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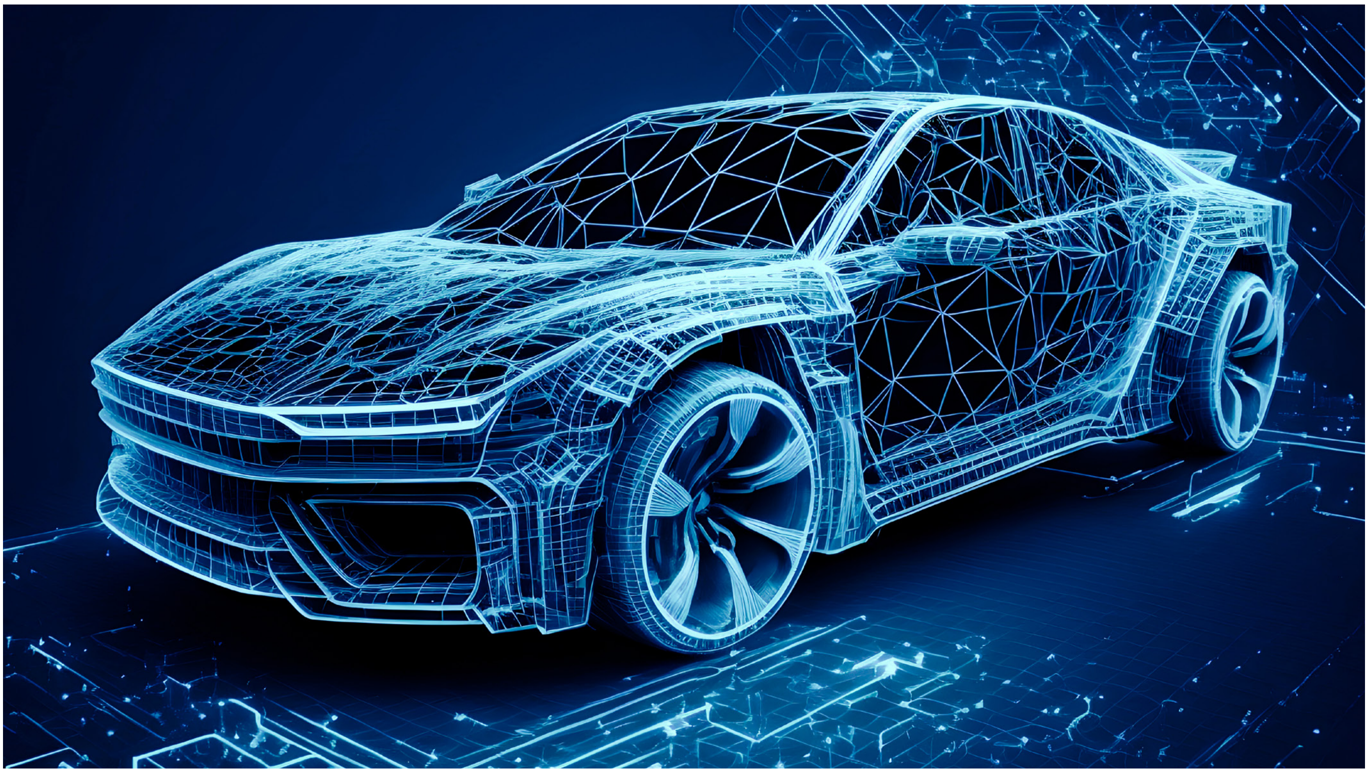
Newsflash | January 2024

Driving Forward: advantages and challenges for foreign direct investments in Vietnam's automotive sector



I. Introduction

Investment climate in Vietnam

Vietnam stands out as one of the fastest-growing economies in the Association of South East Asian Nations ("ASEAN").

Driven by a dynamic business environment, set in a strategic location, and with abundant workforce, Vietnam offers favorable conditions for market entry and business development. These advantages coupled with the government's proactive economic initiatives in recent years have positioned Vietnam as an attractive market for foreign direct investments ("FDI") and helped the country emerge as a prominent manufacturing and production hub alongside other key players in South East Asia.

Automotive industry in Vietnam

Vietnam's automotive industry has recently experienced considerable growth with the industry's sales consistently expanding. Annual car sales in Vietnam reached 500,000 units in 2022, and are projected to reach 750,000 - 800,000 by 2025 and 1.7 - 1.8 million by 2035. There are approx. 241 auto part producers in the country, with 134 of them being FDI companies.

Vietnam's aspirations as a future hub for the automobile industry of the region is supported by the government's promotion and implementation of helpful policies.

While foreign car manufacturers, particularly Japanese brands, still dominate the market, local brands like VinFast – an electric vehicle manufacturer – and Truong Hai Auto (THACO) have consistently gained market share over time. At the same time there is a growing number of European brand models being manufactured in Vietnam including inter alia French and Czech brands as well as German luxury brands.

Besides the assembly and finishing of complete vehicles, automotive suppliers have settled and follow to flow into the countries production hubs in the northern, central and southern industrial park, usually under the lead of one or two manufacturers.

II. Regulatory Framework for Foreign Direct Investment in Vietnam

Vietnam offers various options for foreign investors to engage in Business activities. Of the variety of options we generally see one of the two main investment routes being taken by foreign investors:

Incorporation of a subsidiary in Vietnam

An investor or group of investors may establish a – in principle fully owned – subsidiary in the form of a limited liability company, joint stock company or partnership. Each company type has distinct legal requirements, rights and obligations imposed on the investor, though each of them constitutes a separate legal entity able to engage in business activities in its own name and generally providing a liability shield.

Contribution or acquisition of shares/capital in a domestic company

An investor or group of investors may elect to contribute or acquire shares or capital in an already established Vietnamese automotive company. This way the foreign investor may benefit from the existing business infrastructure, business network, capacities, and market experience of the target company.

The foreign owned legal entity in Vietnam has to be registered for the particular business lines in which they aim to operate and may additionally be subject to operational license requirements depending on the specific case. While Vietnam does in principle allow investors to establish a wholly foreign-owned company, specific business lines may be subject to a minimum local ownership requirements and other restrictions.

Hence, where such restrictions apply, a local automotive company that previously operated under Vietnamese laws without further regulatory requirements, may, at the instance of becoming (partly) foreign-owned, suddenly be subjected to restrictions in the scope of permitted business conduct, or may be required to obtain additional licenses in order to proceed with its previous business operations.

Free Trade Agreements with the EU ("EVFTA")

Vietnam has entered into a large number of free trade agreements. The European Union Vietnam Free Trade Agreement ("EVFTA") in particular promotes increased business activities between Vietnam and its trading partners in the EU.

EVFTA creates new opportunities for trade and investment, reduces trade barriers, and aims to provide a stable framework for businesses to operate. The implementation of EVFTA has already had a positive impact on the automotive sector in Vietnam since it came into effect in August 2020, as it facilitates trade and increases market access for automotive companies by decreasing the restrictions mentioned before, benefiting both European and Vietnamese automotive manufacturers.

EVFTA aims to strengthen economic ties among member countries by promoting preferential tariffs and reducing trade barriers. The automotive industry is one of the key sectors to benefit from the reduction of customs duties. This reduction not only lowers the price of imported cars, but also allows local businesses to import production components at lower prices. Currently, the tariffs on cars imported from EU countries to Vietnam are usually ranging from 65% to 75%, while auto parts and components face tariffs ranging from 20% to 25%. Thanks to EVFTA, the import tax on cars, auto parts and components imported from the EU is expected to gradually decrease.

III. Advantages

Incentives for the automotive industry

Investment projects in the automotive industry may be eligible for incentives if such investments fulfill certain criteria. Those may relate to the investment capital value, the number of jobs created, or the project location in areas with (especially) difficult socio-economic conditions. Incentives are currently granted in the forms of tax incentives, waiver or reduction of land use fees and rent, fast depreciations and increased expense deductions for a certain limited period from commencement of operations.

For example, (foreign-invested) companies may enjoy a generous corporate income tax reduction followed by preferential tax rates. Furthermore, certain automotive components and parts may be subject to a preferential import tax rate of 0% in specific cases. Eligibility for incentives and privileges can only be estimated by category, however, each privilege must be applied for by the local entity, hence certainty will only be available after establishment.

Vietnam's special consumption tax for electric vehicles is significantly lower than for fossil fuel operated vehicles, with rates for hybrids in between. As a targeted policy this is likely to encourage investments in the electric vehicle industry of Vietnam even further.

Strategic location and access to global markets

Vietnam's strategic location on the Southeast Asian Peninsula with its 3,260 kilometers of coastline with its ports allow Vietnam access to the world's most important trade routes, facilitating the flow of goods, services, and investments in regional and global markets.

Furthermore, the various free trade agreements Vietnam has entered into allow Vietnam to integrate in the global supply chain and facilitate exports of automotive products produced in Vietnam. This enables automotive manufacturers operating in Vietnam to tap into a large customer base and expand their market reach in the region.

EVs on the rise

Vietnam aims to establish itself as a regional hub for electric vehicle (EV) production and export, targeting to achieve an annual output of one million EV units and sales of 900,000 EVs. According to the Vietnam Automobile Manufacturers Association ("VAMA"), the ownership rate of electric vehicles in Vietnam is predicted to reach one million units by 2028 and 3.5 million units by 2040.

In order to encourage the sale of electric vehicles and promote a national sustainable economy, Vietnam's Ministry of Transport has proposed incentives of up to $1.000 for EV purchasers.

VinFast – the local key player of the automotive industry in Vietnam, is a pioneer serving the local EV trend and is now extending into the US market. By 2022, VinFast has achieved significant local market success in the passenger electric vehicle sector, capturing over 50% of the market share.

At the end of 2022, Mercedes-Benz Vietnam introduced their first electric car line – EQS – In Vietnam. In 2023, Mercedes-Benz was to bring three more pure electric SUV models to Vietnam. Renowned brands in the luxury segment such as BMW, Porsche, Audi, and Volvo have introduced their electric car models as well as their strategies to complete their electric car portfolio in the Vietnamese market in the near future.

Improved logistics performance

During the past few years, Vietnam has prominently integrated itself into the global supply chain whilst becoming a preferred destination for international companies seeking to diversify or even relocate their manufacturing operations in the region. Recognising the growing demand to develop the logistics sector, Vietnam has been implementing measures following a plan to expand and upgrade the logistics infrastructure nation-wide. These measures correlate to the regional hubs and interconnectivity between them. They further target to develop more remote areas of the country that have not yet been utilised as production areas.

Further, Vietnam has had an active cross-border exchange for years with China in the north, and other neighbors in the Region. Export routes to Europe and the US are well-established. In-land infrastructure is increasingly catering towards technology and high-tech industry standards, strongly incentivised throughout the country.

Strong manufacturing capability

Historically, Vietnam has been a top destination for production, especially in the textiles sector. In 2022, the manufacturing sector in Vietnam has been a key driver of economic growth, accounted for over USD 16.8 billion, covering 60.6% of the total registered foreign direct investment in Vietnam.

In recent years, there has been a great increase in the manufacturing of more advanced items including automotive components, industrial machines and semiconductors. With a well-developed factory infrastructure, alongside relatively low employment costs and ample workforce, Vietnam has become a strong base for the manufacturing sector and attracted a large number of new FDI projects across industries. Vietnam's northern region is well-known for its heavy manufacturing, oil and gas industry, and high-tech businesses including vehicle (components) production.

Moving forward we expect extended establishments catering specifically to the high-technology and automotive industry. We further see certain prospectives for changes of relevant regulation targeted to ease the crease of this sector for years to come.

IV. Challenges

Restrictions for foreign investors

Vietnam in principle allows investors to establish a wholly foreign-owned company to conduct certain business activities also in the automotive sector.

Based on the communicated government's vision to 2035, the strategy to develop the nation's automotive sector prioritises connecting and cooperating with major global automotive conglomerates and creating policies to attract foreign capital. Therefore, investors may expect Vietnam's business environment specifically for the automotive sector to become increasingly open.

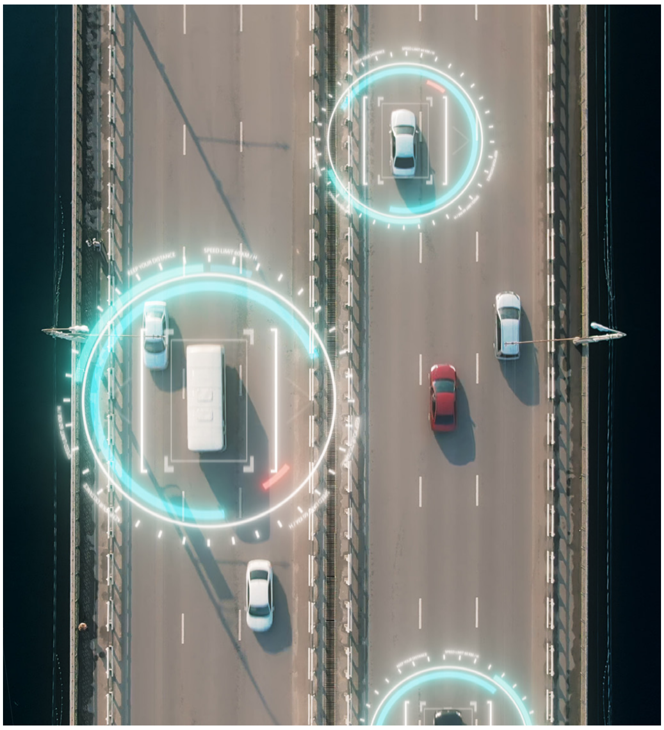
As if now, still, prevailing regulation requires investors to in general to obtain the appropriate operating licenses prior to commencement of manufacturing in the automotive industry. Conditions and requirements vary greatly subject to the specifics of each project, however, in principle, a holistic observation of obligation pertaining to land use rights, facilities, assembly lines, automotive testing lanes and others must be met. This often requires investors to allocate significant resources to the expansion to Vietnam prior to market entry and to prepare and plan well-ahead in order to avoid common pitfalls.

Against this background, in the past strategies to mitigate the risks of loss of initial investments or to meet licensing requirements, investors have outsourced their production to licensed Vietnamese manufacturers. This is a path chosen by some European car manufacturers to date and requires a reliable local partner. If, after careful consideration, this turns out to be the most favorable amongst market entry options, still, time and effort should be duly allocated to due diligence assessments of potential partners and their background in order to safeguard own interests.

Bureaucratic obstacles and regulatory complexity

Even with ongoing reforms, prevailing regulations for the automotive sector still contain ambiguities and are subject to differing interpretations by the authorities. In practice, foreign investors may encounter setbacks such as prolonged processing times, contradictory guidance, and non-statutory requirements set by authorities during the licensing process. Successful navigation through the complexity of Vietnamese laws demands clear insights into local practices and the opinions of local authorities.

Overall, having a well-prepared plan, capital resources and a profound understanding of the legal framework and its interpretation by authorities is essential for successful investments in Vietnam.



V. Practical considerations

Success Stories

The first-mover automakers Toyota, Hyundai, and Mitsubishi have invested hundreds of millions into local production facilities over the past decade and today provide the top three best-selling auto brands to the local market in Vietnam. Recognising the potential, the German luxury segment has also successfully tapped into Vietnam's dynamic consumer market of their own kind, with an overall positive outlook. From these success stories we would deduct that it may take time and (financial) commitment initially, however, the growth potential of the local consumer market is open. For exporters (EU importers) time will yet have to show which benefits truly transpire from the EVFTA. However, as of today Vietnam has successfully made the shift from textiles and garments to hardware, tech- components and assembly line.

Outlook

Vietnam is emerging as a rising star in terms of GDP growth in South East Asia making it a potential automobile consumption market. In 2023, Vietnam's automobile industry is on the path toward growth and expected to benefit from increased demand and government support for the development of the industry.

Further the Vietnamese government decisively set the target to promote automobile production and exports through various proactive policies and initiatives. The electric vehicles sector is expected to be the priority segment in the industry. While there are still challenges that need to be addressed, the industry has significant opportunities for growth and development in the coming years.

VI. Your contacts in Vietnam

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Release: January 2024