

## M&A IN VIETNAM: CHANGES AND NEW PRACTICES FOR YEAR 2020

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### **Introduction**

As a periodical review and guidance about Vietnam's corporate and M&A, this article updates on new legislation and legal practice that may affect M&A activities inward to the Vietnam, particularly on entering Vietnam market and running the acquired business in the country.

### **New free trade agreements make Vietnam's market even more accessible to foreign investors**

On 14 January 2019, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (**CPTPP**) entered into force for Vietnam. On 30 June 2019, the Free Trade Agreement (**EVFTA**) and the Investment Protection Agreement between Vietnam and the EU were signed. After the agreements of the World Trade Organization (**WTO**) that Vietnam got accession by joining the WTO twelve years ago, the CPTPP and the EVFTA are the most ambitious free trade agreement (**FTA**) Vietnam has concluded. In addition to these huge FTAs, Vietnam has bilaterally concluded many other FTAs with their key trade partners such as the USA, Japan, Korea, Hong Kong, the ASEAN countries (**AFTA**) and China (via the AFTA).

Of note, these new FTAs are considered as "new generation" in that any restriction to foreign investment must be specified directly in the FTAs, otherwise foreign investment is restriction-free.

The FTAs enable Vietnam to diversify accesses to cheaper imports so as to boost the competitiveness of Vietnam's exports, and to make the jump into higher valued-added production through partnership with foreign companies that can transfer the knowledge and technology. In Resolution No. 50-NQ/TW of Vietnam's Politburo dated 20 August 2019 on management of and projecting on foreign investment toward year 2030 (**Resolution 50**), Vietnam targets to attract USD 30 billion to 40 billion per year during 2021 – 2025.

Foreign investors find Vietnam more attractive to set up companies to manufacture and enjoy the preferred import tariffs the FTAs grant to made-in-Vietnam products, to import into Vietnam the products whose tariffs lowered by the FTAs, and to enjoy doing business in a market of about 96 million people at the golden population. Vietnam becomes more and more attractive to foreign investment.

### **Use of M&A to invest in Vietnam: additional advantages**

M&A is investment by way of acquiring an existing business, by share acquisition or asset acquisition. In Vietnam, M&A is more than a shortcut to help save time entering the market. To name a few of the additional reasons for M&A: regarding staffing, in many sectors, such as in healthcare, education and real estate businesses, it is more cost effective and efficient to have the staff recruited first by local investors, before a foreign investor comes in and acquire to own or co-own the business and the existing personnel. For licensing, M&A also helps: over many years, there has been no foreign invested life insurance company that is incorporated anew; instead, foreign life insurance investors choose to acquire existing companies. For synergy,

many Vietnamese owners seek foreign investors as a way to get to knowledge and technology, while foreign investors find the synergy in the new generation of Vietnamese entrepreneur.

## **Updates for entering the Vietnam market**

*“Only fools rush in” (Haley Reinhart). Topping the economies in terms of the number of FTAs, Vietnam is highly accessible to foreign investors. Still, there are things that a foreign acquirer needs to consider carefully before entering the Vietnam market. To make the right decision, it is vital to raise the right questions. With the developments in policies and legislation in Vietnam, a foreign acquirer should start with the following key questions.*

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### ***Is the targeted business restrictive to foreign investment?***

*Vietnam still maintain ‘negative list’ of business sectors where foreign investment still subject to certain restrictions, whether as investment conditions e.g. in retail or logistics services or pharmaceutical trading, or as investment prohibition i.e. no market opening at all. In addition to the existing ‘negative list’, there are two points to note. Point one, Resolution 50 introduces new condition for screening foreign investment namely “national security”, which is understood to target projects in sensitive industries such as information technology or data process, or sensitive geographical locations. Resolution 50 is the Politburo’s document, not legislation; however, the tightening could start already in the practice of appraising proposed acquisition by foreign investors. Point two, the ‘negative list’ remains subject to changes to be introduced via the Amendment to the Law on Investment, which is expected to be promulgated around June 2020.*

It is important to identify and confirm if there is any foreign investment restriction, and the verification should be conducted in relation to the applicable market openings under the relevant FTAs. When the restrictions are confirmed, to help achieve the commercial purposes of the transaction, measures could be deployed, such as restructuring the target company’s business, crafting special investment structures, or seeking exception-based approval.

### ***Is the proposed transaction subject to merger filing?***

The new Competition Law takes effect from 1 July 2019. In addition to expanding its extra territorial application to “foreign enterprises that operate in Vietnam”, the new Competition Law introduces for the first time series of criteria for determining whether an acquisition transaction would be subject to conducting merger filing procedures. In the past, the criteria of relevant combined market share of 30% was used as a starting threshold for review. Now, this threshold is to be tightened at 20%; in addition, additional criteria such as total assets of the parties to the proposed transaction; total revenue of the transaction parties; and the deal value. With the new tests, acquisition transactions are more likely subject to being required to conduct

merger filing. As merger filing is quite time-consuming, this matter has to be anticipated and got cleared timely for concluding a transaction.

### **Updates for running the acquired business**

To run the acquired business efficiently, the acquirer should raise the following key questions.

#### ***Have the key managers been retained properly?***

Many times the real ‘asset’ that an investor targets to acquire is the target company’s managers. More often, these include the founder of the company. As part of the deal for their sale of shares in their company, these key managers are retained. Accordingly, these former owners shift from employer position to employee position. This is a significant change and the impacts of which are potentially big and decisive on the performance of the acquired business. The relation should be handled tactfully. Vietnamese employment regulations are reputational for its employee-friendliness; so, the relation with the key managers has often been structured to manifest in the form of a service agreement, rather than an employment one. Nevertheless, the new Labor Code dated 20 November 2019 appears to deal with this, by stipulating that in case a person is remunerated for working under another person’s management, instruction and supervision, the relation shall be considered an employment contract, irrespectively of how the contract is named. This requires even more sophisticated legal tools for managing successfully the relation.

#### ***Has the difference in company valuation is handled properly?***

Vietnam’s economy keeps performing well and has generally has been growing faster than the rest of the world. However, considering the vulnerability of Vietnam’s economy, there comes an obstruction preventing the parties from agreeing on price under an M&A transaction: the difference of each party’s valuation of the target company.

There are many ways to help with this, and from the recent practice, using earn-out payment has proved an efficient, highly acceptable to the parties.

Earn-out structure is quite sophisticated. Thus the earn-out terms need to be highly anticipatory. Further, in the context where earn-out payment is applied to managers who are formerly the owners, mentioned immediately preceding, the management rules need to be properly considered and set out, to help balance, harmonize and meet the expectations of not only the acquirer but also the managers.

#### ***What are the new protections of minority shareholder?***

Regarding protection of minority shareholder, there are two key notes – one is current and the other futuristic. The current is that recently a new type of preference share combining both political preferences (e.g. voting right) and economical preferences (e.g. preferred rights to distribution of dividend or of company liquidation) has been accepted. This new legal practice, which has been awaited for decades, is a good news especially for financial investors.

Also regarding protection of minority shareholder, it should be noted that the draft Amendment to the Law on Enterprises is proposing to reduce the minimum of shareholding from the current 10% to be 3% only, and to abolish the current minimum time of holding the minimum shares

of at least 6 months, for a minority shareholder to have the right to nominate their person to the Board, and request for convening general meeting of shareholders.

***And finally, if it comes to exit, what could be the difficulties?***

Exiting from an investment in Vietnam could become more difficult in two cases, one is current and the other futuristic. The current one is that exercising put options have shown very low rate of success. This requires additional measures to be deployed at the outset when this measure is considered.

As to the other difficulty, according to the new Securities Law dated 26 November 2019, a company may only go IPO if, among other conditions, its paid-up capital is VND30 billion or more (close to USD1.3 billion). This is triple the current amount of VND10 billion. So, exiting by way of IPO could be more difficult.

***Conclusion***

Vietnam has decisively made itself more accessible to foreign investors. Investing by way of M&A in Vietnam is quicker and generally simpler way to enter the market. Of note, the country is transforming fast, and M&A is to deal with existing, running businesses. A foreign acquirer should start off on the right foot, for which raising the right questions is the key to making the right investment decisions.