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Why a carmaker bought a grocery franchise in Vietnam

Odd partnership highlights a trade rule since scrapped by the TPP and EU deal

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HO CHI MINH CITY -- It sounds like the setup for a Vietnamese riddle: Why did the car company buy the supermarket? But instead of a punchline, the answer reveals a common yet obscure aspect of foreign investment in Vietnam.

The blandly named economic needs test, or ENT, is a little-known trade tool that Vietnam uses to control foreign investment and protect local companies. To expand in the country, foreign chains must pass the test by applying to local governments, which decide if their cities need the new business. If the answer is no, the expansion is blocked.

The test is required for foreign companies like E-Mart, a chain of markets and minimarts. South Korea's No. 2 retailer opened its first hypermarket in Ho Chi Minh City in 2015 and was looking to branch into more stores.

But faced with a number of regulatory requirements, including the ENT, E-Mart finally decided to franchise its bumblebee yellow stores to Thaco, a domestic company better known for assembling Mazdas and Peugeots than running retail shops.

"Despite the efforts to settle terms with the Vietnam [local] government, E-Mart saw franchise as the only option," Cara Song, a Nomura analyst in Seoul, told Nikkei Asia.

E-Mart declined to comment for this article.

Thaco, founded by Vietnam's third-richest man, says the move will help it diversify into retail, including car showrooms.

While the franchise arrangement allowed E-Mart to clear one hurdle, it also highlighted the potential pitfalls awaiting foreign businesses attempting to expand in Vietnam.

The ENT process is "really burdensome" and takes so long that, in the end, many foreign companies choose instead to franchise out to a Vietnamese partner, said Baker McKenzie senior adviser Fred Burke.

Passing the needs test would have allowed E-Mart to run its own stores in Vietnam, but the test is "totally opaque," Burke said.

"We have foreign clients coming to us saying, ENT is slowing us down too much," he said by phone.

Foreign chains can open their first shops in Vietnam, but every additional location usually requires an ENT. The communist country won this concession when it joined the World Trade Organization in 2007.

Vietnamese officials decide if they need the chain store based on "existing retail outlets, the market stability, the population density, the size of the district, and other elements related to district planning," the WTO wrote in an analysis in March.

The needs test is a drag on foreign investment and holds Vietnam back, according to Burke, who noted that ENT papers for one client's application blanketed a conference table that seats 20. He said companies have to be able to scale up their businesses in a certain time frame to justify entering the Southeast Asian market.

Some investors, like fashion brands H&M of Sweden and Uniqlo of Japan, stick with the ENT to the end to retain control of their shops. Others bypass the test altogether through a key loophole, which exempts foreign chains if their stores are located in shopping malls and occupy less than 500 sq. meters. Another way to avoid the test is to set up a joint venture. GS25, another Korean minimart, has a joint venture with Vietnam's Son Kim Retail.

Franchising has been the market entry tool of choice for other convenience stores like 7-Eleven, which licenses its brand to Seven System Vietnam. It has also been used in sectors from cosmetics to fast food. Dunkin' Donuts franchises out to Vietnam Food and Beverage Co.

While E-Mart will not operate the chain directly, Song expects it to profit from the franchise contract.

"As the Vietnam operation is doing very well," she said, "the company expects to see new store openings going forward and to take [a] good sum of royalty income."

Under the contract, which runs to 2030, E-Mart will supply the Vietnam business with advisers and products under its generic No Brand label, Thaco said.

With Vietnam's traditional markets declining in popularity, the number of convenience stores in 2020 jumped 6.7% from the year before and the number of supermarkets rose 3.8%, according to Nielsen. As they've proliferated, the chain stores have fallen under more ENT scrutiny.

Opponents to Vietnam's ENT have made headway. Hanoi agreed to scrap the test in a trade deal with the European Union as well as in the Trans-Pacific Partnership. For countries not in those pacts, including South Korea, their consumer-facing companies remain subject to the test.

Some argue that Vietnam is still a developing market and that local businesses need time to prepare for competition.

"The economic needs test (ENT) rule allows for more gradual and manageable foreign direct investments," VF Franchise Consulting CEO Sean Ngo told Nikkei.

Kim Jaewon contributed reporting.