International Journal of Advanced Science and Technology
Vol. 29, No. 11s, (2020), pp. 604-610

An investigation into Vietnamese Government intervention of Venture Capital Market

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Abstract
This article explored the government-sponsorship and policies towards the Vietnamese VC sector by evaluating the Vietnam legal environment investigating the advantages and disadvantages and determining the most suitable structure of Government intervention in Vietnam VC market from lessons learnt by other countries.

Keywords: Vietnamese Government Intervention, Venture Capital Market, Vietnam legal environment

I. MAIN TEXT

Over the past twenty years Vietnam's economic trajectory has been unequivocally upward, as the Socialist Republic has indoctrinated liberal market programs and opened to international participation. Vietnam's growth rate has averaged 7.1% per year, putting Vietnam in the same league as China and India as one of the world's exceptional growth stories.

Until recently and like many other Asian neighbors, in Vietnam, the state dominates the economy. The government-controlled credit allocation decisions and the policy making process was not inclusive or transparent. Subsequent to the *doi moi* reforms in 1986, a new constitution in the 1990s and participation in numerous international trade regimes over the past 15 years, the Vietnamese market has become more liberal and private actors now an indispensable part of the competitive landscape.

With the widening involvement of international actors and the surge of private companies comes changes to industrial policies[1] to increase Foreign Direct Investments (FDIs) and to enter new economy based on high-value-added industries and services; and to become a "startup nation," as proclaimed[2] by Vietnam's highest leadership. In addition, the state's role has shifted from a financier with central authority over markets to a market facilitator that finances and empowers their private sectors. Vietnam has allowed greater economic scope and have enacted policymaking to uncomplicate and accelerate private firm's establishment, both domestic and foreign. However, this shifting balance of power is ongoing, and the expectation is that capital market building, including VC markets, would need to be the product of public-private partnership rather than a purely private sector effort.

To get out of the middle-income trap Vietnam will have to restructure the economy, expanding the share of high-tech industries, find new export markets, level the playing field for local private businesses, deal with the bulky and ineffective state sector, and increase the robustness of its institutions.

Since the 1980s many governments have identified that there is insufficient amount of high-risk capital available for high technology start-ups and entrepreneurship. Eager to replicate the success of the VC industry from California's Silicon Valley policymakers in Vietnam sought to correct this market failure and

[1] New rules allowing foreigners to take bigger stakes in Vietnamese companies took effect in 2015 allowing foreign shareholdings of up to 100 percent in some firms, versus the previous 49 percent ceiling. This is one of the most liberal measures adopted as Vietnam pursues broad economic reform.

[2] http://e.vnexpress.net/news/business/vietnam-strategizes-to-be-a-start-up-nation-3419755.html

have begun to intervene in Venture Capital (VC) which has become an increasingly important development role for Vietnam.

Contrasting the VC sector with its regional neighbors, Vietnam is a late comer and has one of the smallest VC markets in Asia. In most market, intervention come from a combination of the following government actions: (i) co-investments – providing loans, matching funds, or guarantees to VC managers, (e.g. Vietnam Silicon Valley with the support from Ministry of Science and Technology) (ii) tax relief - allowing carried interest to be categorized as capital gains or as tax exempt, (currently is 20% gains derived from the sale of a Vietnam company while transferring of public securities like bonds, public shares by a foreign entity are subject on a deemed basis at 0.1% of the total sales proceeds) and (iii) regulations - legislation regarding VC partnership structures, foreign investor participation and reporting requirements, currently, Vietnam government is drafting a new law for operating venture investing followed a section from the SME law.

The government intervention implementation based on main beneficiaries of VC is essential for the emergence, growth of innovative companies, enhances economic development, wealth and job creation (Kortum and Lerner, 2000). Hence it is vital for Governments to kick start the industry through co-investment in VC; allowing tax incentives to encourage innovations and jobs; and legislate to encourage domestic investments in startup and to attract foreign capital.

The success of United States, Singapore, Taiwan, and Israel government have come from well-structured government policy such as: tax incentive to attract the investment of individual in high risk asset. Taiwan created Hsinchu Technology District in 1980 with the objective of attracting Taiwanese technologists and entrepreneurs located in the Silicon Valley to return to Taiwan. The successful of Israeli VC industry have numerous contributions from Yozma[3], the government funded VC. Given the availability of various tax incentive schemes, Singapore attracted many foreign VCs to use as their regional base, the efficiency of legal system, financial market and urban infrastructure have always been a draw in encouraging multinational companies to establish their headquarters in the country.

According to Doing Business report 2018, Vietnam rank 68 in the ease of doing business4, particularly in starting a business regulation, ranked 123. Hence, to provide more opportunities for VC and entrepreneurship, Vietnam should improve their regulation climate.

✔ Reform making it easier to do business ✘ Change making it more difficult to do business

VIETNAM		**East Asia & Pacific**		**GNI per capita (US$)**	**2,050**
Ease of doing business rank (1–190)	**68**	**Overall distance to frontier (DTF) score (0–100)**	**67.93**	**Population**	**92,701,100**
Starting a business (rank)	123	✔ **Getting credit** (rank)	29	✔ **Trading across borders** (rank)	94
DTF score for starting a business (0–100)	82.02	DTF score for getting credit (0–100)	75.00	DTF score for trading across borders (0–100)	70.83
Procedures (number)	9	Strength of legal rights index (0–12)	8	*Time to export*	
Time (days)	22	Depth of credit information index (0–8)	7	Documentary compliance (hours)	50
Cost (% of income per capita)	6.5	Credit bureau coverage (% of adults)	19.7	Border compliance (hours)	55
Minimum capital (% of income per capita)	0.0	Credit registry coverage (% of adults)	51.0	*Cost to export*	
				Documentary compliance (US$)	139
Dealing with construction permits (rank)	20	**Protecting minority investors** (rank)	81	Border compliance (US$)	290
DTF score for dealing with construction permits (0–100)	79.03	DTF score for protecting minority investors (0–100)	55.00	*Time to import*	
Procedures (number)	10	Extent of disclosure index (0–10)	7	Documentary compliance (hours)	76
Time (days)	166	Extent of director liability index (0–10)	4	Border compliance (hours)	56
Cost (% of warehouse value)	0.7	Ease of shareholder suits index (0–10)	2	*Cost to import*	
Building quality control index (0–15)	12.0	Extent of shareholder rights index (0–10)	7	Documentary compliance (US$)	183
		Extent of ownership and control index (0–10)	6	Border compliance (US$)	373
✔ **Getting electricity** (rank)	64	Extent of corporate transparency index (0–10)	7		
DTF score for getting electricity (0–100)	78.69			✔ **Enforcing contracts** (rank)	66
Procedures (number)	5	✔ **Paying taxes** (rank)	86	DTF score for enforcing contracts (0–100)	60.22
Time (days)	46	DTF score for paying taxes (0–100)	72.77	Time (days)	400
Cost (% of income per capita)	1,191.8	Payments (number per year)	14	Cost (% of claim)	29.0
Reliability of supply and transparency of tariffs index (0–8)	6	Time (hours per year)	498	Quality of judicial processes index (0–18)	6.5
		Total tax and contribution rate (% of profit)	38.1		
Registering property (rank)	63	Postfiling index (0–100)	95.71	**Resolving insolvency** (rank)	129
DTF score for registering property (0–100)	70.61			DTF score for resolving insolvency (0–100)	35.16
Procedures (number)	5			Time (years)	5.0
Time (days)	57.5			Cost (% of estate)	14.5
Cost (% of property value)	0.6			Recovery rate (cents on the dollar)	21.8
Quality of land administration index (0–30)	14.0			Strength of insolvency framework index (0–16)	7.5

[3] Yozma operates like fund of funds by providing $8 million for ten other VCs which were required to raise another $12 million from foreigners

[4] Doing Business based on ten different factors to rank business environment, those are starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protesting investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency

Besides, Vietnam is not a lack of innovative ideas compared to other developed and developing countries, but lacking the necessary infrastructure and capital allowing them to execute. Increasingly governments around the world have got engaged in VC by both directly investing or indirectly through fund of funds and allowing tax incentives, hence this article will be the basic foundation for the creation of the government-sponsored VC in Vietnam by evaluating the Vietnam legal environment by comparing with lessons from other countries, investigating the advantages and disadvantages, and determining the most suitable structure of Government intervention in Vietnam VC market. With primary data from interviews: 4 VC, 1 private equity, 2 government owned funds, 2 government officers, including the Minister of Science and Technology, and 1 lawyer in 2014, and secondary data updated from Circulars, Decrees, and research.

VIETNAMESE LEGAL SYSTEM

The research about the establishment of Ho Chi Minh City Investment Fund for Urban Development (HIFU) (Thành (1997)) has stated that the Government is prohibited to invest in VC by State Budget Law (SBL), however, in SBL, no article mentions this. Furthermore, in clause 1, article 31, it is said that allowing the use of government budget to invest and support for enterprises, economic organizations, financial institutions, and contributed equity, venture with the businesses operating in fields required the participation of the State. Thus, the main barriers are created by the Prime Minister to prohibit government owned companies to invest outside their main operation industry which caused significant damage to Vietnam economy (e.g. Vietnam Electricity (EVN). In addition, according to Vietnam Investment Law, Article 68, clause 1 mentions: "Investment capital from the state budget on economic organizations is done through State Capital Investment Corporation (SCIC)". This helps to explain the movement of SCIC when co-investing with Oman to establish Vietnam Omen Investment (VOI)[5].

In 2013, MOST established Vietnam Silicon Valley by their budget. However, this movement went against the Article 68 of Investment Law (lack of participation of SCIC). Indeed, based on the High Technology Law, Article 24 mentions the definition for VC investment and tax incentive for investment in high technology industry, and Article 25 mentions about the establishment of high technology VC fund. According to clause 2 of article 25, financial capital of this fund will come from state budget, sponsors of individuals and foreign institutions, and clause 4, it mentions about the role of the MOST and the Ministry of Finance (MOF) to establish and operate this fund. Thus, it means the establishment of Vietnam Silicon Valley does not require participation of SCIC and they can use state budget to finance operation and investment.

According to Minister Nguyễn Quân, even though the Government provides the legal support the activities of VC, it has not provided a circular for this law before 2018. During this time, Vietnam VC funds were supposed to operate under the Securities Law (SL) and other related legal documents. Even if VC has to operate under the Securities Law, its investment activities do not have specific regulations which support for their investment activities.

Not until recently, Vietnam is updating venture capital investing law, and with existing tax incentives for businesses which include enterprise income tax (EIT), preferential rates, EIT exemption and EIT reduction are granted on the basis of location, industry or manufacturing size.

Investment sectors which are entitled to benefit from such incentives include the following:

- High-tech industries.
- Scientific research and technological development.
- Infrastructural development.
- Software product production.
- Education and training.
- Medical services.

[5] VOI mainly focuses in private equity market of Vietnam is founded as the joint venture between the State General Reserve Fund of Oman and the State Capital Investment Corporation of Vietnam in 2009

- Sports and cultural activities.
- Environmental activities

In terms of location, tax incentives are granted to enterprises established in the following:

- Economic zones.
- High-tech zones.
- Geographical areas with difficult socio-economic conditions.

Unless a large-scale project tax exemption incentive applies, tax incentives typically include the following:

- Preferential tax rates of 10% or 20%.
- Tax exemptions for two or four years
- A 50% tax reduction for four, five or nine years.

There is no EIT incentive applicable to investment in venture capital companies in particular. However, such investments may nonetheless benefit from the above incentives if they are made in enterprises or investment sectors which fall into the above categories.

In regard to Startup Regulations, in 2016, the Prime Minister approved the “Supporting National Innovative Start-up Ecosystem to 2025” Project, or Project 844, through Decision 844/QD-TTg/2016. It focuses on supporting the national innovation startup ecosystem through 2025 and developing a legal system and a national e-portal for startups by 2020. In addition, it will also provide funding support to 200 startup enterprises. In January 2018, the Law on Supporting Small and Medium-Sized Enterprises came into effect, with detailed provisions for support to start-ups in areas such as technology transfer, training, trade promotion, investments, preferential loans, and incentives for venture capital funds. Decree 38/ND-CP, which came into effect in March 2018, focuses on innovative start-up investments. It identifies and recognizes start-up investment activities as a business and provides legal status to innovative start-up companies and funds. In addition, one of the regulations stipulates that the State can also invest in a startup, maximum to 30 percent of the total investments into a company.

MARKET FAILURE OF VC INDUSTRY IN VIETNAM

First off, most of the VCs in Vietnam focus on certain industries, especially technology. It is explained by the fantastic Internet growth in Vietnam and the impressive potential up-side in this area. This generates VC’s decisions oriented and missing lots of another promising non-tech startup.

Year	Users	Population	% Pop.	Usage Source
2000	200,000	78,964,700	0.3 %	ITU
2005	10,711,000	83,944,402	12.8 %	VNNIC
2007	16,737,129	85,031,436	19.7 %	VNNIC - July/07
2008	20,669,285	86,116,559	24.0 %	VNNIC - Nov./08
2009	22,779,887	88,576,758	25.7 %	VNNIC - Dec./09
2012	30,802,752	90,549,390	34.0 %	VNNIC - Feb./12
2016	68,541,344	97,338,579	70.4%	IWS - Dec./19

Internet Usage and Population Statistics in Vietnam, by internetworldstats.com

Secondly, the characteristic/sector of the company itself, besides, can lead to the failure of Vietnam market in terms of fundraising. VCs rarely take high risk for no potential growth product (not similar with experience in global market and not accepted by local market) or early-stage startups (high cost for monitor but low return).

Third, the first sight of VCs in a company lies on the managers, so lacking experience and administration knowledge of most young entrepreneurs depress many VCs. Moreover, the gap in technology knowledge or the underestimating of true value between startups and VCs are other failures of VCs industry in Vietnam.

Lastly, the lack of complete and supportive Vietnamese startup ecosystem fails mostly in VC market. A strong ecosystem aids not only to fortify faith of VCs on a bonding and mutual growing accelerating community but also to open an exit route for their risky business investment.

VIETNAM GOVERNMENT INTERVENTION IN VC INDUSTRY

The support for government based on their beliefs about government abilities to fix market failures in VC market by several methods:

- 1st market failure - VCs only invest in some specific areas - the government intervention can help to reduce failures by establishing their own venture capital to invest in other industries or fund of funds to encourage investments in some specific industries.
- 2nd market failure - risk aversion - high cost of capital, high cost of operation and riskiness. The government can directly inject capital in VC market by establishing their own VC and invest in early stage companies. The other approaches can be co-investment with VCs, as limited partners, to reduce the cost of capital, and providing insurance6 for VC in Israel
- 3rd market failure - entrepreneurs lacking operation skills and knowledge about VC creating funding gap - the government can play as educators for startup unlike those small scale events organized by VCs like talk show and seminar less effects much to startups.
- 4th market failure - gap among startups - government should organize and connect startups by a strong bonding ecosystem, as well as, cooperating with VCs to acquire the links of supportive their future portfolio companies from the very beginning.

However, there are still some reasons against the participation of government intervention in VC:

- Firstly, the ability of government as fund manager may be inadequate to the task of managing companies and dealing with entrepreneurs. In fact, government owned companies tend to have low performance and generate lower return compared with private companies. Because of lacking motivation of profit and maintaining mechanism for citizen, government owned companies do not have competitive advantage against private companies. While VCs play an important role in the development of innovation and economy, inadequate mandates can cause bad consequences.
- The second reason against government intervention in VC market come from people who believe in the intervention of government will affect the efficiency of the market. Government subsidies can cause crowding out private VCs and increase the operation cost of other VCs.
- The third issues that government is bureaucrats which can be the huge barriers for government subsidies VC. Probability of loss when VC invest in early stage companies can become greater executives of government officers. Interest groups can use their political influence to capture capital from state budget.

Beside supports and against government programs, there are some neutral comments:

Lacking well-established financial market can become a burden for VC development in Vietnam, financial market will provide channel for capital recovery and revolving funds. However, according to Nguyen Bao Hoang, general manager of IDG Vietnam, he still believes in the development of financial market in Vietnam.

Successful investment in early stage companies can promote Merger and Acquisition activities in Vietnam. International investors tend to establish new businesses in other countries, but because of complexities in

[6] Venture capital invest in some particular industry and early stage development companies in Israel

establishing new companies in Vietnam, they tend to acquire available companies in the market, especially startups.

The other comment is keeping transparency of programs. The corruption of Vietnam government is really dangerous and can affect the outcome of government programs for support VC industry. The document to apply for government subsidies should be clear and easy for VC to capture government funds.

GOVERNMENT SUPPORTS IN VIETNAM

Source: Cento Research (2019)

Vietnam Silicon Valley: Understand the possibility of government intervention in VC industry, the Vietnam Silicon Valley (VSV) was established on June 4, 2013 by Nguyen Quan, Minister of Science and Technology, located in Hanoi. Overall, VSV will carry out three main activities aiming at startups and early stage entrepreneur: Startup Accelerator, Demo Date and Initial Public Offering. The formation of 4-month startup accelerator has critically solved two knottiest questions of Vietnam VC industry: inefficiency of multi-portfolio capitalist and fledgling entrepreneurs. The VCs can simultaneously effectively manage the whole portfolio and be guaranteed for the investment and growth of invested young potential startups. Besides that, regarding investment, the Science and Technology Department will support at least $10,000 in each raw startup idea here to grow in advance while waiting for other investment from suggested VCs. Currently, VSV is incubating more than 18 potential tech startups which attracts up to $2 million from both domestic and foreign investors, strengthen the faith of success of its genitor, the Minister. Will the Vietnam Silicon Valley be successful as the origin? It varies, depending on not only the proactive of VCs but also other main factors.

SpeedUP is a VND 11.75 billion (US$ 520,520) fund, which has been started by Ho Chi Minh City's Department of Science and Technology. The fund invests in 14 startups, with investments ranging from VND 350 million (US$ 15,500) to VND 1,282 billion (US$ 56,792).

Startupcity.vn is an online platform launched by Hanoi's People Committee that has details about startups and investors and aims to connect investors with entrepreneurs.

Vietnam – Finland Innovation Partnership Programme is a program financed jointly by both governments. It is currently in its second phase through 2014-2018 and has a budget of EUR 11 million. The fund's investments focus on innovative companies that are aiming for international growth and currently includes 18 innovative companies and 5 high growth startups in their portfolio.

Saigon Silicon City Center is a 52-hectare complex, which is being built to support tech-focused startups and international firms. It is expected to attract investments worth US$ 1.5 billion by 2020.

Mekong Business Initiative is a partnership program between the Asian Development Bank and the Government of Australia that focuses on alternative financing, including venture capital, angel investments, and fintech in Cambodia, Laos, Myanmar, and Vietnam.

Mobile Applications Laboratory (mLab) East Asia was launched by Ho Chi Minh City and has an incubation program that focuses on mentoring, training, access to equipment, and financing.

National Technology Innovation Fund (NATIF) is a government agency and financial institution under Vietnam's Ministry of Science and Technology that provides grants and preferential loans for R&D, innovation, and technology transfer.

National Agency for Technology, Entrepreneurship, and Commercialization Development (NATECD) is a national platform under Vietnam's Ministry of Science and Technology that provides training, mentorship, and financial aid to startups.

II.CONCLUSION

Vietnam is in the process of updating legal framework for operation of VC as a small section under the SMEs Law, instead of on Securities Law, Investment Law, Corporate Law and other related legal documents. Only in High Technology Law, they have mentioned the definition of VC activities and capital supports through MOST. Besides, Vietnam VC industry has several failures that need the intervention from the government, and corruption, lack of transparency, complexity of paperwork, fund management skills are the main factors against the role of government in this market. Recently, the government has some initiatives such as: forming a stock exchange market for tech startups, drafting the VC law, and even allocate city budget for startup grants through a private entity approach. Hence, fund of funds program can minimize the effect of political influence, giving the investment decision to proper capitalist, trusted and attracting more LPs.

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