross domestic product giving the condition, similar to China, to be a rapid-growth economy. The country, with 94 million people, is mainly a rural country with several opportunities in the industry and urban developments.

Gross Domestic Product
The gross domestic product of Vietnam had an average growth from 1986 until 2006 over 7.5% per year. The increase in foreign investments, the agriculture and commodities products exports to China, Singapore and other countries of Asia increased the gross domestic product from 6.3 billion dollars in 1986 to 186.2 billion dollars in 2016. The highest growth rates were in 1995 and 1996 of 9.5% and 9.3% respectively previous to the baht currency crisis of 1997 (Baidu, 2016). Today, the gross domestic product per capita is 1077.91 USD. The economy changed from an agriculture economy to a service economy having the service sector 36% of the total gross domestic product of the country; the Agriculture is responsible for 10% of the gross domestic product of the country. The condition of the country to be a rural country give to the agriculture and importance in the population and the participation of the sector economy in the employment participation.

Interest rate and inflation

The institution responsible for the monetary policies of the country is the State Bank of Vietnam. The State Bank of Vietnam started operations after the merger of the National Bank of Vietnam of South Vietnam with the State Bank of Vietnam from the north (Bloomberg Professional, 2016). The Central Bank of Vietnam has the following functions:

▪ The stability of the currency and the formulation of monetary policies.

▪ The supervision of the financial institutions, including the most important bank in the country, the Vietin Bank
▪ Recommend economic policies to the government.
▪ Take charge of the administration of the international reserves of the country.
The State Bank of Vietnam is the responsible for the value of the benchmark interest rate of the country with a value of 6.5% in the first semester of 2016. From 2006, the benchmark of the interest rates achieved a maximum value of 15% to avoid a flux of capital out of the country. The first time, the interest rate achieved the value of 15% was after the subprime crisis of the United States of America and the second time was in 2012 (Focus Economics, 2016). The value of 6.5% is higher than other countries in the South East Asia facilitating the influx of foreign capitals to the country.
The inflation is another economy indicator that is the responsibility of the State Bank of Vietnam. The country had in the last twenty years an evolving inflation from the lowest value of -2.6% in 2001 to 28.2% in 2009. The country suffered the highest inflation in the 2009 period thanks to the effect of the subprime crisis from the United States of America. The inflation in Vietnam makes reference to the Consumer Index Price, which most important categories are: Food and drink (36.1%), Construction materials and housing (15.7%), and transport (9.4%).

In spite of the self-sufficient condition of the country to produce all the necessary food for the Vietnamese population, the global increase in the price of commodities and food affected the costs of the food and drink category of the Consumer Index Price (GBS, 2016). The increase in the real estate prices affected the Consumer Index Price. The cost of offices and houses in the Ho Chi Min area are similar to the cost of similar real estate properties in Shanghai, Tokyo, and London.

Currency

The Vietnamese currency is the dong (VND). The current value is 22,222.22 VND per USD (XE, 2016). The currency, after the extinct Zimbabwean dollar and the Iranian rial, is the least valued of the world. Previous episodes of high inflation in the country and the depreciation of the currency to spur exports are the cause of the current value of the currency. The responsible for the value of the currency is the State Bank of Vietnam (Index Mundi, 2016).
The currency, thanks to previous episodes of depreciation and devaluation has different bank notes presentations from 200 dongs to 500,000. The use of the currency for day to day operations difficult the accountability procedures and payment systems, caused by the low nominal value of the currency compared to the US dollar.
The currency, similar with other currencies in South East Asia is strongly related to the US dollar and the prices of commodities, including oil and food. The currency has not relevance in the South East Asia market where the Chinese renminbi, the Japanese yen and the Australian dollar dominate the exchange between the countries after the use of the US dollar or the European Euro (Ocra Worldwide, 2016).

Balance of trade

The country from the economic reforms of 1986 recorded positive trade balances in almost all the years. The General Statistics Office of Vietnam has a partial value of 1302 million dollars from January 2016 to May 2016. Considering historical values, the highest trade balance value was reached in 1444 million dollars in January 2014 and a record negative value of -3888 million dollars in December 1996. The record negative value was in the context of the baht currency crisis of late 1990's. The record positive value was in the context of the peak in the commodity prices of 2014.
The country has positive trade balances with the United Arab Emirates, United States of America, Cambodia, United Kingdom and Hong Kong. The country has negative trade balances with Thailand, China, Singapore, Korea, and Taiwan.

Taxation

The taxation system for corporations that is the Corporate Income Tax (CIT) has a standard value of 28%, which applies to Vietnamese and foreign investments and enterprises. It is possible to receive preferential CIT rates from 10% to 20% if the enterprise or company invests in strategic sectors for the local government. Some of the strategic sectors of the government are renewable energies, biotechnology, and education. The application of tax reliefs is possible, according to the Vietnamese tax legislation (PWC, 2016).

A tax reduction may be applied when the capital is transferred to a legal entity established in Vietnam.

The general sales in the country are affected by a general value-added tax (VAT) of 10% and a special lower rate of 5% applicable to essential goods and services for the population, for example, water, electricity, food, education and health services. For the exportation of goods and services, the applied value added tax is 0%.
The personal income tax (PIT) that is the tax for individual's income has a progressive rate from 0% to 40% according to the income scale. The first requisite for the individual to be considered for the payment is to be a fiscal resident, that is, stay in the country for more than 183 days in the year. For non-residents, the personal income tax is 25% (Stratfor, 2014).

Tariff

The country participates actively in the negotiations for the Trans-Pacific Partnership Trade Agreement. The country is committed to dropping up to 98% of all the tariffs of goods and services for import and export, although the country started that process since 2001. The TPP is a commercial agreement between 12 countries: Australia, Canada, Brunei, Japan, Chile, Mexico, New Zealand, Malaysia, Peru, the United States of America, Singapore and Vietnam. The average tariff today in Vietnam customs is 6.5% having the highest tariffs the consumer and luxury goods and the low tariffs the machinery, equipment and raw materials.
The roadmap for the tariff reductions inside the TPP will take ten years after the approval of the twelve parliaments of the signing countries of the agreement. The tariff policy increases the competitivity of the country against China, which is outside the commerce agreement and will help to increase the trade balance between Vietnam and other countries in South East Asia (TUOI TRE NEWS, 2016).

Foreign Direct Investment

The foreign direct investment increased every year since 1986, thanks to the market reforms that simple and secure rules for foreign investors to invest in the country with the security to generate revenues and to withdraw dividends when the investors want. The foreign investments. The foreign investments in Vietnam had the highest value in the second quarter of 2008 with a value of 25,790.92 million dollars, and the lowest value was in the fourth quarter of 2006 with a value of -2,649.50 million dollars. The taxation and tariff systems added to an educated population increase the interest of multinationals and local companies to invest in the country with possibilities to have a return on investment higher than other economic regions as North America or Europe. The latest legislative reforms helped the country to create a better business environment (The Global Economy, 2016).

Microenvironment

Industry structure of Vietnam

The country changed its economy structure from 1986 from a rural country to a manufacture and service country. In Table 1, it is possible to find the diversified condition of the economy, having the agriculture, the previous most important economic activity 20 years ago, a 10% in the participation of the gross domestic product (The World Bank, 2016).
The services economy sector includes finance, tourism, hospitality, catering, transportation, and commerce. The tourism industry had changed the country since 1997 it is possible for tourists to travel freely inside the country. The number of visitors to the country was 2.1 million visitors in 2000, 6.8 million visitors in 2012 and for 2016 the estimations are 8.1 million visitors (Trading Economics, 2016).
The manufacturing industry includes textiles, electronics, and commodities transformation. Thanks to the availability of raw materials, educated population and the benefits of the country for export, the manufacturing industry is responsible for the 13% of the total output of the gross domestic product.
The agriculture is responsible for the 10% of the gross domestic product and the most important employer in the country. The rectification of the farmlands is an opportunity for the country to increase agriculture production per area (Viet Nam National Administration of Tourism, 2016).

Agriculture value of Vietnam

The output in the agriculture has constantly increased from 1986 until today with a value of 489 million dollars per 1000 square kilometers of arable land. The new investments in the farmlands, the biotechnology, and new techniques helped the country to increase the efficiency and revenues in the farmlands. The value of the output in 1986 was 50 million dollars per 1000 square kilometers or arable land (Viet Nam National Administration of Tourism, 2016).

Opportunities in Vietnam's agriculture

■ Low skills cost and cheap labor: The country has an extensive experience in agriculture techniques, and its farmers offer competitive costs compared with other South Asia countries.

■ Solid agricultural potential and natural resources: The hydrology of the country offers excellent conditions for the agriculture activity.

■ 70% of Vietnamese population lives in the rural areas: The country has an agrarian culture in the majority of the population. The first activity that the Vietnamese family develops is the agriculture. The urban development was a phenomenon that takes speed after the 1986 reforms.
■ Vietnamese economy barely affected by the Chinese slowdown (the main competitor is China): The slowdown in China did not affect the Vietnamese economy because Vietnam is more likely a competitor that a supplier for the country.
■ Development strategy based on economic openness: The Vietnamese strategy is similar to China, applying open economy strategies to boost all the economy sectors (Vietnam Trade Promotion Agency, 2016).

The country is the first exporter in the world of pepper and second exporter of coffee and rice.

Risk in Vietnam's Agriculture
External risks:
■ Vietnam and surrounding countries have a potential conflict with China due to shared interests in the South China Sea.
■ Typhoons, natural disasters, and global warming may affect the agriculture activity in the country.
■ The value of the US dollar and the volatility in commodities prices affects the agriculture sector of Vietnam directly.
Internal Risk:
■ The lack of democracy and independent institutions in the country increase the risk of corruption and bribery.
■ The political system is technically a one-party dictatorship which made difficult have litigation against the government in the Court.
Identification of a relevant sector to invest.
According to the previous analysis, the agriculture sector offers great opportunities for a United Kingdom company to invest in the rubber industry. The Martin’s Rubber Company is looking to install a facility outside the United Kingdom that guarantees the company the supply of rubber raw material and avoids the dependence of Malaysian and Brasilian providers with variable prices. With an own facility that cultivates natural rubber inVietnam, it will allow Martin’s to have control in all its production process from the raw material to the end product. Martin’s will create a subsidiary in Vietnam: The Martin’s Vietnam Rubber company that will own a farmland and a manufacturing facility. The Vietnam subsidiary will sell semi-elaborate products to The Martin’s Rubber Company and finished products to new clients in South East Asia and Australia.

The company will execute an investment of 500 million dollars for the new subsidiary.

Weighted Average Cost of Capital of Vietnam's agriculture
The calculation of WACC, similar to the calculation for companies and projects, the calculation for the Vietnam's agriculture, follows a similar path, using the WACC formula:
WACC = E/(D+E)*rE + D/(D+E)*rD*(1-t)

The cost of equity is calculated using the CAPM formula (WACC EXPERT, 2016):

CAPM = rF + B*(rM-rF)
rF = 2.52%, B = 0.79%, rM = 6.63%
CAPM = 5,77%

For the WACC calculation (WACC EXPERT, 2016):

D/(D+E) = 27%; E/(D+E) = 73%; rD = 6.12%; t = 22%
CAPM = 5.5%

Cash Flow scenario for The Martin's Vietnam Rubber Company

The company has an investment Project of 500 million dollars for a rubber farmland and manufacture facility in Hanoi. The facility erection will take two years. The investment will be divided into equal parts in the two years of erection. Once the agro-industrial facility is open, it will have a positive cash flow of 50 million dollars in the first year of operation and 8% of growth in cash flow each year until the year 14 of operation, time of depreciation of the facility. The net present value of the investment is:
For the calculation it will be used the previous value of WACC of 5.5%. The value of Net Present Value is:
NPV = -250/(1+r)^1+ -250/(1+r)^2 + 50/(1+r)^3 + 54/(1+r)^4 + 58/(1+r)^5 +63/(1+r)^6 +68/(1+r)^7 +73/(1+r)^8 +79/(1+r)^9 +86/(1+r)^10 +93/(1+r)^11 +100/(1+r)^12 +108/(1+r)^13 +117/(1+r)^14 +126/(1+r)^15 +136/(1+r)^16
NPV = 235.67 million
The net present value of the investment is positive, giving the approval of the project to be executed by the company in Vietnam.

Conclusion

Vietnam is a good investment. 2016, Vietnam has performed better than other Southeast Asian countries. Vietnam has raised old restrictions on foreign investment, and in some sectors is already permitted to invest up to 100% of the capital. On the other hand, Vietnam has devalued its currency to keep external competitiveness after the devaluation of the Chinese Yuan in 2015 (World Data Atlas, 2016).
Vietnam with 85 million populations, young and well qualified, together with the outer dynamism, has all the components to be a growth economy and therefore investment object.
The proposed project to open a subsidiary of a UK rubber company in Vietnam has positive net present value giving green light to the company to invest in the country.

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