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Why Corporate Governance Matters for Vietnam

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NEW APPROACH TO MANAGEMENT OF STATE INVESTMENTS IN ENTERPRISES

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For years, despite many difficulties created by the economy in transition and adverse impacts of 1997 financial crisis, Vietnam State owned enterprises (hereby referred as SOEs) continue to achieve encouraging performances. SOEs remain the key component in a variety of sectors of the economy, critically influence economic growth and contribute principally to the State Budget (SOEs’ annual contribution to State Budget accounts for more than 40% of State Budget revenues and more than 50% of export revenues)

However, SOEs still experience moderate growth rate, weak competition capability, inefficient use of capital and do not make a full use of its potential capabilities and existing advantages, which do not meet general requirement for development and integration. A large number of SOEs fails to preserve and add value to State investments, and there still exist the case in which enterprises loss capital invested by the State. A majority of SOEs is small in size (more than 60% among SOEs has less than VND 5 billions in capital), has inappropriate capital structure. Moreover, State administration over SOEs’ activities remains inadequate and overlapping.

The Central Party Resolution No III, in an attempt to overcome these issues, put forward a policy on restructuring and diversifying ownership patterns of SOEs. The purpose is to strengthen and improve performance of this economic section. At the end of July 2004, 2.224 enterprises and enterprises’ components completed their restructuring. Among these restructured enterprises, 1.412 were equitized, 199 were allotted, sole or leased out, 362 undertook merger or consolidation, 102 were bankrupt or liquidated, 149 were transformed into other ownership patterns such as sole membership limited company or income generated administration entities.

The result is encouraging. Restructured SOEs have so far mobilized an additional amount of VND 3.300 billions for their business activities. Objectivity and transparency has been gradually enhanced through public share auctioning regime which allows investors to have access to companies’ shares and contributes to push up capital market. Equitized enterprises not only success in preserving State invested capital but also maintain a dividend pay-out rate of 10-15% per year.

In addition to ownership diversification, adopting of new approach to management of State investments in enterprises is of importance. For a long time, there have been many limits and obstacles regarding the management of State investments in enterprises. Ownership and assets management are not separated, allowing State administration to interfere deeply into enterprises’ day-to-day business operation, hence limiting the enterprises’ dependence and responsibility. Various level of authorities involve in the decision on investment of State owned asset, causing investments to be inefficient, stretching, overlapping and irrelevant to the State master plan. As consequent, the State fails to concentrate its investment into sectors which are of the State interest, investment management is not consistent and ineffective due to concentration of local interests, hence ignorance of interest of the nation as a whole.
The newly promulgated 2003 Law on State Enterprises has made a reform on State investments in enterprises management regime. According to the Law, the following individuals and organizations assume the role of representative of State ownership in SOEs:

1. The Prime Minister directly represent or mandate relevant ministries to be representative of State owned assets and to exercise a ownership’s certain rights and obligations in special important SOEs whose establishment is decided by the Prime Minister
2. Ministries and Provincial People Committees act as owners of SOEs which do not have Board of Management and which are established upon their decisions
3. Board of Management acts as state ownership representative in State owned corporations and SOEs with Board of Management
4. State Financial Investment Corporation (SFIC) acts as ownership representative of enterprises whose charter capitals are wholly invested by SFIC and represents the ownership in other enterprises it has invested.
5. SOEs represent State owned assets ownership in companies invested by them.

In short, the 2003 Law on Enterprises expressly defines the rights of every single individual and organization over the management and ownership of State owned assets in such invested enterprises. In addition, it allows the creation of a State Financial Investment Corporation to manage State investments in enterprises and make investment of State owned assets assigned by the State.

New approach to management of State investments in enterprises through a State owned financial intermediary has been successfully implemented in quite a few countries in the region.

The Chinese Government established its State owned assets Investment Company as an intermediary between the State and State invested enterprises. The company’s responsibility is to act on behalf of the Government to directly involve in the management of State investments in enterprises, thus ensure that these assets will be preserved and expanded in value term. The company’s functions are:

1. Act, on behalf of the Government, as the owner of State investments in enterprises
2. Through the realization of ownership over the State investments in enterprises to control, supervise State owned assets and allocate them in an optimal way.
3. Appoint and remove enterprise’s key leaders and participate in enterprise’s important solutions.
4. Administer revenues generated by the State investments in enterprises and decide to reinvest those revenues into the same enterprise or into other ones.
5. Supervise enterprises’ performance and financial situation.

At the present time, a larger number of State owned assets investment companies have been established in big cities and provinces of China such as Peiking, Shanghai, Guangdong and particularly in Special Economic Zones.

The Singaporean Government created Temasek Group in 1974. Temasek, whose total assets were USD 50 billions by the end of 1998, is directly under control of Singaporean Ministry of Finance. Capital resources managed by Temasek include revenues generated from sale of State assets, liquidation of SOEs and dividends collected from State equity investments, added by initial funds allocated by the Singaporean Government. Temasek operates independently and only reports to the Ministry of Finance for approval investment decisions which are in the excess of its assigned
duties. Enterprises invested by Temasek, which are principally equitized SOEs, are not influenced by line ministries with the exception of the implementation of ministries’ State Administration functions. Base upon its capital contribution, Temasek can interfere into the invested enterprises through appointment or removal of the enterprises’ management, approval of business plan, requirement of business and financial reports and supervision of the enterprises’ activities as a stockholder. At the moment, enterprises invested by Temasek account for 10.3% of Singapore GDP. Temasek have invested in 21 enterprises (called first layer enterprise), of which 7 have already been listed in the Stock Market.

Given international experience and specific circumstance of Vietnam, it is necessary to switch over from the administration based management regime to a new investment approach through the establishment of a State Financial Investment Corporation to:

1. Collectively manage State investments in enterprises, hence improve capital use efficiency, preserve and increase the State investments in enterprises in value term.
2. Make separation between State Administration and enterprises’ business independence whose implication is that the State Administrations will no longer interfere into enterprises’ business activities.
3. To switch over from direct capital allocation regime to investment based principle, thus gradually eliminate direct capital allocation from State Budget to enterprises whose 100% State own is no longer necessary.
4. Speed up the process to SOEs restructuring and reform, develop stock market as well capital market.

The Corporation’s organizational structure and operations would be under the following direction:

Firstly, regarding organizational structure, the Corporation is a SOE with Board of Management, established under the decision of the Prime Minister and whose operations are regulated by the Law on State enterprises.

Secondly, regarding investment principle, the Corporation’s investments will focus on strategically important sectors of the economy which have great impact on economic development; on highly efficient economic sections, as well as on sectors capable of generating return on investment. The Corporation’s investments also focus on technological modernization and enhancement of competition capability of its invested enterprises.

Thirdly, with regard to investment form, the Corporation will conduct two main form of investment: direct investment which includes investment into restructured SOEs whose management is assigned by the State to the Corporation and capital contribution to create new enterprises; indirect investment covering purchasing stocks or bonds in Stock market.

Fourthly, in terms of investment method, the Corporation will adopt three methods of investment:

1. Maintain its ownership in invested enterprises.
2. Sell partly or totally its shares in enterprises which are no longer appropriate for its investment strategy or no longer of strategic importance.
3. Sell out all of its shares or liquidate unprofitable enterprises to minimize investment loss.
Certainly, with the establishment and effective operation of the Corporation, there will have positive change on the way State investments in enterprises are managed, contributing to the improvement of SOEs performance in the context of reform and integration.