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Charting the growth of Vietnam's private sector

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Vietnam is one of the few economies that is still expected to grow in 2020 despite the pandemic. Longer term, Vietnam's private sector, which currently employs 83% of the workforce, will be a key driving force of the Vietnam economy. A thriving private sector also creates a pipeline of companies that are potential candidates for listing, helping to maintain the dynamism of the Vietnamese stock market.

Vietnam's limited Covid-19 infections to date and the relative resilience of its economy have been held up as an example of how a developing country can successfully fight the pandemic. While the Vietnamese economy recorded a decade-low GDP growth of 3.68% in 1Q20, it beat consensus expectations by delivering mildly positive growth (+0.36%) in 2Q20. The IMF forecasts that the Vietnam economy will grow 2.7% in 2020, one of the handful of economies that will deliver positive GDP growth in 2020[1]. As the impact of the pandemic diminishes, Vietnam's economy is forecasted to rebound strongly to grow at 7% in 2021. While domestic demand and the government's easing measures have boosted the resilience of the economy in 1H2020, Vietnam's private sector will play a key role in its longer-term dynamism.

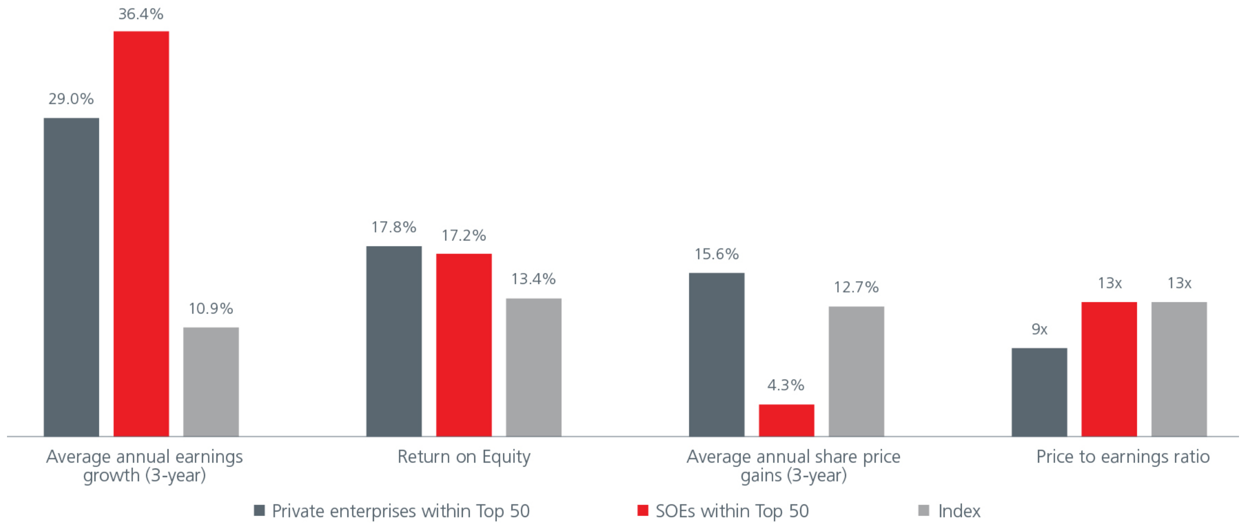
THE PRIVATE SECTOR'S ROLE IN VIETNAM'S STOCK MARKET

The market capitalisation of the Ho Chi Minh stock exchange (HOSE – the main bourse in the Vietnam equity market) grew at a Compounded Average Growth Rate of 31% in the last 11 years, largely supported by the IPOs of private enterprises. During this period, the index returned 14.2% p.a.[2]

Listed private enterprises account for 49% of the top 50 stocks being listed on the HOSE in terms of market capitalisation[3]. 12 have market capitalisations above USD 1bn and are leading companies within their sectors. The revenues and earnings per share of the private companies within the HOSE's top 50 grew by 34% and 29% respectively over the last three years[4]. See Fig. 1

Source: [1]World Economic Outlook. June 2020. [2]Bloomberg. From 2009 to end 2019. [3]Bloomberg. As of February 2020. [4]Bloomberg. As of 4Q2019 for all available companies that have reported results.

Fig 1: Comparison of private enterprises and SOEs on the Ho Chi Minh Stock Exchange



Source: Bloomberg. 11 February 2019. Average annual share price gains over 3-years is based on 1 or 2-year data for stocks which were listed less than 3-years.

shows that these private enterprises generated superior return on equity (17.8%) compared to the State Owned Enterprises (SOEs) and have more attractive valuations (9x PER).

NO LOOKING BACK

Vietnam's private sector was officially recognised as part of the multisector economy in 1986, when the government introduced the economic renovation policy ("Doi Moi") and committed to undertake structural reforms to modernise the economy.

The passage of the new Enterprise Law and Investment Law in 1999 further strengthened the legal framework for the private sector by simplifying registration procedures, removing barriers to entry and raising the corporate governance of companies in line with international standards. Importantly, the new Laws prompted a mindset change by government institutions, ministries and local authorities towards private sector enterprises[5].

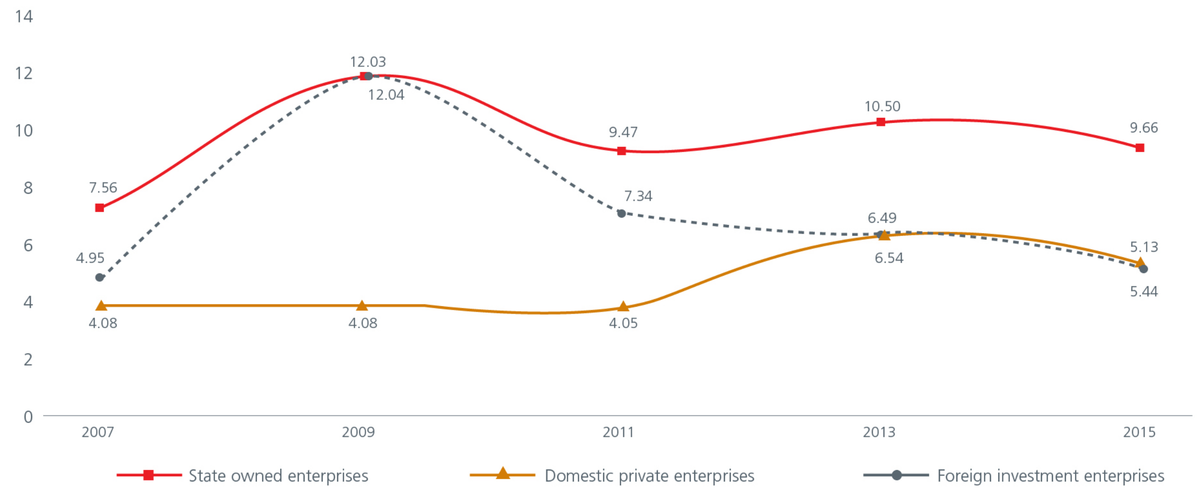
Since then, Vietnam's private sector has grown rapidly. The sector attracted a total of USD546b of capital investment between 2000 and 2015, surpassing even the amount of Foreign Direct Investments (FDI) into Vietnam. Between 2017 to 2018, the total amount of capital invested in newly registered private enterprises rose 17.8%, higher than the 11-12% growth in capital investment for the entire economy. By 2018, the private sector accounted for 43.3% of the country's total capital investment.

Private enterprises have been more efficient users of capital than state owned enterprises (as measured by ICOR[6]). See Fig. 2. In 2015, private enterprises needed an average of 5.13 units of capital, almost half that of SOEs', to produce one additional unit of output.

The private sector's growing importance can also be seen from its tax contributions to the state budget. In 2018, the private sector accounted for 38.2%

Source: [5]Vietnam Private Sector – Productivity and Prosperity. Hanoi, 2018. [6]IOCR measures the amount of additional capital needed to produce one more unit of output.

Fig. 2: Vietnam's ICOR by sectors



Source: Vietnam General Statistics Office..

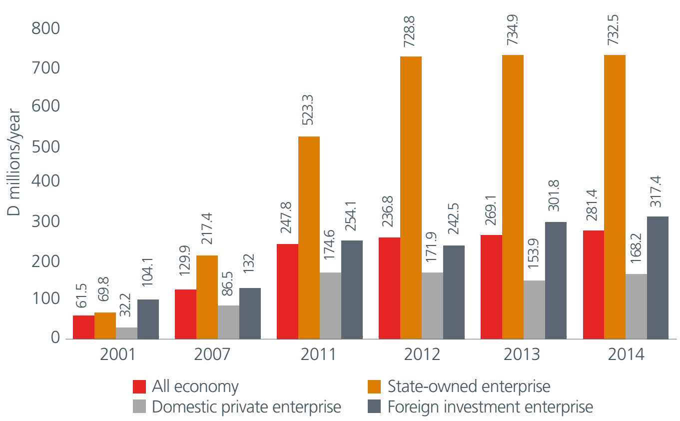
of the state's total tax revenue, followed by FDI companies (33.94%) and SOEs (27.9%)[7]. In 2018, the total tax paid by the private sector grew 15.9% yoy while taxes paid by FDI companies only grew 8.25% yoy. On the other hand, tax contributions from the SOEs fell 26.4% from the previous year, a continuation of the declining trend which started since 2016.

REFINING THE FOCUS

In early 2019, Prime Minister Nguyen Xuan Phuc re-emphasised the importance of the private sector during the Vietnam Reform and Development Forum. He indicated that a dynamic private sector helps create competition and increases flexibility in the economy. The government targets to have two million businesses registered by 2030[8], the majority of which would be private enterprises. To level the playing field, the prime minister promised to continue providing the private sector with favourable conditions, loans, credit, land, human resources and market information. Ultimately, the government aims to lift the private sector's contribution to GDP from 42% in 2018 to 55% in 2025 and 60-65% in 2030.

To reach this goal, Vietnam needs to improve the competitiveness of the private sector[9]. Given Vietnam's double-digit wage growth between 2007 and 2015 and the peak of its working age population, Vietnam's private enterprises need to compete beyond costs. Although the private enterprises have been efficient in using capital and investment (in terms of ICOR), they have been less effective in utilising labour. See Fig 3.

Fig. 3. Vietnam firm-level labour productivity (Millions of dong/year)



Source: Vietnam General Statistics Office (2016).

Source: [7]Department of Taxation – Ministry of Finance (Vietnam) [8]Resolution of the 5th plenum of the 12th Party Central Committee [9]Vietnam Private Sector – Productivity and Prosperity. Hanoi 2018.

The private sector's low productivity is mainly due to the large number of micro and small enterprises, which made up 97% of the total number of domestic private sector enterprises in 2017[10]. The small size and informality of these companies deter them from specialisation, investing into R&D, technology and innovation — factors critical to lifting productivity.

The government can help these small companies become medium and large enterprises. Policies that encourage companies to reinvest profits or engage in mergers and acquisitions can spur these private enterprises to have a longer-term vision and be more committed to sustainable growth. The government can further reduce business costs, strengthen links between private and state-owned/ foreign enterprises and provide resources to support technology adoption.

Not only do larger enterprises tend to be more productive, they can create positive spillover benefits to the value chain or business cluster[11]. Larger companies also typically have higher corporate governance standards and are able to attract higher quality human and financial resources. This helps make them more attractive IPO (Initial Public Offering) candidates.

OPPORTUNITIES FOR LONG TERM INVESTORS

Despite the near-term challenges brought about by the coronavirus, the long-term outlook for the Vietnam economy remains positive. A large working-age[12] population (70% of population), rapid urbanisation and a growing middle-income class will drive consumption. Vietnam is also well positioned as global companies search for alternative/additional manufacturing locations to **diversify their supply chains** and navigate US-China tensions. The disruption to global supply chains as a result of China's lockdown of key cities at the onset of the coronavirus outbreak, has highlighted the need for firms to put greater consideration in their "China plus one or two" strategy. This could potentially quicken the pace of global supply chain relocation to Vietnam. Against this backdrop and with the government's support, the prospects for Vietnam's private sector look promising.

In turn, Vietnam's listed equity market can be expected to grow, creating opportunities for long-term investors. As more (larger) private companies list, this can also help to improve the market's liquidity – a current concern among many foreign investors. In the meantime, the market's low liquidity and pricing inefficiencies create attractive opportunities for experienced investors who possess superior local knowledge and have a deep understanding of the market's idiosyncrasies.

Source: [10]Vietnam General Statistics Office (2018). [11]Vietnam Private Sector - Productivity and Prosperity. Hanoi, 2018. [12]Defined as between 15-64 years. Vietnam General Statistics Office.

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