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Manufacturing retains its dominant position in FDI projects

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While FDI project numbers and capital continue to rise, there is change afoot when it comes to industries and investing countries.

Vietnam's foreign direct investment (FDI) landscape was in flux in 2017. As at November, the country had attracted over $33.09 billion in a total of 2,293 projects; increases of over 82.8 per cent and 52 per cent, respectively, year-on-year.

While impressive, the more important insight into Vietnam's FDI figures lie in the shifts in industry focus and nationality of investors. Investors' changing preferences shed important light on future opportunities and challenges in Vietnam's investment landscape.

Industry performance

In 2017, manufacturing retained its dominant position in total FDI projects, with over 830 registered as at the end of November. Unlike previous years, however, the sector has shown signs of stagnation. Compared to the same period of 2016, which saw 930 projects registered as at November, new manufacturing projects in 2017 were down slightly.

Services, on the other hand, are growing rapidly. At the high-end, hospitality, professional services, and support services have become significant drivers of FDI growth. For support services in particular, Vietnam is increasingly looked upon as a location for business process outsourcing. Demand for professional services is expected to maintain a fast pace of growth as new companies, both foreign and domestic, enter the market.

Beyond high-end services, many investors are also drawn to Vietnam's rapidly emerging middle class. Blossoming local spending on consumer goods has resulted in growth in retail investment, as established global brands fight to establish name recognition within the country. Coupled with continued population growth and strong demographic shifts towards urban areas, both retail and real estate projects are projected to capture a significant share of investment in the years ahead.

Appetite for investment

Vietnam's network of trade agreements plays a significant role in determining the appetite for FDI in Vietnam. Investors in countries with existing free trade agreements (FTAs) with Vietnam, particularly those focused on manufactured goods, have long benefitted from being able to export products from Vietnam at a significant discount compared to similar production facilities located in China, which does not enjoy the same network of FTAs.

In 2017, the strong position of South Korea and India underscored the role that trade agreements play in attracting and retaining investment. South Korea, a longstanding investor in Vietnam and a benefactor of a bilateral trade agreement with Vietnam, registered 767 new investment projects. India, which started its implementation of an FTA with ASEAN in 2010, saw new investments into Vietnam grow by more than 128 per cent in 2017.

In 2018 and beyond, France and Hong Kong will be two countries and territories to watch. France, and in fact any country within the EU, will begin to benefit from the implementation of the EU-Vietnam FTA, which is slated to come into being in 2018. The agreement is scheduled to remove tariffs on a variety of imports and exports and should facilitate the distribution of European goods in Vietnam as well as the incorporation of European companies in the country.

Hong Kong, long the entry point for multinationals seeking to penetrate into China, has historically been at a disadvantage within ASEAN compared to Singapore. During the final months of 2017, Hong Kong and ASEAN reached an agreement on an FTA that is slated to see implementation in the years ahead. Companies with regional management centers in Hong Kong and a desire to pursue China+1 diversification will likely choose to invest via this entity, thus increasing the potential for Hong Kong investment in the years ahead.

Popular locations for FDI

FDI in Vietnam tends to be concentrated in the north and the south. Major cities such as Ho Chi Minh City act as hubs for investment with surrounding provinces, such as Binh Duong, Long An, and Dong Nai, providing support for space-intensive or environmentally-sensitive investment projects.

Ho Chi Minh City and its surrounding provinces currently hold the largest share of new FDI projects in the country. Southern Vietnam has long held a reputation for being more open to investment and as such has been able to attract a more diversified range of FDI projects. While manufacturing may be declining in Vietnam, Ho Chi Minh City is likely to retain a strong position in newly-emerging areas of foreign investment such as retail, hospitality, and professional services.

Northern Vietnam, while second to the south in terms of project numbers, has recently increased in popularity due to its close proximity to production facilities in southern China. For Chinese manufacturers, Vietnam's northern provinces are well positioned to provide low-cost alternatives for aspects of Chinese production chains. Complimenting these trends, northern Vietnam has long been regarded as the industrial heartland of the country and is, as a result, well positioned to host a variety of manufacturing operations.

Concerns for investors

In 2017, investors cited inadequate education among workers, infrastructure deficits, and corruption as among their top concerns. Business leaders are well aware that the days of low-cost labor in Vietnam are limited and investors are increasingly looking to productivity and higher value add production as a means of increasing their competitive position.

Vietnam's economic shift towards higher value-added production, however, has come with costs. Existing investors' scaling up of production, coupled with the continued registration of new investment projects, has put a strong and growing strain on both skilled labor supply and infrastructure. Investors often find that identifying the right workers takes time and that logistics routes are becoming ever more congested.

Investors' education and infrastructure needs are closely tied to the ability of the Vietnamese Government to provide investment, institute reforms, and, where necessary, attract foreign capital and support. Business leaders are quick to credit the government's facilitation of foreign investment in recent years but are also pragmatic with regard to the challenges that issues such as corruption pose for future development.

It is important to note that, while concerns over hiring and infrastructure are a growing concern, these are challenges also faced by Vietnam's regional competitors. Vietnam's strong FDI figures show that, while investors are aware of the challenges they may face, they are still confident in the ability of the Vietnamese market to create a return on their investment.
Recommendations

Looking towards 2018, Vietnam's understanding and policy regarding foreign investment will be more important than ever. The country's ability to meet the expectations of investors and to effectively transfer the benefits of investment inflows towards development will determine if it is able to continue to rise up the value chain effectively.

Given the position of Vietnam's economy, its current trade networks, and the sentiment in its business community, the following are some areas where Vietnam stands to improve its attractiveness as a destination for FDI in 2018.

Industry support. Vietnam's moves up the value chain and into the service economy will require steady upgrades to the skills of its workforce. While difficult, Vietnam's most effective action to resolve this will be to enact policies in support of "winning industries". Government agencies at all levels will have to strike a fine balance between providing the resources these industries require without becoming overly involved in regulation or dependent upon these industries as a source of employment and revenue generation.

Trade integration. In 2018, the faster Vietnam can implement its trade agreement with the EU, the more of a first-mover advantage it will have over its regional competition. The same can be said of the agreement with Hong Kong, but this FTA is with all of ASEAN so the benefits will not be isolated to Vietnam alone.

Beyond the EU, Vietnam's significant trade and investment relationship with Taiwan and the US make these countries prime candidates for future trade negotiations. Vietnam's good standing with the US and previous negotiations for the TPP makes it particularly well suited for a bilateral agreement, despite the protectionist rhetoric from the current US administration.
Regional specification. Vietnam's business conditions are far from uniform across the country. For many foreign investors, opaque reporting on conditions within smaller or less popular provinces can make pre-market research difficult to conduct or act upon. This may in part explain why Vietnam's major cities have also become its industrial hubs.

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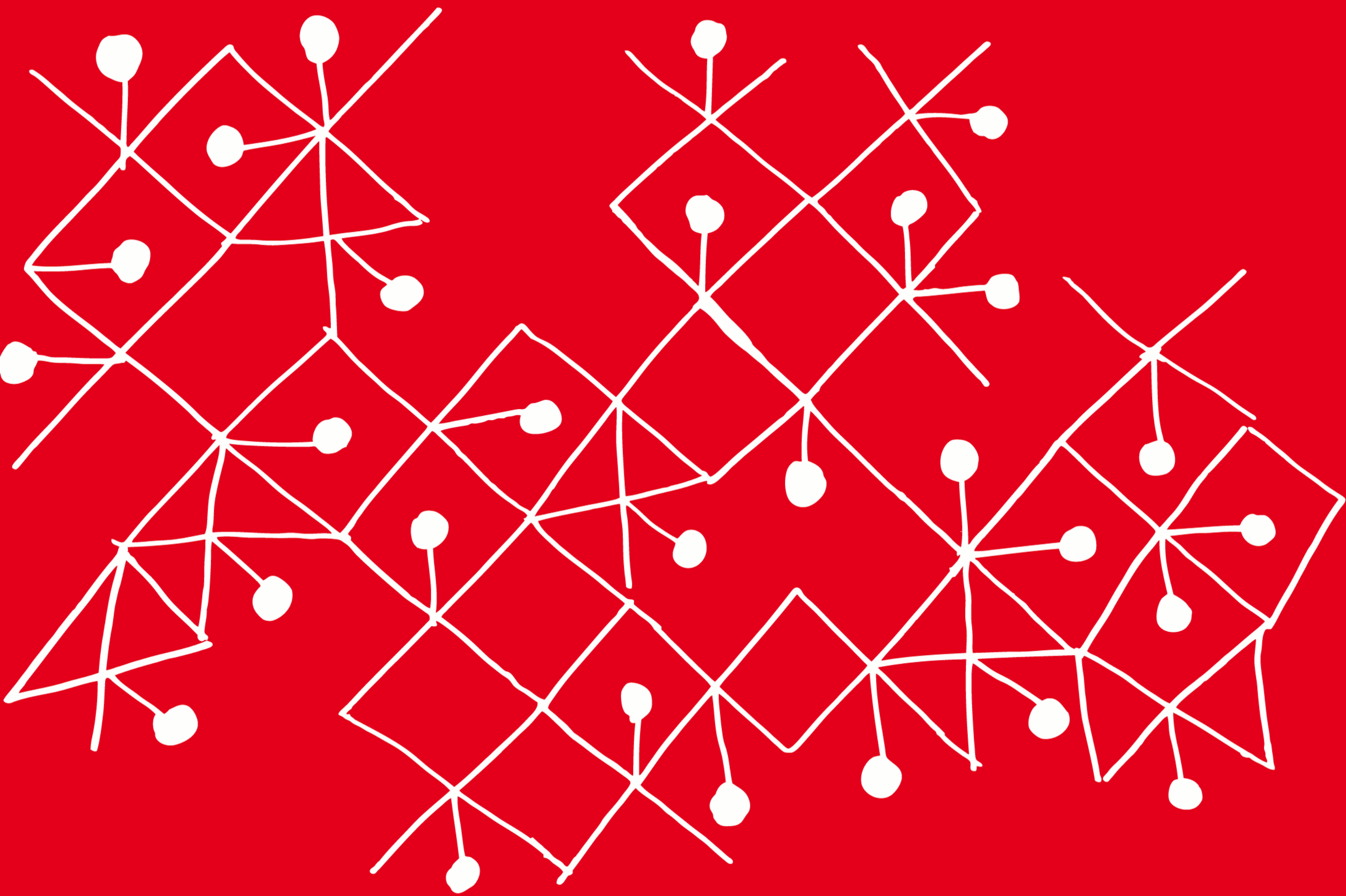

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