Looking past the 49 per cent cap

Many private firms with an appetite for foreign investment capital are forced to go hungry because of Vietnam's tight investment controls. However, some innovate private and government thinking can deliver a variety of foreign shareholding options, writes RUSSIN & VECCHI

Foreign ownership of public companies is restricted within the tight confines of Vietnamese law. In fact, foreigners can hold no more than 49 per cent of shares in public companies and specific types of public companies face even stricter limits. For example, foreigners can hold no more than 20 per cent of an insurance company or bank, with some exemptions for so-called "strategic investors".

There is little room to explore innovative ideas on limits within the current legal framework. However, public companies that have hit the foreign ownership cap have a few options to attract additional foreign capital. The issuance of preferred shares to foreign investors is one possible solution. Under Vietnamese law, preferred shares do not carry voting privileges and do not appear to count towards foreign ownership limits. Nguyen Son, head of Market Development at the State Securities Commission (SSC), has intimated that preferred shares could enable enterprises to raise capital without threatening existing shareholders' control of a company that had reached its foreign ownership rate. In fact, Vietnam's stock exchanges do not list preferred shares. They are only available on the Over-the-Counter market. While preferred shares are available to companies that need additional foreign capital, it is an imperfect solution. There is limited legal text to regulate the interests, rights and obligations of a preferred shareholder. This, too, will pose a challenge as the views of regulators will be important.

This limitation on the percentage of listed shares held by foreigners hinders investment in Vietnam's public companies. This is also reflected in the total capitalisation value of the Hanoi and Ho Chi Minh City exchanges amounting to just $45 billion, far less than in neighbouring Thailand ($460 billion), Indonesia ($427 billion) and the Philippines ($186 billion). In reality, Vietnam's bourses are unlikely to catch up with regional rivals until they open the door to foreign investors to participate more actively.

According to the Wall Street Journal, at least 10 of Vietnam's 30 largest listed

companies are close to maxing out their foreign share ownership limits. This lack of room for foreign investors to manoeuvre is deterring new players from entering the market. The trend is graphically illustrated by Le Anh Tuan, chief economist at Dragon Capital, who revealed that an institutional investor had recently planned to disburse $100-300 million into Vietnamese stocks, but backed out after realizing how limited the market options were for foreign investment.

However, there are signs that Vietnam is open to market reforms. Last year, the SSC suggested allowing listed firms to issue a limited percentage of non-voting shares to foreign investors. Under the SSC proposal, Vietnam would lift the foreign ownership cap in listed companies from 49 to 59 per cent, with 10 per cent allocated to non-voting shares. This would allow more foreign investment, but assure that companies remain under Vietnamese control.

While this proposal has yet to be implemented, in reality it would have

little impact as it would only free up an additional 10 per cent of shares in ordinary public companies and not provide a solution for restricted sector companies, like banks and insurance companies.

A more effective solution is a new securities instrument for foreigners, similar to that available in Thailand that, like Vietnam, limits foreign ownership in public companies. These "non-voting depository receipts" (NVDRs), offered to foreign investors by Thailand's exchange, are similar to ordinary shares and offer entitlement to dividends and other rights. However, these NVDRs are not voting shares unless they are in the hands of Thai investors. Most importantly though, NVDRs allow foreigners to invest in listed companies that have already reached their foreign ownership limits.

The NVDR-type instrument model would be a better choice for the SCC, as the 10 per cent share limit would be unnecessary and NVDRs would offer more liquidity and demand than simple non-voting shares.

In addition to NVDR-type shares that revert to ordinary shares when sold to domestic investors, Vietnam should consider allowing public companies to offer non-convertible non-voting shares. Founders of new enterprises, particularly tech firms, often wish to retain a voting majority even after going public. Facebook's Mark Zuckerberg, for example, maintains a controlling share of votes because he insisted on retaining an "irrevocable voting proxy" over the shares owned by Sean Parker and a number of other major Silicon Valley investors. In another example, Internet giant Alibaba decided to leave negotiations to join the Hong Kong Stock Exchange after the bourse refused to relax its "one-share, one-vote" rule. Allowing a dual-class share structure would help Vietnam's exchanges attract more initial public offerings.

While adopting similar instruments in Vietnam will require reform of legislative infrastructure, the country should vigorously explore market reforms to allow for greater participation by foreign investors. Last year's SCC proposal while modest, was a promising sign that Vietnamese policy-makers are interested in improving market access. An open discussion and exchange of ideas will help promote and accelerate reform.

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RUSSIN & VECCHI

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