

# Vietnamese State-Owned Enterprises after Equitization: Performance, Emerging Issues, and Policy Recommendations

Tran Tien Cuong and  
Bui Van Dung, Pham Duc Trung, Nguyen Kim Anh,  
Nguyen Thi Lam Ha, Nguyen Thi Luyen, and Trinh Duc Chieu

## ABSTRACT

*Equitization is the sole method of state-owned enterprise reform in Vietnam. This paper analyzes the results of a survey on the performance of equitized enterprises. Its findings clarify the causes of pre- and post-equitization differences and the impact of ownership structure on the performance of equitized enterprises, focusing on arising problems in the post-equitization period, particularly those regarding corporate governance. Based on the results of survey, the paper also provides some policy recommendations to speed up the equitization process and enhance post-equitization corporate governance in the years to come.*

*Key words: SOES, equitization, corporate governance.*

In the first part of this paper (VEMR, Winter 2006), we shed light on the performance of state-owned enterprises (SOEs) after equitization (Section 1), and the causes of increased growth in equitized SOEs (Section 2). In this second part, we focus on the process and emerging issues (Section 3), arising problems in the post-equitization period (Section 4), and provide some policy recommendations to speed up the equitization process and enhance post-equitization corporate governance in the coming years (Section 5).

## 3. The SOE equitization process and emerging Issues

### 3.1. Implementation duration

According to survey results, the implementation duration of equitization is 13.59 months on average, during which it takes 9.95 months from the date of issuance of the equitization decision to the date of approval of the equitization plan, and 3.64 months from this date of approval to the

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Dr. Tran Tien Cuong is Director of Research Department for Enterprise Reform and Development Policies (RDERDP), CIEM. Bui Van Dung, Pham Duc Trung, Nguyen Kim Anh, Nguyen Thi Lam Ha, Nguyen Thi Luyen and Trinh Duc Chieu are research fellows at RDERDP, CIEM. The key contents of this paper are largely based on the research project titled 'The Study on Post-Equitization of State-Owned Enterprises' funded by the World Bank, Hanoi, September, 2005.

business registration date. But according to the latest regulations on equitization, the equitization process (including elaboration of the equitization scheme, completion of the scheme, sale of shares, adjustment of the scheme, organization of the shareholder meeting(s), business registration proceedings, and handover between the SOE and the joint-stock company) shall not exceed nine months.

### 3.2. Equitization modes

Some 31% of these enterprises apply the mode of selling the entire state capital (with or without issuing stocks) during equitization, while the remaining 69% retain the state share. At the same time, the survey data also shows that the state share in all equitized enterprises accounts for only 26% of the chartered capital (see Table 4).

There are a number of reasons behind most enterprises retaining the state share. Firstly, the advocacy/guidance of the supervisory agency or parent company was to retain the state share during equitization, even in enterprises that are not required to be under state control. Secondly, it was

planned to sell the entire state capital but workers and external shareholders either could not afford it or were unwilling to buy. Thirdly, the equitized enterprises were required to have a state-controlling share.

The survey data and questionnaire samples are not yet sufficient to analyze in detail the abovementioned reasons. However, by using deductive logic it is easy to confirm the first reason, which is the intentional retaining of the state share, as the most important one. This is because enterprises equitized to date are not so large that investors cannot afford to buy all of the shares; while on the other hand the number of enterprises with a state-controlling share is still small.

There are other reasons for the intentional retaining of the state share during equitization. Nearly 40% of surveyed enterprises stated that the concerns of workers about losing their state employee status were a significant influence. The corresponding figure for enterprises where the concerns of managers about their status was an influence is about 30%.

**Table 4: Equitization modes of SOEs under the central Government, provinces, and general corporations (%)**

Equitization mode	Supervisory agency		
	Central Government	Province	General Corporations
Selling entire state capital	8	34	32
Selling entire state capital and issuing additional shares	1	8	0
Selling part of state capital	46	36	43
Selling part of state capital and issuing additional shares	19	9	18
Retaining state capital	26	13	7
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>

### 3.3. Valuation methods

In Vietnam there are currently two methods of valuation being employed: the assets method and the discounted cash flow (DCF) method. The survey results show that 97.9% of equitized enterprises applied the assets method, which means that their value is calculated based on determining the value of all current assets at the time of equitization, as well as the reasonable return accepted by both the seller and buyer. Meanwhile, a more modern and market-based valuation method, such as DCF, although taking into account the future advantages of the enterprises, is not used or only rarely used.

The key reason for this is that the assets valuation method is by nature based on book value, which is familiar to Vietnamese enterprises as well as relevant state management agencies. At the same time, the DCF method contains a risk of over-valuation, which may make it difficult to sell, while under-valuation may cause a loss of state capital.

In addition, the DCF method has two possible risks for investors. Firstly, the state capital value is based on the future return, which is difficult to determine under Vietnam's circumstances, especially for equitized enterprises transformed from SOEs. Secondly, while assessing the actual value of the enterprise it is necessary to include outstanding debts, the cash balances from the bonus fund and the welfare fund, and the non-business resources (if any) of the equitized enterprises. From the point of view of the research team, this is an important reason that makes only a few enterprises (influenced by managers and workers) and competent state authorities select the DCF method during equitization, including enterprises that are subject to apply that approach.

Some enterprises have recently conducted stock auctions, which are part of implementing new regulations aimed at avoiding internal equitization. The auction of stocks is to be based

on the floor price, the determination of which is based on the two abovementioned methods.

In addition, some surveyed enterprises noted that major obstacles in corporate valuation are matters of business advantage, geographical/location advantage, trademark value, and, especially, land value. These difficulties are understandable because these factors vary between localities and between enterprises operating in different business lines and domains, so it is impossible to introduce a common regulatory document. As a result, there is no consistency in implementation in terms of localities and timing. There were cases where the value of the land use rights, equipment, and advantages were assessed too high or too low, resulting in major difficulties after equitization.

### 3.4. Policies to encourage equitization

Current policies to encourage equitization consist of incentives on tax, land, investment, treatment of redundant workers, and resolution of assets and debts. Although a majority of equitized enterprises recognized the positive impacts of these policies, they are yet to be effective factors in speeding up equitization. Only around 10% of enterprises stated that these policies played a very important role in encouraging the enterprises to accept equitization. Of the policies, the preferential policy toward workers in purchasing shares and the tax incentives were assessed slightly higher than others.

#### *Workers' interests in equitization policies*

Economic motivation is a key factor among workers. Criteria such as "becoming real owners and receiving dividends", "being eligible to buy stocks at a preferential price", and "having the opportunity to increase incomes", etc., attract their attention more than other criteria.

#### *Managers' interests in equitization policies*

For managers, in addition to the economic

benefit of becoming owners and receiving dividends, their strongest motivation during equitization concerns management. Up to 95.2% of enterprises stated that increased autonomy is the most anticipated aspect of equitization. A slightly lower rate (90.6%) of managers stated that equitization would create new opportunities for them to show their managerial talent in the new model.

#### *Factors encouraging or hindering the equitization process*

A majority of enterprises stated that state agencies and intermediate organizations and related policies are factors encouraging, or at least not creating a negative impact, on the equitization process. However, the degree of impact differs. Regarding agencies and organizations involved in equitization, the role of agencies working on finances (resolution of debts, taxes, or corporate valuation) is not regarded as highly as the role of agencies/organizations being "representatives of state ownership" at the pre-equitized enterprises (parent companies, line ministries, general corporations, etc.). This is understandable because financial factors are directly related to the economic interests of enterprises.

Regarding equitization policies, besides incentives prescribed in legal documents on equitization (tax incentives, privileged purchase of shares), which are highly and positively regarded by enterprises (nearly 90%), most of the remaining issues create certain obstacles for the equitized enterprises to differing degrees. For example, up to 65% of enterprises do not regard the policy on land use rights as a major positive factor encouraging equitization, 55% do not consider the policy on ownership transfer as encouragement for equitization, 45% stated that treatment of financial and labor issues was not motivation to step up the equitization process, and only 27% of enterprises had a positive assessment of the policy for external share purchasers.

#### *Recommendations by enterprises on equitization policies*

The survey results show that most equitized enterprises emphasize the need to enhance the dissemination of information on equitization, provide clear guidance on applicable incentives in the equitization process, strengthen cooperation between concerned agencies in stepping up equitization, transfer all bad debts to an asset management agency (or similar organization) before equitization, and provide other financial information such as debt freezing, debt rescheduling, or debt cancellation before undertaking equitization.

The following solutions also attract special attention from enterprises: streamlining and providing clear regulations on the corporate valuation process; strengthening financial status before equitization, such as debt freezing, debt rescheduling, or debt cancellation; and disseminating clear information on applicable incentives and the equitization process.

In addition to the recommendations proposed in the questionnaire, equitized enterprises also emphasized the needs to promulgate clear policies encouraging external share purchasers and improving the implementation of the policy on transferring the ownership of assets and land use rights.

Attention has been paid to information dissemination but it was still limited among the equitized enterprises, thus failing to have a strong impact on workers and managers at the enterprises. Opinions have been expressed that it is necessary to disseminate information on the policies and benefits of equitization in particular and SOE reform in general to all people, agencies, and organizations in society. This would make managers and workers at enterprises feel confident about the process and devote themselves to equitization.

The State still does not have appropriate policies to encourage the purchase of shares of enterprises operating in business lines and domains that are "less attractive" to investors and, indeed, their workers.

## 4. Post-equitization and arising problems

### 4.1. Perceptions of the equitized enterprise model

Equitization is the transformation of a state-owned company or an affiliate of a state-owned company into the corporate model of joint-stock company in accordance with the provisions of the Enterprise Law (1999). However, opinions exist that an equitized enterprise is a combination of an SOE and a private sector enterprise. Even some equitized enterprises share this viewpoint. About 40% of enterprises surveyed stated that the equitized enterprise model has the characteristics of both an SOE and a private business. The remaining enterprises are divided into two extremes: an equitized enterprise is either like an SOE or a private sector enterprise. This means that although there has been some significant improvement compared to the SOE model, the equitized enterprise model is still interwoven and related to the operational mode of SOEs. This feature should be taken into consideration when studying the post-equitization process.

The issues are as follows:

- *As regards ownership and property rights*, 42% of surveyed enterprises stated that the ownership and property rights of the equitized enterprise are similar to those of both SOEs and private businesses, while up to 38% stated that these rights are similar to those of SOEs, and only 20% stated that they are similar to those of the private sector.

This assessment by enterprises is not just perceptual but derived from the obstacles they faced during the equitization process. For example, there are no clear regulations on the transfer of land use rights or the transfer of property ownership; there is no clear distinction between land allocation and land lease; and no documentation certifying ownership of main technological lines. Thus, related rights and interests applicable to the equitized enterprises cannot be as clear and transparent as those of enterprises in the private sector.

- *As regards investment credits*, the percentage of enterprises stating that it is the same for equitized enterprises as private businesses is higher (about 30%), but there are still about 40% stating that it is like both SOEs and private sector enterprises.

- *Regarding labor management*, only a few enterprises stated that equitized enterprises are like private businesses, but mainly follow the management style of SOEs.

- *Regarding corporate governance*, up to 46% of enterprises stated that corporate governance of equitized enterprises still has the features of SOEs, 38% said that there is no distinction between the private business and SOE models, and only 16% agreed that it is like the private business model.

- *Regarding relationships with state management agencies* such as local authorities, central government, and police, only 13-14% of enterprises said that equitized enterprises are more like private businesses than SOEs.

- *As regards the relationship with state-owned commercial banks*, the response rate of "more like private enterprises" is higher than other relationships (about 25% did not respond); however, generally speaking, equitized enterprises are still generally "more like both SOEs and private businesses".

In a nutshell, from the perceptions of surveyed enterprises it can be noted that although having been converted to operate in the joint-stock company model in accordance with the Enterprise Law, the production, business, and management mechanisms of equitized enterprises still have the combined characteristics of the SOE and private sectors, especially in terms of corporate governance and labor management. Such intertwining exists, on the one hand, because equitized enterprises want to retain to some extent the old operational mode, while on the other hand there is lack of an effective legal framework and business environment for the equitization process or favorable conditions for enterprises to adopt a totally new mechanism after equitization.

#### 4.2. Business environment

To learn about the concerns of equitized enterprises regarding the business environment, the research team raised four key issues: (i) ownership and property rights, (ii) credits, investment and other issues relating to market access, (iii) labor management, and (iv) law abidance and governance issues. Each issue is measured by three indicators: "critical", "very important", and "important".

##### *Land and land use rights*

Of the four issues, ownership and property rights is of the most interest, with 31% of enterprises regarding land as a "critical" issue. Nevertheless, only 38.3% of enterprises possess land use rights with clear rights and benefits. Thus, the issue of land and facilities for production and business remains the critical obstacle to all business types, including equitized enterprises.

The survey shows that the size of the land and facilities/workshops of most enterprises has not reduced since equitization. The problem is that, before registration under the form of a joint-stock company, the land use rights issue was not clarified or solved, and neither were related rights and

obligations. This circumstance makes it difficult for enterprises to develop their production and business plans, build facilities, workshops and stable long-term infrastructure, or make contributions to joint ventures in the form of property on the land the enterprises are using. This problem is more evident as regards trade and service enterprises in cities and urban centers.

Instances of land use rights not being included in the enterprise's value during equitization are very common. Although enterprises continue to rent or be allocated land at a much lower price than the market price under state regulations, as land use rights are not included in the enterprise's value the enterprises face difficulties in transactions with banks or when expanding production or business.

Another difficulty relating to the land use rights of some enterprises, which were formulated through the equitization of units of independent state companies or parts of member units of general corporations, is that the land is under the name of the parent company or general corporation. In some cases these equitized enterprises do not have the land use rights nor hold the land allocation/lease contracts, so they must ask the general corporation to collateralize land use rights to obtain loans. The reason is that both the equitized enterprise unit and the parent company (i.e. the member unit of a general corporation) have used the land that was allocated to the general corporation before equitization.

Conversely, there are cases where the parent company or general corporation have collateralized the land areas that have been used by the equitized units of state enterprises or parts of member units to obtain loans. This has created difficulties in the operation of equitized enterprises over the long term.

Finally, there is a risk of making SOE equitization become the "equitization of real

estate", especially in large economic centers, if the valuation of land use rights included in the enterprise's value is conducted incorrectly or the value of the land use rights is determined at too low a level.

*Ownership of assets*

Unclear ownership of assets has long created many difficulties for equitized enterprises. The survey of equitized enterprises that originated from book-based cost-accounting units or dependent cost-accounting units shows that main production lines or highly valuable assets have been mostly owned by the parent company/general corporation and were not totally transferred to or registered under the name of the equitized enterprise, thus causing problems after equitization.

*Relationships with state agencies and organizations*

Opinions were expressed about inequality and discrimination against enterprises before and after equitization. To verify these opinions, the research team asked questions about any changes in relations between the equitized enterprises and state management agencies and credit and financial institutions. As the responses show, most equitized enterprises (over 80%) state that their relationships with state management agencies such as the tax office, customs, export and import licensing offices, land administration, central and provincial agencies, have not changed after equitization. Regarding relationships with state-owned commercial banks, 50% stated that there was no change, while 28% saw it as being more difficult after equitization.

How can these changes be explained?

In the view of the research team, not all of equitized enterprises have to deal with agencies such as customs, export and import licensing, and central agencies (especially those enterprises in provinces that mostly target the domestic market), so the assessment is primarily based on external information sources and not derived from their

own relationships. With local authorities and tax offices, most equitized enterprises have been transformed from SOEs and others are still in the tax exemption/reduction period, so it is understandable why their relationships remains unchanged.

*Relationships with credit institutions*

The survey results also show that most enterprises saw no change in their relationship with credit institutions after equitization. Among enterprises stating that there were changes in relationships, most said that these had become "more difficult" since equitization, including relationships with private commercial banks, branches of foreign commercial banks, and especially state-owned commercial banks and state loan programs. In that context, most enterprises positively assess their financial relations with shareholders' friends, families, and workers.

A 2002 study conducted by Professor Leroy Jones also proved that difficulties in accessing credit sources are not just a problem for equitized enterprises or a specific country, but is a global issue. All around the world, whenever managers of state, private, equitized, or any other type of enterprise are asked to assess their difficulties, credit access always tops the list. This means that besides these general difficulties, equitized enterprises face more obstacles in accessing formal credit sources than state companies do.

*Labor issues in equitized enterprises*

There were opinions expressed that less attention is being paid to workers of an equitized enterprise compared to the pre-equitization period. However, the survey results show that such opinions are not justified, because:

- Most equitized enterprises disseminated labor laws to their workers in various ways. The most common way was to introduce the provisions of the laws at conferences or general meetings of workers.

- Average working hours of workers at the surveyed enterprises were 45.68 hour per week. According to the regulations in the Labor Code and implementing documents (Decree 109/2002/ND-CP and Decree 195/1994/ND-CP), working hours at all enterprises should not exceed eight hours per day, or 48 hours per week in normal working conditions. So the average working hours of workers at equitized enterprises are in compliance with existing regulations.
- Trade unions are able to preserve their role in equitized enterprises, at least to the level pre-equitization. After transformation, 100% of equitized enterprises have trade unions, of which up to 87% of their permanent workers are trade union members. When assessing the role of trade unions after equitization, about 30% of enterprises regarded it as "more active" than before transformation, nearly 10% said it plays "little role" or is "inactive", and the remainder said there is "no change" compared to pre-equitization. Similarly, about 20% of enterprises stated that the number of trade union meetings is "less" now than before equitization, 10% said "more", and 70% said "no change".

There are also some obstacles for equitized enterprises regarding the workplace and salaries. Many do not know how to take advantage of the new model to develop their own workplace norms and technical and professional standards, or to be proactive in the paying of wages to workers, so they still use the old salary scheme from when they were an SOE. Thus, they also "inherited" the old disadvantages of the public sector salary scheme, which is not based on productivity or performance efficiency and fails to create motivation for managers and workers in the enterprises.

A number of equitized enterprises face

difficulties in paying social insurance premiums for their workers and managers. Social insurance offices in provinces only accept social insurance premiums paid on the basis of the salary scheme and list registered by enterprises. As mentioned, not many equitized enterprises have developed their own salary schemes and lists to serve as the basis for paying salaries and registering with concerned agencies, so they also have difficulties in paying social insurance premiums.

Some equitized enterprises managed to develop and register their own salary schemes and lists for workers and managers but still face difficulties, as social insurance offices are very rigid in requesting a reputable "ranking", as in state companies.

The abovementioned issues attract a degree of attention and interest from equitized enterprises. Nevertheless, some of the specific issues led to the following interesting results:

*First*, about 45-50% of enterprises stated that access to the foreign exchange market and export market, and the right to be guaranteed access to foreign joint ventures is not so important to them. This means that these enterprises can focus on the domestic market and internal relations.

*Second*, up to 41% of enterprises do not pay much attention to accessibility to public bid contracts. There may be two reasons for this: (i) the enterprises believe that these contracts are reserved for a certain group of enterprises, so did not find it necessary to give them due regard; and (ii) the business fields of equitized enterprises are not or are rarely related to public bids. If the first reason is the case, it is very worrying.

*Third*, about 64-65% of enterprises stated that regular inspection or intervention by state authorities is not an issue. This means that the work of inspection, checking and intervention by functional bodies are within allowable limits and in compliance with existing laws.



### 4.3. Corporate governance after equitization

Guaranteeing the basic rights and interests of shareholders, especially minority shareholders, is one of the key targets of Vietnam's ongoing corporate governance reform. Rights include ownership of shares/contributed capital; sale or transfer of shares/contributed capital; access to important information about the company's performance; participation in management and monitoring of the company's activities through the

highest decision-making body in the company (the shareholder meeting); participation in voting for and dismissal of managers of the company; and enjoyment of profits generated from the invested capital. Some of these rights are reviewed below.

#### *Shareholder structure*

Table 5 and Table 6 represent an overall picture of shareholder structure at the time of undergoing equitization and in 2004.

**Table 5: Shareholder structure of equitized enterprises (%)**

Shareholders	Structure in equitization year	Structure in 2004	Changes
1. Managers	17.22	18.63	+ 1.41
2. Laborers	44.60	43.54	- 1.06
3. Central government	2.18	2.03	- 0.15
4. Provincial governments	14.52	12.38	- 2.14
5. State general corporations	10.95	10.68	- 0.27
6. Other SOEs	2.50	3.01	+ 0.51
7. Other Vietnamese individuals	6.37	7.86	+ 1.49
8. Vietnamese enterprises and organizations	1.57	1.62	+ 0.05
9. Foreigners	0.09	0.27	+ 0.18
<b>Total</b>	<b>100.00</b>	<b>100.00</b>	<b>0.00</b>

**Table 6: Shareholder structure of equitized enterprises by supervisory agency (%)**

Shareholders	Year of equitization			2004		
	Provincial	Central	General corporation	Provincial	Central	General corporation
Managers	19.43	11.43	19.17	20.85	12.51	22.57
Workers	47.16	37.16	50.72	46.57	35.63	47.46
Central government	0.49	2.84	14.21	0.49	2.64	12.67
Provincial governments	22.08	0.91	0.00	18.75	0.91	0.00
State general corporations	0.75	37.86	1.27	0.88	36.49	1.27
Other SOEs	2.55	1.66	6.05	3.26	1.89	6.05
Other Vietnamese individuals	5.83	7.14	5.47	7.31	8.48	6.86
Vietnamese enterprises and organizations	1.70	0.88	3.11	1.70	1.03	3.12
Foreigners	0.01	0.12	0.00	0.19	0.42	0.00
<b>Total</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>

From the tables, the following observations can be made.

- Internal equitization is still common in the equitization of SOEs in Vietnam. Some enterprises have recently conducted auctions of shares, but their numbers are still small. It is therefore noted that workers (including managers) are the most influential shareholders in equitized enterprises.
- The presence of state shareholders can stem from two causes: (i) state shares were retained with different aims (to control or not control the equitized enterprise), or; (ii) all shares were not sold and this forced the involvement of state shareholders. The first reason is the more common. However, whatever the reason is, the fact is that the amount of state shares comes second after the amount of shares owned by workers.
- As the dominant position is held by shareholders, being workers and state share-holders, external investors only play a minor role and account for just 10-11% of total shares. This causes a lack of "strategic shareholders" in equitized enterprises, which has been talked about for quite some time.

However, the overall picture may easily lead to a misunderstanding about the "strength" of worker shareholders. The characteristics of worker shareholders are inconsistent and Vietnam does not have or only has unclear provisions regarding "share concentration". Thus, in reality, worker shareholders are "treated" as regular individual shareholders; by the quantity of shares they own individually they are the smallest shareholders, even smaller than external individual shareholders. With such an approach, state shareholders are the largest owners of equitized enterprises (as regards the total number of equitized enterprises).

The tables above also show slight but interesting changes in the shareholder structure of equitized enterprises. The shares of worker

shareholders and those of the state shareholder have fallen, while the shares of external investors, including foreign investors and managers, have increased. In particular, by 2004 the amount of shares held by foreign investors rose 19-fold in provincially-managed enterprises and 3.5-fold in centrally-managed enterprises, compared with the year of equitization. Nevertheless, the fact that no foreign investors held any shares in member enterprises of state general corporations at both points of time requires further consideration in the context of more entities and individuals becoming eligible to acquire shares and at a time when Vietnam is making tremendous efforts to attract foreign financial resources, high technology and managerial expertise.

*Investment objectives of shareholders*

The survey results show that, as with shareholders in any joint-stock company, profits and dividends attract the most attention.

Thus, shareholders of equitized enterprises mainly pay attention to the results and efficiency of their investment in the form of shares rather than performance issues such as capital, assets, and investment, or the director's income.

Nevertheless, Vietnam's equitized enterprises have a large number of worker shareholders. So it is not surprising that the indicator of "salaries, bonuses, and the incomes of workers" attracts a lot of attention from shareholders more so than dividends and profits.

*The right to be informed*

Within the regulations on transparency of information in joint-stock companies, it seems that shareholders of equitized enterprises have no problems in accessing basic information on production and business performance (see Table 7). Even "sensitive" information such as "salary and income of the director" was provided to shareholders when requested by up to 70% of respondent enterprises.

Regarding modes of implementation, most enterprises said that information was provided at

Table 7: Guaranteeing the rights of share holders to be informed (%)

Information on	Information provided to shareholders by the companies				
	As stipulated by law	Sometimes	Rarely	Never	Total
1. Profits	98.9	0.7	0.2	0.2	<b>100.0</b>
2. Dividends	98.9	0.7	0.2	0.2	<b>100.0</b>
3. Turnover (100%)	92.4	4.3	2.6	0.7	<b>100.0</b>
4. Salary and income of the general director/director	70.3	11.0	7.1	11.5	<b>100.0</b>
5. Capital and assets	91.2	5.7	2.4	0.7	<b>100.0</b>
6. New investment projects	89.9	7.0	2.2	1.0	<b>100.0</b>
7. Salaries and income of laborers	88.4	7.0	1.9	2.7	<b>100.0</b>
8. Other information	76.7	14.0	7.0	2.3	<b>100.0</b>

shareholder meetings in accordance with existing regulations. Except for some listed companies, joint-stock enterprises normally have small shareholder structures and so can hold meetings of all shareholders (as done by 98% of respondent enterprises).

The guaranteeing of the rights of shareholders is relatively positive. However, many enterprises said that shareholders actually only receive basic information included in the financial reports presented at the annual shareholder meeting. Not provided with detailed information, small shareholders (mostly workers in the company) felt like outsiders, not owners, and some even regarded the equitized enterprises as "borrowers" and themselves as mere "lenders".

#### *Awareness among shareholders of their rights and obligations*

The survey revealed that a significant number of shareholders do not have a proper understanding of their rights, interests and obligations towards the enterprise. There exist two extremes:

- Shareholders who do not understand the legal provisions on the rights of share-holders and an enterprise's bodies

such as the Board of Management, the Board of Control, and the Director, as well as the procedures for convening shareholder meetings, especially extraordinary meetings, resulting in their serious or excessive intervention in the management and execution of the company or undesired internal conflict.

- Shareholders who are too "hesitant" and do not fully exercise their legitimate powers in the management and execution of the company, making shareholder meetings become "review meetings" and a mere formality. The shareholders themselves, from the position of "investors", became merely "savers". Many worker shareholders of equitized enterprises do not feel they have a role as real owners to actively participate in discussions and voting on important issues of the company, such as strategic orientations, objectives, tasks, utilization of profits, selection of the Board of Management, etc., at the shareholder meetings.

The survey results show that only 36% of enterprises stated that their shareholders have

adequate understanding about their rights and obligations, despite these rights and obligations being clearly stipulated in the relevant legal documents. Similarly, less than 46% stated that shareholders fully implement their shareholder rights and obligations.

#### *State shareholders*

On average the State holds 26% of shares in the surveyed equitized enterprises, and in some special cases hold up to 87%. State shareholders have a special position in the shareholder structure of equitized enterprises, in terms of representatives and the increase or decrease of state shares.

Ministries, provincial people's committees, general corporations, and independent state companies (parent companies) are the representatives of state shares in affiliated joint-stock companies. However, they normally assign an individual or a group of people to directly represent and implement the rights and obligations of the state shareholders at enterprises with state equity.

This representative or group of representatives can be from inside or outside the enterprise. Where a group of people are assigned, each will manage a certain proportion of shares. Notwithstanding this, there are cases where there is no clear determination of the share proportions assigned to each of the representatives, and there are no specific regulations on how many people the state shareholders (or any other shareholder) can nominate for Board of Management election at the shareholder meeting, creating a dilemma for joint-stock companies.

Generally speaking, in most cases the state shares have been assigned to a group of persons for management, regardless of whether the shares are state-controlling or not. For a number of reasons the questionnaire was unable to clarify whether the empowerment mode is relevant or not. But the recommendations of enterprises are worth consideration: 63.14% suggested that powers should be assigned to just one person, while 36.86% suggested assigning to a group of persons.

Respondents saying it should be assigned to just one person believed that this increases the sense of responsibility and the individual will focus on the interest of state shareholders.

Contrary to the concerns of many who responded that equity representatives must be objective and neutral, the survey results show that up to 83% of the enterprises believe that such representatives can have shares in equitized enterprises.

It can, therefore, be noted that there is no agreement on how the appointment of representatives of state shares should be made. However, equitized enterprises suggested that detailed instructions and guidance be issued and that handover of equity ownership (at least at provincially-managed equitized enterprises) to the newly established State Capital Investment Corporation be completed as soon as possible.

Lastly, another issue of interest is what the position and role of state shareholders will be in the future. According to the survey results, the percentage of enterprises that want to sell or do not want to sell a proportion of state shares is 54% and 45%, respectively. The higher percentage of enterprises who want to sell a portion of state shares reaffirms the tendency to reduce state shares, as discussed above.

#### *Management and execution of equitized enterprises*

The survey results show that in nearly 70.64% of equitized enterprises the Chairperson of the Board of Management concurrently holds the position of Director. It is necessary to establish that this concurrent holding of management positions is not contrary to the provisions of the law (Article 85 of the Enterprise Law 1999). The advantage of concurrent holding of positions is to avoid or limit possible conflicts between the board and the director and expand the relationship between the management and executive bodies. Moreover, the concurrent holding of management positions would reduce overhead costs for the enterprise, making it suitable to small-sized equitized enterprises.

The disadvantage of this model is that it is not separating management and execution, and therefore is not appropriate for adoption as a modern corporate governance model with effective monitoring and inspection of the management apparatus. The Board of Management in a joint-stock company, as well as in some other corporate types, is set up to protect the interests of shareholders and supervise the management apparatus (headed by the Director/General Director) and the utilization of investment capital of the shareholders in production and business activities. If the functions of the Board of Management and directors are not separated then there is the risk that the interests of shareholders cannot be guaranteed.

Another issue is personnel. In spite of active changes in performance efficiency, the personnel issue has remained unchanged. About 80-90% of enterprises retain the key management positions, such as members of the Board of Management, the Director, the Deputy Directors, and the Chief Accountant, including enterprises that have held voting for these positions two or three times.

The minimal change in key management personnel is partly because shareholders have trust in existing managers, while the managers themselves are capable of fulfilling their tasks. More importantly, it is because enterprises do not have sufficient motivation or the conditions to secure higher-quality management personnel.

Clearly, equitization has created new motivation but the minimal changes in management have resulted in slow changes in mindset and corporate governance. Shares were sold mainly internally to workers, resulting in a lack of external strategic investors that hold sufficiently large shareholdings to insist on changes in the strategies and management of the enterprise.

*Internal disputes*

Earlier surveys on corporate governance showed that, in general, the number of respondents recognizing disputes within an enterprise was

insignificant and the number of disputes did not correspond to reality.

The current survey on equitized enterprises reveals a similar situation. Only some 7% of surveyed enterprises responded that there were disputes between shareholders or groups of shareholders, 5.2% admitted there were disputes between the Board of Management and the Director, and 3.2% said there were disputes leading to lawsuits. Meanwhile, 13.7% confirmed there were disputes between shareholders and management.

Regarding state shareholders, 90% of enterprises said they have no complaints, questions or denunciations regarding the business activities relating to organizations or individuals representing state shares.

Providing that the answers of surveyed enterprises correspond to reality, this situation can be explained as follows:

- The concurrent holding of Board of Management Chairperson and the General Director at the majority of equitized enterprises has led to reducing disputes between the two, as discussed above. However, the down side is the hidden risk of failing to protect the interests of shareholders, as also mentioned above. This explains why the rate of disputes between shareholders and management is much higher than other kinds of disputes. Moreover, although the rate of 13.7% is not high, if it was applied to the more than 2,400 existing equitized enterprises, the number of enterprises having disputes between shareholders and management would be rather high, at around 320.
- Economic disputes occur often in Vietnam but most enterprises are not careful in recognizing them. When there are disputes, the common solution is to keep the dispute "in house", reconcile any differences, negotiate, and try to avoid bringing the case to the court. In 2004, the World Bank

and CIEM conducted a study on this issue<sup>93</sup>. Generally speaking, Vietnamese enterprises do not have a "tradition" of settling disputes through intermediary organizations and are not concerned about public opinion or the opinion of their partners when having a dispute settled by a legal body (especially by the courts). This stems from shortcomings in the provisions of the law on contracting. For instance, it is not clear which legal document on contracting has the higher validity; there is inconsistency in applying the provisions of the law on contracting; and the contents of the legislation are out of date and do not reflect the diversity and renovation of economic life in general, and linkages, cooperation and corporate management in particular.

#### *Disclosure and transparency*

According to existing regulations, all equitized enterprises must abide by the reporting and transparency regime. According to the survey results, 27.5% of the enterprises conduct annual audits, 18.7% conduct audits as required, and the remaining 54.7% do not conduct audits. A figure of nearly 55% of enterprises not conducting audits is not a "good" one in terms of corporate governance, but is still better than in other business sectors in Vietnam, especially state companies.

#### **4.4. Impacts of the business environment on governance of equitized enterprises**

Equitized enterprises have both positive and watchful views on the regulatory environment and post-equitization policies. Positive factors have been the Enterprise Law and relevant documents regulating business management and organization and changes in and perspectives of the equitized enterprises. These factors received the highest positive assessment (around 80% of respondent enterprises). Other factors (credits, land, relationships with authorities, and differences in the business environment) are assessed as moderately positive.

Negative factors for corporate governance have been policies on land, credits, and discrimination based on ownership, which are regarded as being much more of a "hindrance" than other policies.

## **5. Policy recommendations**

### **5.1. Valuation of equitized enterprises**

#### *Valuation methods*

It can be noted that the valuation methods employed during the equitization of surveyed enterprises are confirmed by this study as being monotonous and uniform, without adequate attention paid to the characteristics of business lines and the domains of the enterprises. Opinions were expressed that the valuation method prescribed in existing documents is somehow compulsory. Thus, when the role of intermediate institutions in the corporate valuation is recognized, in the long term these institutions must be allowed to decide on the appropriate valuation method for each specific case. It is possible to diversify valuation methods by determining the enterprises subject to designated methods, combining other methods as well for verification.

#### *Organization of valuation of equitized enterprises*

It is necessary to establish a system for supervising and monitoring the corporate valuation process and inspection activities of the units involved in conducting corporate valuation, including valuation procedures, service quality, and personnel, while not totally putting the work out to contract as is now done. The body to conduct the inspection and monitoring is stipulated in the newly promulgated Ordinance on Valuation. This body is responsible for creating the prerequisite conditions for organizing the valuation of equitized enterprises, such as:

- Standardizing reports of valuation organizations using common templates in order to (i) facilitate the professional activities of the valuation organizations, at the same time enhancing their responsibility

for implementation and consultancy tasks, (ii) help potential investors to better understand the business performance and development capacity of the enterprises, (iii) facilitate analysis and evaluation of the equitized enterprises by different business lines, and (iv) assist state management agencies to firmly grasp the overall picture of the task.

- Enhancing the capacity and quality of valuers and managers. Concerned agencies should organize training courses on corporate valuation for officers in charge of this task in state management agencies and consulting organizations, with assistance from foreign trainers.

#### *Administrative reform in corporate valuation*

Key measures to be taken are:

- Promulgating clear, specific and transparent standards, conditions, processes, and procedures for writing off tax debts and unrecoverable debts, utilizing accrued profit to compensate for losses in previous years (if any), and compensate for asset losses and debts incurred in the financial treatment process.
- Relaxing of time limits for corporate valuation, which are not to exceed 30 days for enterprises and 60 days for general corporations. These regulations should be for guidance only but not compulsory, especially in cases where enterprises are valued under the DCF method. Pursuing an aim of meeting deadlines may result in a reduction in valuation quality.
- Studying additional regulations on the valuation of any intangible assets that are an advantage in a corporate type, which do not rely on state capital and financial subsidy but rather has financial autonomy, self-mobilizes capital, makes profits, and has a high rate of return on operational

capital (including not only state equity). Adjusting existing regulations on the basis of determining business advantages, in which the rate of return on operational capital is used instead of the rate of return on state equity.

- Supplementing guidance on the valuation of intangible assets in cases where the amortization period for the intangible fixed assets has expired, but in reality the enterprises still continue using the assets effectively and generate income from them, particularly enterprises that have high asset value and are not subject to valuation under the DCF method.

#### *Improvements in share auctions*

- Consider shortening the time limit for auction registration, facilitating investor choice;
- Adopt a mechanism for protecting confidential information regarding investors;
- Define an appropriate proportion of stocks to be sold to small investors based on the actual average auctioned price (these investors place orders without offering a specific price, so accept the average market price);
- Apply information technology, especially state-of-art technology, in the auction process;
- Amend and supplement legal provisions guiding the auction process;
- Enhance information disclosure for enterprises (financial reports should be conducted every year or two years); and
- Broaden the dissemination of information on equitization and auction via the Securities Trading Center and securities postings for investors (especially for employees and workers of equitized enterprises).

*Attracting strategic shareholders to participate in auctions*

It is necessary to more efficiently attract the participation of foreign strategic investors in any auction of shares. Their participation should be more flexible and appropriate in order to enhance their efficiency and impact on the value of the auctioned shares and the value of the equitized enterprises. For example, after technical requirements have been met, strategic investors can access, study the status, and assess the strategies and future business plans of the enterprises in order to be able to determine their value and make the most competitive and reasonable public offer.

**5.2. Financial treatment**

Regarding financial treatment before equitization, it is necessary to supplement the following regulations:

- Clearly define punitive regulations on the liabilities and responsibilities of enterprises for the resolution of financial problems before determining the value of the equitized enterprises and during the transformation process in accordance with the competence and provisions of law.
- By the time the value of an enterprise is announced, the enterprise must hand over to the Debt and Asset Trading Company all assets that are not used, left in stock, or subject to liquidation, as well as unrecoverable debts that have been excluded from the value of the equitized enterprises.
- It is necessary to include in the value any payments made in advance by equitized enterprises to suppliers of goods and services, such as house rentals, land rentals, money paid for goods, and salaries.
- There should be more detailed instructions on how commercial banks must treat debts of equitized enterprises, as stipulated by

Article 12 of Decree 69/2002/ND-CP on the management and treatment of accumulated debts for SOEs.

- Detailed guidelines should be provided for specific cases in order to overcome the problem of misuse of equitization to waste state assets. For example, enterprises must use their financial contingency fund and pre-tax profits up to the time of equitization to compensate for losses as at the time the equitized enterprise is converted into a joint-stock company. If they are not able to pay compensation, budget debt write-off or bank debt write-off should be applied in accordance with state regulations on the treatment of accumulated debts. If enterprises still have losses after adopting the abovementioned measures, they will be deducted from state capital. If the balance is in surplus after compensation has been paid, it will be included in the state capital of equitized enterprises.

When enterprises inherit the capital contribution made in joint ventures, if the joint venture is at a loss as planned, the value of the contributed capital recorded in their investment license must be taken into account.

Beside the abovementioned general issues, it is necessary to have special regulations on financial treatment and the sale of shares for large-scale SOEs, general state corporations and, in particular, state-owned commercial banks. For instance as regards the following:

- Liquidation of contracts should not be applied to the collateral of customers who borrowed loans prior to equitization;
- Regarding receivables, which are mainly undue credits, especially long-term credits, banks should not apply debt recovery measures before the time of equitization;
- To guarantee a desired equity proportion and scale at banks after equitization it is not necessary to "rigidly" apply debt



treatment measures, as SOEs normally do (compensating from the contingency fund, reducing profits at the time of equitization, or deducting state capital), but rather have a mechanism to compensate the banks for the large bad debts and overdue debts of customers, especially SOEs, or projects and national targeted programs, etc. Similarly, the regulations on the treatment of payable debts during the equitization of SOEs are not relevant to the equitization of commercial banks, especially the deposit accounts of customers.

- Regarding the modes of equitization for banks as well as general corporations, it is only necessary to focus on the mode in which state capital is retained and additional shares are mobilized from external sources. Moreover, due to the position and role of general corporations and commercial banks, the sale of shares to mobilize capital from external sources cannot be widely conducted at the time of equitization, but instead gradually through various stages according to the plan and roadmap to steadily reduce state capital while ensuring a controllable level.

### 5.3. Equitization of large-scale general corporations and SOEs

Over the last few years there have generally only been small SOEs equitized, and no large-scale state corporations or state-owned commercial banks have undergone the process. To address this situation it is necessary to undertake the equitization of these large SOEs.

Government Decree 187/2004/ND-CP touches upon this issue but only deals with simple principles. The problem is that there should be detailed provisions for methods and measures as well as support relating to the equitization of large-scale general corporations and state companies (including state-owned commercial banks).

To equitize general corporations it is necessary to firstly clarify the modes of equitization. General corporations are a combination of independent and dependent cost-accounting enterprises, while the subjects of equitization from the beginning of the pilot program until now have only been independent SOEs, member enterprises of general corporations or units of independent enterprises. Therefore, in helping general corporations to maintain their previously established links, the equitization process should be undertaken at the same time as restructuring and transforming the general corporations into holding companies through one of the following methods, depending on the specific features of the transformed business:

*First*, equitize member enterprises of general corporations that have sufficient conditions for doing so. The remaining entities and the head office will then be transformed into a holding/parent company, and that holding company will then be equitized.

*Second*, establish a holding company on the basis of the head office and dependent affiliates of the general corporations and at the same time equitize that holding company. The equitization will then be expanded to the remaining enterprises of the general corporations.

*Third*, equitize both the head office of the general corporation and all of its dependent and independent units at the same time. This approach is expected to bring about radical changes and shorten the time needed but may also complicate the valuation of the equitized entities and reduce the available resources of the general corporations.

All three modes require the amendment of Decree 187/2004/ND-CP on SOE equitization. □

#### Notes:

- 1 Policy Note on Promoting Business to Business Commercial Contracts in Vietnam "Contractual Linkages between Vietnam's Large and Small-scale Firms: Disputes Settlement and Contract Enforcement".